

## Casenote

### Defining Misappropriation: The Spousal Duty of Loyalty and the Expectation of Benefit\*

In a case of first impression, *SEC v. Yun*,<sup>1</sup> the United States Court of Appeals for the Eleventh Circuit settled two disputed aspects of insider-trading liability.<sup>2</sup> First, a duty of loyalty and confidentiality between spouses may be shown if the spouses have a history or practice of sharing and maintaining business confidences or, if in disclosing the confidential information, the spouse breaches an agreement<sup>3</sup> to maintain the other spouse's business confidences.<sup>4</sup> Second, in a misappropriation theory of insider-trading liability action, the Securities and Exchange Commission ("SEC") must prove that the misappropriator expected to benefit from the tip.<sup>5</sup> The decision in *Yun* creates a split with the Second Circuit Court of Appeals by more broadly defining the spousal duty of loyalty and confidentiality.<sup>6</sup> Furthermore, the court increased the commonality between the classical theory and the misappropriation theory of insider-trading liability by holding that the

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1. 327 F.3d 1263 (11th Cir. 2003).

2. *Id.* at 1273, 1280.

3. The agreement must be an actual promise or explicit acceptance by one spouse to keep confidential the material, nonpublic information (business confidence) shared by the other spouse. *Id.* at 1273.

4. *Id.*

5. *Id.* at 1280.

6. *Id.* at 1272.

SEC must prove that the misappropriating outsider or “tipper”<sup>7</sup> had an intent to benefit from the tip.<sup>8</sup>

### I. FACTUAL BACKGROUND

During a post-nuptial<sup>9</sup> division of assets, Donna Yun learned from her husband, an executive at a subsidiary of Scholastic Corporation (“Scholastic”), that he believed the price of Scholastic shares would drop following the upcoming earnings announcement.<sup>10</sup> Yun agreed to keep this information confidential at the request of her husband.<sup>11</sup> However, while at work, Yun called her attorney to discuss her husband’s statement of assets. While Yun was on the phone, Jerry Burch, Yun’s business associate and friend, entered her small office to gather materials for a client and heard Yun tell her attorney what her husband had said about Scholastic’s impending earnings announcement. Later that evening, Yun, Burch, and another co-worker attended an awards banquet together.<sup>12</sup> The next morning Burch called his broker to request authority to purchase “put options”<sup>13</sup> in Scholastic based on

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7. Tippers are people who give a tip or make a disclosure of confidential information to tippees. Tippers were first found liable in *Dirks v. SEC*, 463 U.S. 646 (1983). In *Dirks*, a classical theory of insider trading action, the Supreme Court held that insider-trading liability may be extended to: (1) an insider who trades based upon confidential information, and (2) an insider who tips (makes a disclosure of confidential information—rather than trades) and expects to benefit from the tip. *Id.* at 659. In *Yun*, a misappropriation theory of insider trading case, the Eleventh Circuit, seeking not to dichotomize the two theories of insider-trading liability, similarly decided that (1) an outsider who trades based on confidential information is liable, and (2) an outsider who tips (makes a disclosure of confidential information—rather than trades) and expects to benefit from the tip is liable. 327 F.3d at 1279-80.

8. 327 F.3d at 1280.

9. “Post-nuptial” means during the marriage. *Id.* at 1267.

10. While at a senior management retreat, Mr. Yun received information that Scholastic was going to make a negative earnings announcement, which would likely result in a decline in the market price of Scholastic shares. *Id.*

11. Yun’s husband knew Yun would discuss the information with her attorney, but Yun’s husband expected Yun’s attorney not to disclose the information. *Id.* at 1267-68 n.4.

12. *Id.* at 1268. The SEC contends that Yun disclosed the confidential information at the cocktail party. *SEC v. Yun*, Litigation Release No. 17047, 75 S.E.C. Docket 985 (June 22, 2001). However, according to the parties, while at work, Burch overheard Yun’s telephone conversation with her attorney regarding the future of Scholastic stock, but Burch only contacted his stockbroker after doing his own research—not after learning more from Yun at the reception. Molly McDonough, *The Walls Have Ears: Woman May Be Liable for Stock Tip Overheard by Co-worker*, 2 No. 17 A.B.A. J. E-REP. 3 (May 2, 2003).

