# COMMENTS

## LENITY CALLING:

## A PLEA TO END *CHEVRON* DEFERENCE FOR CRIMINAL INSIDER TRADING LAW*

### I. INTRODUCTION

Various complexities and ambiguities pervade the interpretation of Securities and Exchange Commission (SEC) rules and regulations, especially when these laws are applied in the criminal context and are used to enforce criminal penalties. With administrative crimes generally and insider trading specifically, a tension exists between granting deference to the administrative agency's interpretation and resolving ambiguity in favor of the defendant by applying the rule of lenity.[1] Justice Scalia and other legal scholars have argued that it is problematic to apply deference to an administrative agency's interpretation of a regulation when that regulation carries criminal penalties.[2]

---

* Liza B. Fleming, J.D. Candidate, Temple University Beasley School of Law, 2017. I thank the *Temple Law Review*, especially Leslie Minora, Rachel Reznick, and Erin O'Gurek for their improvements to this Comment. I thank my faculty advisor Professor Lauren Ouziel for her invaluable advice, guidance, and feedback on many drafts. I thank my mother for her edits to this Comment, my family for their constant love and support, and Jose for always challenging and inspiring me.

1. Several scholars have discussed the tension between the deference established in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), and the rule of lenity, especially with respect to administrative crimes. *See, e.g.*, Elliot Greenfield, *A Lenity Exception to* Chevron *Deference*, 58 BAYLOR L. REV. 1, 61 (2006) (proposing a general lenity exception to *Chevron* deference for all administrative crimes); Kristin E. Hickman, *Of Lenity,* Chevron*, and KPMG*, 26 VA. TAX REV. 905, 909–11 (2007) (discussing the tension between *Chevron* deference and lenity in the context of tax shelters); Cass R. Sunstein, *Law and Administration After* Chevron, 90 COLUM. L. REV. 2071, 2115–16 (1990) (stating, without explicitly referencing lenity, that principles requiring statutes to be interpreted in favor of criminal defendants "should not be overridden" based on agency interpretation); Mark D. Alexander, Note, *Increased Judicial Scrutiny for the Administrative Crime*, 77 CORNELL L. REV. 612, 616 n.29 (1992) (noting that when lenity and deference collide, lenity "cannot compel the abandonment of" deference, but that it provides a reason for rejecting it in the context of administrative crimes (emphasis omitted)). See *infra* Part II.F for an analysis of the tension between deference and lenity.

2. See *infra* Part II.H for a discussion of the late Justice Scalia's opinion. Many legal scholars have argued that *Chevron* deference should not be applied to administrative crimes generally because deference conflicts with the rule of lenity. *See, e.g.*, Greenfield, *supra* note 1, at 60 ("Just as courts require that a criminal defendant be found guilty . . . beyond a reasonable doubt, courts should also require that there not be substantial ambiguity as to whether a defendant's actions were intended by Congress to come within the scope of its statute."). And some have argued for exceptions to *Chevron*

Deference makes it difficult to afford defendants notice and due process, particularly with securities law, where actors look to the law to guide their trading behavior[3] and where the penalties for willful violations can be especially harsh.[4]

Insider trading is especially unique because the penalties are far more severe than those of other administrative crimes.[5] The severity of the penalties for insider trading has not been considered as it relates to the deference established in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*[6] and its impact on defendants.[7] This Comment seeks to explore the uniquely severe penalties for insider trading and to advocate for the application of the rule of lenity for this administrative crime. By highlighting this aspect of insider trading as a means of advocating for a lenity exception, this Comment aims to contribute to the growing research on the tension between *Chevron* deference and lenity.

---

deference for various specific administrative crimes. *See, e.g.*, Alina Das, *Unshackling Habeas Review:* Chevron *Deference and Statutory Interpretation in Immigration Detention Cases*, 90 N.Y.U. L. REV. 143 (2015) (arguing for an exception to *Chevron* deference in habeas review of statutory immigration detention challenges in federal court).

3. *See infra* notes 171–72 and accompanying text.

4. See *infra* Part II.G.1 for a discussion of the increasingly severe penalties for willful violations of insider trading law.

5. *See infra* Part II.G.1.

6. 467 U.S. 837 (1984).

7. In fact, only one article has advocated for a lenity exception to *Chevron* deference specifically for the administrative crime of insider trading. *See* Anna Currier, Comment, *The Rule of Lenity and the Enforcement of the Federal Securities Laws*, 5 AM. U. BUS. L. REV. 79 (2015). In her comment, Currier argues that the rule of lenity should be applied under Rule 10b-5 only in criminal proceedings because *Chevron* deference conflicts with due process principles. *Id.* at 107. Much of her comment focuses on *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), *abrogated by Salman v. United States*, 137 S. Ct. 420 (2016), and argues that the balancing of lenity and deference can be seen in the court's holding. Currier, *supra*, at 96. Currier then argues that although the rule of lenity has been applied in other types of civil cases, it should only be applied to criminal insider trading because "the Commission would lose a key advantage of bringing enforcement actions in its administrative forum because courts would no longer give these administrative actions *Chevron* deference." *Id.* at 100. "[U]sing *Newman* as the framework," she suggests that applying lenity to criminal insider trading "could create a fair system that respects due process as well as the Commission's expertise and mission of protecting investors." *Id.* at 106. As part of the executive branch, the SEC "is not empowered to define crimes." *Id.* Currier concludes by stating that in Rule 10b-5 criminal proceedings, lenity must be applied because it preserves a defendant's due process rights and because the SEC does not have the power to define crimes. *Id.* at 107.

By contrast, this Comment focuses on why insider trading is different from other administrative crimes; it specifically analyzes the fact that insider trading is ambiguous because it is almost entirely judge-made law and the fact that the stakes are high, with harsh penalties imposed for criminal convictions. It explains that trading in securities is heavily regulated, so individuals need notice to conform to insider trading laws. These dual characteristics of insider trading—its ambiguous doctrine and severe penalties—make it worthy of special treatment. This Comment proposes two solutions for criminal insider trading: that courts should apply lenity as an exception to *Chevron* deference or that courts should be more willing to find that the SEC has exceeded its rulemaking authority at step two of the *Chevron* framework.

This Comment argues that § 10(b) of the Securities Exchange Act of 1934[8] (the 1934 Act) and its implementing regulations are broader and more ambiguous than other administrative laws and regulations that carry criminal penalties. In fact, insider trading law is almost entirely judge-made,[9] which is problematic considering the serious punishment criminal defendants face. Thus, this Comment advocates that in a criminal proceeding, *Chevron* deference should not apply to § 10(b) and its accompanying regulations. This Comment further argues that courts should apply the rule of lenity to resolve ambiguities in insider trading law in favor of defendants. In the alternative, this Comment suggests that if courts must apply *Chevron* deference, they should more readily challenge the rulemaking authority of the SEC at step two of the *Chevron* framework.

Section II provides a general background of insider trading law, including § 10(b) and the rules promulgated pursuant to it, and the tension between deference and lenity in criminal administrative law. Section III argues that § 10(b), Rule 10b-5,[10] and Rule 10b5-2[11] are different from other criminal administrative laws and advocates for a lenity exception to *Chevron* deference in criminal proceedings. Allowing courts to continue deferring to agency interpretations has serious consequences for both defendants and the public.

## II. Overview

This Section provides an overview of insider trading law and § 10(b), as well as Rules 10b-5 and 10b5-2. Further, it explores *Chevron* deference, the rule of lenity, federal common law in criminal law, and the relationships and tensions among these with respect to insider trading. It also discusses the penalties for criminal insider trading as compared with other administrative crimes. Finally, it outlines Justice Scalia's opinion that *Chevron* deference is inappropriate for administrative crimes.