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A put option is an option contract that gives the holder of the option the right to sell a certain quantity of an underlying security to the writer of the option, at a specified price up to a specified date. The value of a put increases as the price of

information he had obtained “at a cocktail party.”<sup>14</sup> Despite the warnings of his broker regarding the risks of options trading and insider trading prohibitions, Burch purchased Scholastic put options in an amount equal to nearly half the value of his investment portfolio. Scholastic announced that its earnings would be well below analysts’ expectations; Scholastic shares dropped. Burch sold his Scholastic put options, realizing a profit of \$269,000, a 1300 percent return on his investment.<sup>15</sup>

After investigating the trades, the SEC brought an insider-trading action against Yun and Burch as recipients of stock tips, alleging insider trading in violation of section 10(b) of the Securities Exchange Act of 1934 (the “Exchange Act”),<sup>16</sup> and Rule 10b-5.<sup>17</sup> The trial court denied

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the stock decreases.

*Yun*, 327 F.3d at 1268 n.6.

14. *Id.* The disclosure of confidential information in this case could have been made in two ways: (1) Yun could have inadvertently disclosed the confidential information to Burch when Burch overheard Yun’s telephone conversation with her attorney; or (2) Yun could have voluntarily disclosed the confidential information to Burch at the awards banquet. Viewing the facts in the light most favorable to the SEC, the nonmoving party, the Eleventh Circuit accepted that the disclosure of confidential information was made during the evening of the awards banquet. *See id.* at 1267, 1268; *see also* SEC v. Yun, 148 F. Supp. 2d 1287, 1296-97 (M.D. Fla. 2001) (finding an adequate foundation for a jury determination that Yun voluntarily disclosed the confidential information at the awards banquet); SEC v. Yun, 130 F. Supp. 2d 1348, 1357 (M.D. Fla. 2001) (finding that the SEC presented sufficient evidence for a reasonable juror to conclude that Yun’s disclosure of confidential information was voluntary); *cf.* SEC v. Switzer, 590 F. Supp. 756, 766 (W.D. Okla. 1984) (finding that liability in insider trading cases cannot result from an inadvertent disclosure when spouses discussed confidential information during a football game and such information was inadvertently overheard by another spectator).

15. 327 F.3d at 1268.

16. 15 U.S.C. § 78j(b) (2001). Section 10(b) of the Exchange Act provides:

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 . . . , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors.

*Id.*

17. 17 C.F.R. § 240.10b-5 (2002). Rule 10b-5, which was adopted pursuant to the SEC’s rulemaking authority given by section 10b of the Exchange Act, states:

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, [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,

the motion for summary judgment filed by Yun and Burch.<sup>18</sup> At trial the “jury found that [Yun and Burch] had ‘violated [section] 10(b)’ under the ‘misappropriation theory’ of liability.”<sup>19</sup> Following the jury verdict, Yun and Burch moved for judgment as a matter of law or for a new trial.<sup>20</sup> The district court denied these motions.<sup>21</sup> Accordingly, judgments were entered against Yun and Burch holding them jointly liable for the profits generated by the prohibited trading, plus prejudgment interest, and individually liable for a penalty.<sup>22</sup> Yun and Burch appealed, arguing that the district court erred in denying their motions for judgment as a matter of law and in instructing the jury on elements of the misappropriation theory of insider-trading liability.<sup>23</sup>

The Eleventh Circuit affirmed the district court’s decision denying appellants’ motions for judgment as a matter of law.<sup>24</sup> However, the court vacated the district court’s judgment and remanded the case for a new trial because the district court’s jury instructions on the elements of the misappropriation theory of liability were erroneous.<sup>25</sup>

## II. LEGAL BACKGROUND

Section 10(b) of the Exchange Act makes insider trading unlawful by prohibiting “any person” from “us[ing] or employ[ing], in connection with the purchase or sale of any security . . . , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe.”<sup>26</sup> One purpose of section 10(b) is “to eliminate ‘use of inside information for personal advantage.’”<sup>27</sup> To violate section 10(b), an individual trading in securities with material, nonpublic information must breach a fiduciary duty by failing to disclose to the other trading party the confidential information or by failing to

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in connection with the purchase or sale of any security.

*Id.*

18. *Yun*, 327 F.3d at 1267.

19. *Id.*

20. *SEC v. Yun*, 130 F. Supp. 2d 1348, 1349 (M.D. Fla. 2001).

21. *Id.* at 1357.

22. *SEC v. Yun*, 148 F. Supp. 2d 1287, 1288 (M.D. Fla. 2001).

23. *Yun*, 327 F.3d at 1267.

24. *Id.* at 1282.

25. *Id.* At trial the jury instructions allowed the jury to find liability if Yun’s disclosure of confidential information to Burch was found to be “severely reckless.” *Id.*

26. 15 U.S.C. § 78j(b) (2001).

27. *Dirks v. SEC*, 463 U.S. 646, 662 (1983) (quoting *In re Cady, Roberts & Co.*, 40 S.E.C. 907, 912 n.15 (1961)).

abstain from trading on the confidential information.<sup>28</sup> Historically, the obligation to disclose arises from “[(1)] the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and [(2)] the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure.”<sup>29</sup>

Insider trading can be prosecuted under section 10(b) and Rule 10b-5 using two theories: the classical theory and the misappropriation theory.<sup>30</sup> Under the classical theory, corporate insiders are liable when they trade on the basis of confidential material, nonpublic information gained by reason of their corporate position.<sup>31</sup> In contrast, the misappropriation theory imposes liability on “outsiders” when they trade in breach of a duty owed to the source of the confidential information.<sup>32</sup>

#### A. *The Classical Theory*

In *Chiarella v. United States*,<sup>33</sup> the United States Supreme Court held that “there can be no fraud [for non-disclosure] absent a duty to speak”<sup>34</sup> and that a duty to disclose under section 10(b) arises from a relationship of trust and confidence, not from the mere possession of confidential information.<sup>35</sup> In clarifying when “tippees”<sup>36</sup> violate section 10(b), the Court in *Dirks v. SEC*<sup>37</sup> reaffirmed that a duty arises from a fiduciary relationship between an insider and a tippee and not from one’s ability to obtain confidential information.<sup>38</sup> Therefore, in *Dirks*, the Court held that:

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28. *Chiarella v. United States*, 445 U.S. 222, 227-28 (1980) (limiting the reach of *Cady, Roberts* by explicitly requiring a fiduciary duty between the parties to the transaction before a violation can occur); cf. *SEC v. Tex. Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (deciding that all trading while in possession of material information creates a duty to disclose the confidential information to the other trading party or to abstain from trading). In *Chiarella* the Court emphasized that mere possession of confidential information does not create a duty to abstain from using the confidential information or a duty to disclose the confidential information to the party with whom the trade on confidential information is made. 445 U.S. at 227-28.

29. *Chiarella*, 445 U.S. at 227 (citing *Cady, Roberts*, 40 S.E.C. at 912 n.15).

30. *Yun*, 327 F.3d at 1269.

31. *United States v. O’Hagan*, 521 U.S. 642, 651-52 (1997).

32. *Id.*

33. 445 U.S. 222 (1980).

34. *Id.* at 235.

35. *Id.*

36. A tippee is a person who receives a tip from the tipper, who made the disclosure of the confidential information.

37. 463 U.S. 646 (1983).

38. *Id.* at 657-58.

a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when [(1)] the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and [(2)] the tippee knows or should know that there has been a breach.<sup>39</sup>

The Court concluded that not all disclosures are a breach of duty; therefore, to determine whether the disclosure is a breach, the purpose of the disclosure must be examined.<sup>40</sup> The Court held that “the test is whether the insider personally will benefit, directly or indirectly, from his disclosure.”<sup>41</sup>

### B. *The Misappropriation Theory*

In 1997 the Court decided in *United States v. O'Hagan*<sup>42</sup> that the misappropriation theory could provide a basis for a criminal conviction under section 10(b).<sup>43</sup> The Court characterized the misappropriation theory as “hold[ing] that a person commits fraud ‘in connection with’ a securities transaction, and thereby violates [section] 10(b) . . . when [a person] misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information.”<sup>44</sup> According to the Court, misappropriation is the necessary complement to the classical theory defined in *Chiarella*.<sup>45</sup> Under the misappropriation theory, the section 10(b) deception requirement is met because the trader deceives the source by not disclosing the scheme to trade securities to the source of the information.<sup>46</sup> The fraud is committed “in connection with the purchase or sale of [a] security”<sup>47</sup> because the fraud is accomplished when the outsider uses the confidential information to purchase or sell securities without disclosing the use of the information to the insider in breach of a fiduciary or fiduciary-like relationship.<sup>48</sup>

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39. *Id.* at 660.

40. *Id.* at 662.

41. *Id.*

42. 521 U.S. 642 (1997).

43. *Id.* at 653.

44. *Id.* at 652.

45. *Id.* In *Chiarella* the Court determined that corporate insiders could not trade on confidential information because insiders owe a duty of confidence and trust to the stockbrokers. 445 U.S. at 227-28.

46. *O'Hagan*, 521 U.S. at 653.

47. 15 U.S.C. § 78j(b) (2001).

48. 521 U.S. at 655-56.