### *A. The Original Rules and Three Theories of Insider Trading*

Insider trading law is governed generally by § 10(b) and the administrative regulations promulgated pursuant to it. But over time, common law theories of liability for insider trading have evolved and a rich body of case law has developed.

#### 1. Statutory and Regulatory Framework of § 10(b) and Rule 10b-5

Since the 1960s, the government has utilized § 10(b) to regulate and

8. 15 U.S.C. § 78j(b) (2012).

9. See *infra* notes 21–22 and accompanying text for the assertion that insider trading law is crafted judicially.

10. 17 C.F.R. § 240.10b-5 (2017).

11. *Id.* § 240.10b5-2.

prosecute insider trading.[12] Section 10(b) authorizes the SEC to prosecute individuals for fraud, manipulation, and insider trading in connection with a security purchase or sale.[13] Section 10(b) provides that it shall be unlawful for any person 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 Commission may prescribe."[14] Section 10(b) was purposely written broadly; it was a "catch-all clause" designed to cover fraudulent activity generally.[15] Neither § 10(b) nor any of its implementing SEC rules contain the phrase "insider trading" or explicitly prohibit the act of insider trading.[16] Since insider trading is not mentioned or defined in the statute or regulation, it can be understood as a type of securities fraud created by common law.[17] Section 10(b) does not prohibit specific conduct but rather makes certain conduct that violates an SEC rule unlawful.[18]

In 1942, the SEC promulgated Rule 10b-5 pursuant to its rulemaking authority under § 10(b).[19] Rule 10b-5 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,
>
> (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

12. Frank J. Sensenbrenner & Margaret Ryznar, *The Law and Economics of Insider Trading*, 50 WAKE FOREST L. REV. 1155, 1158–61 (2015).

13. 15 U.S.C. § 78j(b).

14. *Id.* (emphasis added).

15. United States v. Newman, 773 F.3d 438, 445 (2d Cir. 2014), *abrogated by* Salman v. United States, 137 S. Ct. 420 (2016).

16. *Id.* For example, Rule 10b-5 never mentions insider trading explicitly but provides a list of prohibited acts, including that "[i]t shall be unlawful for any person . . . [t]o employ any device, scheme, or artifice to defraud, . . . in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5.

17. J. Kelly Strader, *(Re)Conceptualizing Insider Trading*, 80 BROOK. L. REV. 1419, 1427–28 (2015). Indeed, other administratively regulated crimes, such as those governed by the Resource Conservation and Recovery Act of 1976 (RCRA), Pub. L. No. 94-580, 90 Stat. 2795 (codified as amended at 42 U.S.C. §§ 6901–6908a (2012)), are ambiguously written. *See* Lisa K. Sachs, *Strict Construction of the Rule of Lenity in the Interpretation of Environmental Crimes*, 5 N.Y.U. ENVTL. L.J. 600, 608 (1996) (explaining that the RCRA contains an "ambiguous scienter requirement" (emphasis omitted)).

18. Steve Thel, *Taking Section 10(b) Seriously: Criminal Enforcement of SEC Rules*, 2014 COLUM. BUS. L. REV. 1, 4–5. Because of the way in which it was written, § 10(b) gives no notice to traders in possession of material, nonpublic information of what is required to trade legally. *See id.* at 29–30.

19. Daniel J. Bacastow, Comment, *Due Process and Criminal Penalties Under Rule 10b-5: The Unconstitutionality and Inefficiency of Criminal Prosecutions for Insider Trading*, 73 J. CRIM. L. & CRIMINOLOGY 96, 99 (1982).

> (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.[20]

Section 10(b) and Rule 10b-5 are both written broadly because Congress feared that "a statutory definition would amount to a roadmap for fraud, charting ways for informed traders to circumvent prosecution."[21] Consequently, common law, rather than § 10(b) or Rule 10b-5, established insider trading as a specific offense and shaped the contours of its jurisprudence.[22]

Thus, the broadness of Rule 10b-5 and its consequently broad application allow it to encompass almost any plan that interferes with the efficient operation of the market, whether or not the plan is traditionally considered fraud.[23] Liability under this rule, however, extends only as far as the prohibitions in § 10(b).[24] So the scope of Rule 10b-5 may not exceed the authority Congress granted the SEC through § 10(b).[25]

#### 2. Three Common Law Theories of Liability for Insider Trading

Based on common law interpretations of § 10(b) and Rule 10b-5, the Supreme Court has identified three theories of illegal insider trading: the classical theory, the tipper-tippee theory, and the misappropriation theory.[26] Other scholars, however, have written that there are only two types of insider trading: the classical and the misappropriation theory.[27] Nonetheless, under the classical theory, insider trading occurs when a corporate insider trades on "material nonpublic information obtained from his position within the corporation without disclosing the information" to the public.[28] This theory is based on the understanding that there is "a relationship of trust and confidence between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation."[29]

The tipper-tippee theory imposes liability for insider trading on both the

---

20. 17 C.F.R. § 240.10b-5.

21. Thel, *supra* note 18, at 30. See *infra* Part II.A.2 for a discussion of the common law theories of insider trading that have developed surrounding § 10(b).

22. Thel, *supra* note 18, at 29–30.

23. Bacastow, *supra* note 19, at 101.

24. United States v. O'Hagan, 521 U.S. 642, 651 (1997).

25. *Id.* (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 (1976)).

26. Bradley J. Bondi & Steven D. Lofchie, *The Law of Insider Trading: Legal Theories, Common Defenses, and Best Practices for Ensuring Compliance*, 8 N.Y.U. J. L. & BUS. 151, 156–57 (2011).

27. *See, e.g.*, Robert A. Prentice, *Permanently Reviving the Temporary Insider*, 36 J. CORP. L. 343, 350–51 (2011) (noting two theories of insider trading—classical and misappropriation); Tyler J. Bexley, Note, *Reining in Maverick Traders: Rule 10b5-2 and Confidentiality Agreements*, 88 TEX. L. REV. 195, 197 (2009) (explaining that courts have interpreted § 10(b) and Rule 10b-5 to prohibit two distinct insider trading theories).

28. SEC v. Cuban, 620 F.3d 551, 553 (5th Cir. 2010).

29. *Id.* at 553–54 (quoting Chiarella v. United States, 445 U.S. 222, 228 (1980)).

tipper and the tippee when four elements are fulfilled.[30] First, the tipper—an individual with inside information—must have breached her fiduciary duty to the shareholders of the corporation by disclosing material, nonpublic information to the tippee—the recipient of the information.[31] Second, the tippee must have known or should have known of the breach.[32] Third, the information must have been used in connection with a securities transaction.[33] Fourth, the tipper must have received some personal benefit in return for tipping the information.[34]

Finally, the misappropriation theory provides that a corporate outsider is liable for violating § 10(b) "when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information."[35] With the misappropriation theory, "a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information."[36] Here, liability is not based on the breach of a fiduciary duty of a corporate insider to a shareholder, but rather it is based on the temporary insider's deception of the source of the confidential nonpublic information.[37]

### B. *Establishment of the Misappropriation Theory in* United States v. O'Hagan

In the 1997 case *United States v. O'Hagan*,[38] the Supreme Court first established misappropriation as a theory of insider trading liability under § 10(b).[39] The defendant, James O'Hagan, was an attorney at a law firm representing Grand Met, a company engaged in a tender offer[40] for the common stock of another corporation, Pillsbury.[41] But the defendant himself was not