### 1. The Duty of Loyalty and Confidentiality Between Spouses.

To prevail in an insider-trading action, the SEC must first establish that a breach of loyalty and confidentiality occurred between the misappropriator and the source of the inside information.<sup>49</sup> Historically, business relationships, such as employer-employee<sup>50</sup> or attorney-client,<sup>51</sup> have provided the requisite duty of loyalty and confidentiality.<sup>52</sup> Conversely, whether nonbusiness relationships—such as familial and spousal relationships—provide the requisite duty of loyalty under the misappropriation theory has remained largely unsettled.<sup>53</sup>

The mere existence of a family relationship does not provide a basis to find a confidential relationship.<sup>54</sup> To determine whether a fiduciary-like relationship exists, the quality of the relationship matters.<sup>55</sup> Generally, state courts do not find a legally enforceable relationship of trust and confidence between all family members.<sup>56</sup> To presume that family relationships are fiduciary in nature would conflict with the Supreme Court's requirement that a pre-existing relationship of trust and confidence be expressly established.<sup>57</sup>

The leading Rule 10b-5 case defining the existence of a duty of loyalty and confidentiality in the context of family members is *United States v. Chestman*.<sup>58</sup> In 1991, in a divided en banc decision, the Second Circuit Court of Appeals held that (1) entrusting a person with confidential information does not unilaterally create a fiduciary duty,<sup>59</sup> and (2) marriage alone does not create a relationship of loyalty and confidentiality.<sup>60</sup> To determine what is required to create a fiduciary relationship or a similar relationship of trust and confidence, the court looked at other securities fraud precedents and the common law.<sup>61</sup> The court concluded that a fiduciary relationship involves discretionary authority and dependency, whereby the beneficiary entrusts the fiduciary with

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49. *Id.* at 652.

50. *See, e.g.,* *United States v. Carpenter*, 791 F.2d 1024, 1028 (2d Cir. 1986) (en banc).

51. *See, e.g.,* *O'Hagan*, 521 U.S. at 648.

52. *See, e.g., id.;* *Carpenter*, 791 F.2d at 1028.

53. *See, e.g.,* *United States v. Chestman*, 947 F.2d 551, 567 (2d Cir. 1991).

54. *United States v. Reed*, 601 F. Supp. 685, 706 (S.D.N.Y. 1985).

55. *Id.*

56. *See, e.g.,* *Chestman*, 947 F.2d at 580.

57. *O'Hagan*, 521 U.S. at 652.

58. 947 F.2d 551 (2d Cir. 1991).

59. *Id.* at 567; *see also* *Walton v. Morgan Stanley & Co.*, 623 F.2d 796, 799 (2d Cir. 1980).

60. *Chestman*, 947 F.2d at 568; *see also* *Reed*, 601 F. Supp. at 706.

61. 947 F.2d at 568.

custody over property.<sup>62</sup> Because the fiduciary gains access to the property to serve the fiduciary relationship, the fiduciary becomes bound not to appropriate the property for the fiduciary's personal use.<sup>63</sup> However, the court established that the repeated disclosure of business secrets between family members might substitute for a factual finding of authority and dependency and sustain a finding of a functional equivalent of a fiduciary relationship for the purpose of section 10(b) liability.<sup>64</sup>

In *Chestman* information regarding the sale of a block of the family company's stock was passed from an insider in the company to other members of his family.<sup>65</sup> Throughout this chain, each recipient of the information was told to keep the information confidential. Allegedly, however, the final family member to receive the information, the insider's niece's husband, told his broker and purchased stock.<sup>66</sup> The court determined that because the husband did not owe his wife or her family a fiduciary duty or its functional equivalent, the husband did not defraud his wife or her family.<sup>67</sup> In reversing the broker's (misappropriator's) section 10(b) conviction,<sup>68</sup> the court decided that absent an act of fraud by the husband (tipper), the broker (alleged misappropriator) could not be derivatively liable as the husband's tippee.<sup>69</sup>

**2. The Expectation of Benefit.** The expectation-of-benefit requirement originated in the Supreme Court's decision in *Dirks v. SEC*.<sup>70</sup> In that case, brought under the classical theory of liability, the Court held that to be guilty of a breach, a tipper would have to intend to benefit from the disclosure of confidential information to the tippee.<sup>71</sup> The Court noted that the benefit did not have to be pecuniary—a reputational benefit, a quid pro quo, or even a gift to a friend could satisfy the requisite expectation of benefit.<sup>72</sup>

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62. *Id.* at 569.