30. Bondi & Lofchie, *supra* note 26, at 157.

31. *Id.*

32. *Id.*

33. *Id.*

34. *Id.*

35. SEC v. Cuban, 620 F.3d 551, 554 (5th Cir. 2010) (quoting United States v. O'Hagan, 521 U.S. 642, 652 (1997)).

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

37. *Id.* Additionally, in 2009, the Second Circuit recognized a fourth theory of insider trading—"outsider trading" or "affirmative misrepresentation" theory—in *SEC v. Dorozhko*, 574 F.3d 42 (2d Cir. 2009). Bondi & Lofchie, *supra* note 26, at 158–59. But it is unclear how this fourth theory would apply to situations outside of the computer hacking context, *id.* at 160, and it is beyond the scope of this Comment to explore.

38. 521 U.S. 642 (1997).

39. *O'Hagan*, 521 U.S. at 650. The Court was presented with two questions in this case. *Id.* at 647. Only the first question is relevant to this Comment: "Is a person who trades in securities for personal profit, using confidential information misappropriated in breach of a fiduciary duty to the source of the information, guilty of violating § 10(b) and Rule 10b–5?" *Id.*

40. "A tender offer is an offer to purchase some or all of shareholders' shares in a corporation." *Tender Offer*, INVESTOPEDIA, http://www.investopedia.com/terms/t/tenderoffer.asp (last visited Apr. 7, 2017) [http://perma.cc/74KN-XQ74].

41. *O'Hagan*, 521 U.S. at 647.

engaged in the representation of Grand Met.[42] After the firm ended its representation, Grand Met announced its tender offer.[43] But before this announcement and while the firm was still representing Grand Met, O'Hagan had purchased call options[44] for Pillsbury stock.[45] Each of these call options provided O'Hagan the right to purchase 100 shares of Pillsbury stock within a certain timeframe.[46]

O'Hagan continued to purchase call options, and within that year, he owned 2,500 unexpired Pillsbury options, more than any other individual investor.[47] Next, O'Hagan bought 5,000 shares of common stock for just under $39 per share.[48] A month later, after Grand Met announced its tender offer, the price of Pillsbury shares rose to $60, and O'Hagan turned a profit of over $4.3 million when he sold his stock.[49] The SEC quickly initiated an investigation resulting in a fifty-seven-count indictment.[50] Seventeen of these counts were for securities fraud in violation of § 10(b) and Rule 10b-5.[51]

The Supreme Court held that the "misappropriation [theory] . . . satisfies § 10(b)'s requirement that chargeable conduct involve a 'deceptive device or contrivance' used 'in connection with' the purchase or sale of securities."[52] The Court explained that the basis of the misappropriation theory is deception—the misappropriator is defrauding the principal when she uses information for personal gain, fulfilling the "deceptive device" portion of § 10(b).[53] Because the misappropriation theory is grounded in deception, full disclosure is a defense to liability.[54] If the misappropriator discloses to the source that she will trade based on the source's information, the misappropriator has no longer deceived the principal.[55] The use of the nonpublic information must also be "in connection with the purchase or sale of any security."[56] Therefore, misappropriation liability ensues when an individual uses the information to purchase or sell securities

42. *Id.*

43. *Id.*

44. "A call option gives the holder the right, but not the obligation, to purchase 100 shares of a particular underlying stock at a specified strike price on the option's expiration date." *Call Option*, INVESTING ANSWERS, http://www.investinganswers.com/financial-dictionary/optionsderivatives/call-option-950 (last visited Apr. 7, 2017) [http://perma.cc/M4AJ-R9AS].

45. *O'Hagan*, 521 U.S. at 647.

46. *Id.*

47. *Id.* at 647–48.

48. *Id.* at 648.

49. *Id.*

50. *Id.*

51. *Id.* at 648–49. A jury convicted O'Hagan on all counts, and the Eighth Circuit reversed all of the convictions, holding that liability under § 10(b) and Rule 10b-5 could not be based on the misappropriation theory. *Id.* at 649.

52. *Id.* at 653 (quoting 15 U.S.C. § 78j(b) (2012)).