63. *Id.*

64. *Id.*

65. *Id.* at 555-56. The chain began with Waldbaum, a principal insider, and included Waldbaum's sister, his niece, and her husband.

66. *Id.*

67. *Id.* at 571.

68. *Id.* In *Chestman* the misappropriator was the husband's broker.

69. *Id.*

70. 463 U.S. 646, 662 (1983).

71. *Id.* The Court also required a breach of duty in a fiduciary relationship and that the tippee know of that breach before insider-trading liability is imposed. *Id.* at 660.

72. *Id.* at 663-64.

Although under the classical theory of insider-trading liability, the SEC must show that the tipper had the intent to benefit, directly or indirectly, from the disclosure of the tip, the issue is not so clearly resolved under the misappropriation theory.<sup>73</sup> Several district courts have addressed this issue.<sup>74</sup> The Second Circuit Court of Appeals strongly implied, albeit in dicta, that in misappropriation cases, no need exists.<sup>75</sup> This conflict regarding whether the expectation of benefit is required remains fundamentally unresolved.<sup>76</sup>

### III. COURT'S RATIONALE

In *SEC v. Yun*,<sup>77</sup> the Eleventh Circuit held that a jury question existed as to whether Yun, the wife of a corporate insider, had the expectation of benefit requisite for insider-trading liability under section 10(b)<sup>78</sup> when Yun tipped Burch,<sup>79</sup> a friend and business associate with whom she had previously split real estate commissions, by sharing confidential information she received from her husband.<sup>80</sup> In reaching this result, the Eleventh Circuit first considered whether Yun owed to her husband a duty of loyalty and confidentiality not to disclose the information regarding the impending earnings announcement that Yun's husband had shared.<sup>81</sup>

The Eleventh Circuit first held that under Rule 10b-5, the SEC must establish that the misappropriator breached a fiduciary duty or a similar duty of loyalty and confidence to the source of the confidential informa-

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73. *Id.* at 662.

74. *See, e.g.*, *SEC v. Willis*, 777 F. Supp. 1165, 1172 n.7 (S.D.N.Y. 1991) (noting disagreement on whether an expectation of benefit is required and stating in dicta that there is no benefit requirement in misappropriation cases); *SEC v. Trikalis*, No. CV 92-1336-RSWL (EEX), 1992 WL 301198, \*3 (C.D. Cal. July 28, 1992) *vacated on other grounds*, 1993 WL 43571 (C.D. Cal. Jan. 22, 1993) (holding that some expectation of benefit is required).

75. *United States v. Libera*, 989 F.2d 596, 600 (2d Cir. 1993).

The tipper's knowledge that he or she was breaching a duty to the owner of confidential information suffices to establish the tipper's expectation that the breach will lead to some kind of a misuse of the information. This is so because it may be presumed that the tippee's interest in the information is, in contemporary jargon, not for nothing.

*Id.*

76. *See SEC v. Sargent*, 229 F.3d 68, 77 (1st Cir. 2000).

77. 327 F.3d 1263 (11th Cir. 2003).

78. *Id.* at 1280.

79. The Eleventh Circuit accepted that the disclosure of confidential information (Yun's tip to Burch) occurred during the evening of the awards banquet. *Id.* at 1267, 1268.

80. *Id.* at 1280.

81. *Id.* at 1276.

tion to prevail under a misappropriation theory.<sup>82</sup> Following the rationale in *United States v. Chestman*,<sup>83</sup> the Eleventh Circuit noted that certain business relationships clearly provide a basis for the required relationship, while it is less clear whether a nonbusiness, spousal relationship provides the necessary duty of loyalty and confidentiality required by the misappropriation theory.<sup>84</sup> In *Chestman* the Second Circuit Court of Appeals addressed this issue, holding that either an express agreement of confidentiality or the functional equivalent of a fiduciary relationship must exist between spouses before a court may find a duty of loyalty and confidentiality.<sup>85</sup> Judge Winter and four other Second Circuit Judges dissented in *Chestman*, showing their dissatisfaction with the narrowness of the majority decision.<sup>86</sup> The dissent noted that “it is inevitable that from time to time normal familial interactions will lead to the revelation of confidential corporate matters to various family members” and concluded that a confidential relationship existed as required by section 10(b).<sup>87</sup>

The Eleventh Circuit accepted the dissent’s view in *Chestman* and noted that “insisting on either an express agreement of confidentiality or a strictly defined fiduciary-like relationship, ignore[s] the many instances in which a spouse has a reasonable expectation of confidentiality.”<sup>88</sup> The Eleventh Circuit determined that when spouses have a history of sharing and maintaining business confidences, the spouse who offers information may have a reasonable expectation of confidence, the breach of which would subject the breaching spouse to insider-trading liability.<sup>89</sup> Additionally, when a spouse breaches an agreement made to the other spouse not to disclose the confidential information, this breach of loyalty and confidence is sufficient to subject the breaching spouse to insider-trading liability.<sup>90</sup> The Eleventh Circuit noted that the decision in *Yun* effectuates Rule 10b5-2.<sup>91</sup> In *Yun* the SEC

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82. *Id.* at 1271; *see also Dirks*, 463 U.S. 646, 660 (1983).