53. *Id.* at 654–55.

54. *Id.* at 655.

55. *Id.*

56. 17 C.F.R. § 240.10b-5 (2017).

without disclosure to the principal, not when the individual receives the information.[57] This theory focuses on the kind of information one would use to "gain no-risk profits through the purchase or sale of securities."[58]

The Court concluded that O'Hagan's conduct and misappropriation in general "was properly made the subject of a § 10(b) charge because it [met] the statutory requirement that there be 'deceptive' conduct 'in connection with' securities transactions."[59] The Court noted two safeguards provided by Congress for defendants facing criminal liability under the misappropriation theory.[60] First, the government must prove that a defendant "willfully" violated Rule 10b-5.[61] Indeed, 15 U.S.C. § 78ff(a) provides that "[a]ny person who *willfully* violates any provision of this chapter . . . shall upon conviction be fined not more than $5,000,000, or imprisoned not more than 20 years, or both."[62] Second, a defendant may not be imprisoned for violating this rule if "he proves that he had no knowledge of the Rule."[63]

Justice Scalia dissented, opining that the Court's explanation of § 10(b) and Rule 10b-5's scope was inconsistent with the criminal law rule of lenity.[64] He explained that in light of the rule of lenity, the language of § 10(b), "[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance," must be interpreted to require that the party engaged in deception or manipulation.[65]

### C. *Promulgation of Rule 10b5-2*

After *O'Hagan*, the SEC promulgated Rule 10b5-2[66] to resolve ambiguity and clarify relationships that would give rise to a duty of trust or confidence for the misappropriation theory.[67] Rule 10b5-2 defines and provides a nonexhaustive list of relationships and circumstances in which a person has a "duty of trust or confidence."[68] In its preliminary note, the rule states that

57. *O'Hagan*, 521 U.S. at 655–56.

58. *Id.* at 656.

59. *Id.* at 659. The Court acknowledged that O'Hagan did not challenge the SEC's promulgation of Rule 10b-5 through its authority under § 10(b). *Id.* at 658. Therefore, with respect to Rule 10b-5, the Court only addressed whether O'Hagan's conduct fell within the scope of conduct that the Rule and § 10(b) prohibit. *Id.*

60. *Id.* at 665–66.

61. *Id.* at 665.

62. Securities Exchange Act of 1934, 15 U.S.C. § 78ff(a) (2012) (emphasis added).

63. *O'Hagan*, 521 U.S. at 666; *see also* 15 U.S.C. § 78ff(a).

64. *O'Hagan*, 521 U.S. at 679 (Scalia, J., dissenting). See *infra* Part II.H for further discussion of Justice Scalia's position on deference and lenity in administrative criminal law.

65. *O'Hagan*, 521 U.S. at 679 (Scalia, J., dissenting) (alteration and omission in original) (quoting 15 U.S.C. § 78j(b)).

66. 17 C.F.R. § 240.10b5-2 (2017).

67. William Shotzbarger, Note, *Business and Friendship Don't Mix: The Government's Expansion of Insider Trading Liability Under SEC Rule 10b5-2*, 65 SYRACUSE L. REV. 579, 592 (2015).

68. 17 C.F.R. § 240.10b5-2.

insider trading law is otherwise defined by judicial opinions interpreting Rule 10b-5—opinions like *O'Hagan*.[69]

Rule 10b5-2 applies to any violation of § 10(b), and by extension Rule 10b-5, "that is based on the purchase or sale of securities on the basis of, or the communication of, material nonpublic information misappropriated in breach of a duty of trust or confidence."[70] The rule lists circumstances and relationships in which a "duty of trust or confidence" would arise.[71] The first is "[w]henever a person agrees to maintain information in confidence."[72] The second is whenever the person communicating the information and the person receiving the information have "a *history, pattern, or practice* of sharing confidences, such that the recipient of the information *knows or reasonably should know* that the person communicating the material nonpublic information expects that the recipient will maintain its confidentiality."[73]