83. 947 F.2d 551 (2d Cir. 1991).

84. *Yun*, 327 F.3d at 1271; *see, e.g., Chestman*, 947 F.2d at 566.

85. 947 F.2d at 568-69.

86. *Id.* at 580 (Winter, J., concurring in part and dissenting in part).

87. *Id.* at 579 (Winter, J., concurring in part and dissenting in part).

88. *Yun*, 327 F.3d at 1272.

89. *Id.* at 1273.

90. *Id.*

91. *Id.* Rule 10b5-2, 17 C.F.R. § 240.10b5-2 (2002), became effective on August 24, 2000, and defines three nonexclusive situations in which a person has a duty of loyalty and confidence under the misappropriation theory of insider trading liability. § 240.10b5-2. The three circumstances are as follows: (1) when a person agrees to maintain a confidence not to disclose material, nonpublic information; (2) when the recipient of confidential information has received such information on more than one occasion and the person

provided sufficient evidence that the Yuns had a history of sharing and maintaining business confidences, that Yun agreed to keep the information confidential, and that Yun's husband had a reasonable expectation the information would be kept confidential.<sup>92</sup> Therefore, the Eleventh Circuit concluded that the SEC provided sufficient evidence to establish that Yun owed her husband a duty of loyalty and confidentiality not to disclose the information regarding the impending earnings announcement.<sup>93</sup>

After holding that Yun had a duty of loyalty to her husband, the Eleventh Circuit moved to the question of whether Yun breached her duty of loyalty.<sup>94</sup> However, this question could not be determined without first considering if, under the misappropriation theory of insider-trading liability, the tipper must expect to benefit from the tip.<sup>95</sup> As noted, a number of district courts have given cursory attention to this issue, and the results vary.<sup>96</sup>

The SEC argued that in *Dirks*, the tipper-benefit requirement was not applicable to the misappropriation theory of liability actions because (1) the expectation-of-benefit requirement is used to establish that a corporate insider breached a duty to the corporate shareholders, and (2) in a misappropriation action, the outsider owes no fiduciary or fiduciary-like duty to the corporate shareholders.<sup>97</sup> Consequently, the SEC asserted that applying the *Dirks* analysis would be illogical because no need exists to determine if a breach of duty occurred when the outsiders never owed a duty to the corporate shareholders.<sup>98</sup> Additionally, the

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communicating the information expects that the recipient will keep the information confidential; or (3) when a person receives confidential information from a spouse or other immediate family member without owing that person a duty of loyalty or confidence, yet the person communicating the information expects the information to be kept confidential and the recipient family member knows or should have known of the expectation of confidentiality. *Id.*

92. *Yun*, 327 F.3d at 1273-74.

93. *Id.* at 1274.

94. *Id.*

95. *Id.* Contrary to the position the SEC took in its complaint, the SEC argued to the court that proof of an expectation of benefit is not required in this case. *Id.* Note that the expectation of benefit originated in the classical theory of insider trading liability. *Dirks v. SEC*, 463 U.S. 646, 662 (1983).

96. *See, e.g.*, *United States v. Libera*, 989 F.2d 596, 600 (2d Cir. 1993) (implying that no expectation of benefit is required); *SEC v. Willis*, 777 F. Supp. 1165, 1172 n.7 (S.D.N.Y. 1991) (stating in dicta that there is no benefit requirement in misappropriation cases); *SEC v. Trikalis*, No. CV 92-1336-RSWL (EEX), 1992 WL 301198, \*3 (C.D. Cal. July 28, 1992) *vacated on other grounds*, 1993 WL 43571 (C.D. Cal. Jan. 22, 1993) (requiring some expectation of benefit).

97. *Yun*, 327 F.3d at 1275.

98. *Id.*

SEC contended that the expectation of benefit should not be required under the misappropriation theory because the breach of duty occurs when the outsider makes the unauthorized tip that harms the principal and the harm created does not depend upon whether the outsider had an expectation to benefit from the tip.<sup>99</sup>

The Eleventh Circuit disagreed primarily because the SEC's position would construct an "arbitrary fence" between the classical and misappropriation theories of insider-trading liability.<sup>100</sup> Relying on *United States v. O'Hagan*,<sup>101</sup> the Eleventh Circuit stated that insider trading law should be synthesized because the two theories of insider trading are complementary, and no basis for inconsistency between the two theories exists.<sup>102</sup> The Eleventh Circuit reasoned that no need existed to differentiate a tippee who received confidential information from an insider<sup>103</sup> and a tippee who received such information from an outsider<sup>104</sup> because the tippee must have notice that the confidential information was received through an inappropriate breach of a fiduciary or fiduciary-like duty under both theories of insider-trading liability.<sup>105</sup> Furthermore, the Eleventh Circuit noted that liability does not vary depending on the theory of prosecution, nor does the harm to the securities market vary.<sup>106</sup> Therefore, the court concluded that an expectation of benefit is required under both theories of insider-trading liability.<sup>107</sup>

Moreover, the Eleventh Circuit explained that insider-trading prohibitions are premised on protecting the securities markets from

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99. *Id.* at 1277.

100. *Id.* at 1275. One of the court's major concerns was that the SEC's approach would allow precedent regarding the one theory of insider trading liability to be completely ignored anytime an action was brought under the other theory of insider trading liability. *Id.* at 1275-76.

101. 521 U.S. 642 (1997).

102. *Yun*, 327 F.3d at 1276. "Congress did not intend to create a scheme of law that depends on the label or theory under which the SEC brings its case." *Id.* at 1276 n.27.

103. Typically, liability for this situation would be prosecuted under the classical theory. *See O'Hagan*, 521 U.S. at 651-52.

104. Generally, liability for this circumstance would be prosecuted under the misappropriation theory. *Id.*

105. *Yun*, 327 F.3d at 1276. Here, the Eleventh Circuit is applying the *Dirks* requirement that the tippee must have actual or constructive knowledge of the occurrence of a breach when the tipper made the disclosure of confidential information. *Id.*; *see Dirks*, 463 U.S. at 660.

106. *Yun*, 327 F.3d at 1276.

107. *Id.* "[F]or better or worse, the Supreme Court has required that the only way to taint a tippee with liability for insider trading is to find a co-venture with the fiduciary, and that co-venture exists only if the tipper intends to benefit." *Id.* (citation omitted) (relying on *Dirks*, 463 U.S. at 662).

fraud.<sup>108</sup> The purpose of section 10(b) is to catch fraudulent means of capitalizing on confidential information, not to ban all breaches of fiduciary duty.<sup>109</sup> The securities laws are not designed to impose liability on a person who had no intent either to trade or to tip in a manner that manipulates the market.<sup>110</sup> Finally, the Eleventh Circuit concluded that to adopt the SEC's position not to require the expectation of benefit in misappropriation theory actions "would impose liability more readily for tipping than for trading."<sup>111</sup> Clearly, this result would be "absurd" given that the Supreme Court's rationale for imposing the expectation-of-benefit requirement was to ensure that "a tip rises to the level of a trade."<sup>112</sup>

While the Eleventh Circuit did require an expectation of benefit in this misappropriation-theory case, the showing required to establish an expectation of benefit was not extensive.<sup>113</sup> An actual pecuniary gain is not necessary.<sup>114</sup> For example, in this case, the SEC presented evidence that Yun and Burch were "friendly" and worked together splitting real estate commissions for several years.<sup>115</sup> Therefore, the Eleventh Circuit concluded that the evidence was sufficient for a jury to conclude that Yun had an intent to benefit from her tip to Burch by maintaining a good relationship between a friend and frequent business partner.<sup>116</sup> Accordingly, the Eleventh Circuit determined that a jury question existed as to whether Yun and Burch were liable for insider trading under the misappropriation theory.<sup>117</sup>

The Eleventh Circuit affirmed the district court's decision in denying the appellants' motions for judgment as a matter of law;<sup>118</sup> however, the Eleventh Circuit vacated the district court's judgment and remanded the case for new trial because the district court's jury instruction on the elements of the misappropriation theory of liability were erroneous.<sup>119</sup>

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108. *Id.* at 1278; *see also* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976).

109. *Yun*, 327 F.3d at 1278.

110. *Id.* at 1278-79.

111. *Id.* at 1279.

112. *Id.* (citing *Dirks*, 463 U.S. at 664).