In the third circumstance, a "duty of trust or confidence" results when "a person receives or obtains material nonpublic information from his or her spouse, parent, child, or sibling."[74] However, the person receiving the information can demonstrate that there was no "duty of trust or confidence" by showing:

> [H]e or she *neither knew nor reasonably should have known* that the person who was the source of the information expected that the person would keep the information confidential, because of the parties' history, pattern, or practice of sharing and maintaining confidences, and because there was no agreement or understanding to maintain the confidentiality of the information.[75]

This language means that an individual may establish the kind of relationship proscribed by Rule 10b5-2(b)(3), yet she can avoid liability if either party to the relationship can prove that there was no expectation of confidentiality by the family member who provided the material, nonpublic information.[76]

### D. *Creation of Common Law Around Rule 10b5-2*

Following the creation of Rule 10b5-2, courts of appeals were tasked with its application and with addressing challenges to its validity.[77] First, in *SEC v.*

69. *See id.*
70. *Id.* § 240.10b5-2(a).
71. *Id.* § 240.10b5-2(b).
72. *Id.* § 240.10b5-2(b)(1).
73. *Id.* § 240.10b5-2(b)(2) (emphasis added).
74. *Id.* § 240.10b5-2(b)(3).
75. *Id.* (emphasis added).
76. MARVIN G. PICKHOLZ, PETER J. HENNING & JASON R. PICKHOLZ, 21 SECURITIES CRIMES § 7:26 (2d ed. 2016).
77. *See, e.g.*, United States v. McGee, 763 F.3d 304, 312–13 (3d Cir. 2014) (holding that SEC did not exceed the scope of its authority in promulgating Rule 10b5-2(b)(2)); United States v. Gansman, 657 F.3d 85, 91–94 (2d Cir. 2011) (interpreting Rule 10b5-2 for purposes of a proper jury instruction); SEC v. Cuban, 620 F.3d 551, 557–58 (5th Cir. 2010) (finding that a confidentiality agreement may be

*Cuban*,[78] the Fifth Circuit was asked to decide the scope of misappropriation theory liability under Rule 10b5-2 and specifically whether a confidentiality agreement was sufficient to create a duty to disclose.[79]

In *Cuban*, the SEC charged Mark Cuban with violating § 10(b) and Rule 10b5-2(b)(1) for trading Mamma.com stock in breach of his fiduciary duty to the corporation and its CEO.[80] The SEC alleged that this act constituted insider trading under the misappropriation theory.[81] Cuban allegedly received inside information from the company, was told he could not trade on that information, verbally agreed not to trade, and yet proceeded to sell his stock to avoid a personal loss.[82] Cuban argued that he had merely agreed to keep the information confidential, not to refrain from trading.[83] The SEC argued that consenting to confidentiality creates a duty to either disclose the information publicly or abstain from trading, and regardless, the agreement between Cuban and the CEO additionally contained an agreement not to trade.[84]

At issue in *Cuban* was Rule 10b5-2(b)(1), which provides that an individual "has a duty of trust and confidence for purposes of misappropriation theory" when that individual "agrees to maintain information in confidence."[85] The court allowed the case to proceed, acknowledging the scarcity of case law regarding what exactly amounts to a "relationship of trust and confidence."[86] Given the lack of case law defining the Rule 10b5-2 duty of "trust and confidence," the court held that it was "more than a plausible basis to find" that the conduct was an agreement not to sell rather than a mere confidentiality agreement, and thus Cuban may have breached his duty when he traded on the information.[87]

A few years later, in *United States v. McGee*,[88] the Third Circuit faced the question of Rule 10b5-2's validity.[89] The defendant alleged that the SEC exceeded its congressionally delegated rulemaking authority by promulgating Rule 10b5-2.[90] The court applied *Chevron* deference[91] and found that Rule

sufficient to create a duty to disclose under Rule 10b5-2).