113. *Id.* at 1280.

114. *Id.*

115. *Id.*

116. *Id.* at 1280-81.

117. *Id.*

118. *Id.* at 1282.

119. *Id.* Over objections, the district court had instructed the jury as follows: "(1) 'the SEC must establish, by a preponderance of the evidence, that Mrs. Yun breached a fiduciary duty or other duty of trust and confidence to David Yun by disclosing to Mr. Burch material nonpublic information,' and (2) '[t]he communication of such information must be intentional, or severely reckless.'" *Id.* at 1281. The Eleventh Circuit found that

## IV. IMPLICATIONS

The Exchange Act was enacted to create confidence in the securities market by eliminating the “use of inside information for personal advantage.”<sup>120</sup> In *SEC v. Yun*,<sup>121</sup> the Eleventh Circuit continued to effectuate this purpose by settling two disputed aspects of insider-trading liability.<sup>122</sup>

A. *The Duty of Loyalty and Confidentiality Between Spouses*

By deciding that a duty of loyalty and confidentiality between spouses may be shown (1) if the spouses have a history or practice of sharing and maintaining business confidences or (2) if in disclosing the confidential information the spouse breaches an agreement to maintain the other spouse’s business confidences,<sup>123</sup> the Eleventh Circuit created a split with the Second Circuit by more broadly defining the spousal duty of loyalty and confidentiality.<sup>124</sup> The Supreme Court is likely to address this conflict because this inconsistency generates ambiguity as to how section 10(b) of the Exchange Act should be applied.

The Eleventh Circuit’s decision will impose more readily the duty of loyalty and confidentiality between spouses and possibly other relatives, which will in turn impose liability more promptly for unlawful tipping. This decision will further the purpose of the Exchange Act by imposing liability upon a spouse or family member who defrauds his source by misusing the confidential information while feigning loyalty.

However, one shortcoming of this decision is that the court does not explain the requirement in *Dirks* that the tippee, in this case Burch, must have notice that the tipper’s disclosure of information constitutes an improper breach of a fiduciary or fiduciary-like duty. In this case, the requirement in *Dirks* is less than clearly established. Considering that the Eleventh Circuit had to decide whether a breach of loyalty and confidentiality occurred between Yun and her husband, it is not evident

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the “severely reckless” instruction prejudiced the defendants because it permitted the jury to find them liable on the ground that Donna Yun acted with severe recklessness in disclosing the information, rather than with an intent to benefit personally. *Id.* at 1281-82. Thus, the Eleventh Circuit remanded the case for a new trial. *Id.* at 1282.

120. *Dirks v. SEC*, 463 U.S. 646, 662 (1983) (quoting *In re Cady, Roberts & Co.*, 40 S.E.C. 907, 912 n.15 (1961)).

121. 327 F.3d 1263 (11th Cir. 2003).

122. *Id.* at 1273-74, 1280.

123. *Id.* at 1273-74.

124. *See id.* at 1272. The Second Circuit held that a fiduciary or fiduciary-like relationship exists when one person is dependent on the other or when one person has discretionary authority over the other. *Chestman*, 947 F.2d at 569.

from the facts that Burch could or should have had notice that the tip he received was a result of a breach of a fiduciary-like duty.

*B. The Expectation of Benefit*

While the Eleventh Circuit created inconsistency with a sister circuit in expanding the spousal duty of loyalty, the Eleventh Circuit aligned the two theories of insider-trading liability by requiring the SEC to prove that the misappropriator expected to benefit from the tip in a misappropriation theory of insider-trader liability action.<sup>125</sup> In this case of first impression, the Eleventh Circuit traced the precedents of insider-trading liability before requiring an expectation of benefit in a misappropriation action.<sup>126</sup> However, the court determined that the benefit is sufficient when the tipper is attempting to maintain a good relationship between a friend and a frequent partner in real estate deals.<sup>127</sup> In other words, the Eleventh Circuit appears to be restricting insider-trading liability by requiring another element in misappropriation actions; however, the benefit requirement is so broadly defined that this restriction may be in appearance only.

Establishing consistency between the two theories of insider-trading liability will be beneficial because the courts within the Eleventh Circuit will not determine liability arbitrarily according to varying requirements depending upon which theory the SEC decides to use to prosecute the accused. Given the practical reasoning the Eleventh Circuit offered in deciding this novel issue, other circuits are likely to follow this decision.

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125. *Yun*, 327 F.3d at 1280.

126. *Id.* at 1274-81.

127. *Id.* at 1280.