78. 620 F.3d 551 (5th Cir. 2010).

79. *Cuban*, 620 F.3d at 552–53. For the misappropriation theory, the duty to disclose entails a duty to disclose the "possession and use of the information to its source." Strader, *supra* note 17, at 1431.

80. *Cuban*, 620 F.3d at 552.

81. *Id.*

82. *Id.* After receiving the confidential information, Cuban was alleged to have said, "Well, now I'm screwed. I can't sell." *Id.* at 555. Then, Cuban was alleged to have reached out for more information after agreeing not to sell, but before he proceeded to sell his shares. *Id.* at 557.

83. *Id.* at 552.

84. *Id.* at 552–53.

85. 17 C.F.R. § 240.10b5-2 (2017); *see also Cuban*, 620 F.3d at 555.

86. *Cuban*, 620 F.3d at 558 (internal quotation mark omitted).

87. *Id.* at 557–58.

88. 763 F.3d 304 (3d Cir. 2014).

89. *McGee*, 763 F.3d at 308.

90. *Id.* at 310.

91. See *infra* Part II.E for an explanation of *Chevron* deference and its application to

10b5-2 indeed fell within the agency's authority.[92]

In *McGee*, the defendant obtained material, nonpublic information from Christopher Maguire, a corporate insider, whom he knew through their participation in Alcoholics Anonymous (AA).[93] For almost a decade, Timothy McGee had served as an informal mentor to Maguire and supported him in his sobriety.[94] Throughout this time, the two shared private information and confided in one another.[95] As relevant to this case, Maguire confided in McGee about the sale of a publicly traded corporation because Maguire was closely involved in negotiations, and the pressure caused him to relapse.[96] Acting on this information, McGee purchased 10,750 shares of the company and then sold the shares after the company announced its sale.[97] McGee was subsequently indicted under the misappropriation theory of insider trading for his purchase and sale.[98]

McGee argued that Rule 10b5-2 was invalid because it allows one to be held liable even without a fiduciary relationship between the source of the inside information and the one who misappropriates it.[99] The court explained that deception through nondisclosure is the essence of insider trading liability, and a duty to disclose is based on the specific relationship between parties.[100]

The court applied the two-step *Chevron* framework to Rule 10b5-2(b)(2).[101] *Chevron* deference "provides that, when a statute is silent or ambiguous with respect to [a certain] issue resolved by an administrative agency, a court should defer to the agency's interpretation [of the law] as long as it is reasonable."[102] McGee argued that the court could not apply *Chevron* deference because the rule "unambiguously requires deception" and because "under Supreme Court precedent, deception through nondisclosure requires the breach of a *fiduciary* duty, leaving no room for Rule 10b5–2(b)(2)."[103] The court was not

administrative laws.

92. *McGee*, 763 F.3d at 312–13.

93. *Id.* at 308.

94. *Id.* at 309.

95. *Id.*

96. *Id.*

97. *Id.* at 308. McGee made a profit of $292,128 from this investment. *Id.*

98. *Id.* at 309–10.

99. *Id.* at 308.

100. *Id.* at 311. Thus, "'there can be no fraud absent a duty to speak,' and the duty to speak arises from a 'relationship of trust and confidence.'" *Id.* (quoting Chiarella v. United States, 445 U.S. 222, 230, 235 (1980)).

101. *Id.* at 312–16. Applying the test provided by *Chevron*, "the court must defer to the SEC's construction of Section 10(b) as long as two criteria are met: (1) Congress has not unambiguously forbidden the SEC's interpretation and (2) the SEC's construction is premised on a permissible interpretation of the underlying statute." United States v. Corbin, 729 F. Supp. 2d 607, 617 (S.D.N.Y. 2010) (internal quotation marks omitted).

102. Dan M. Kahan, *Is* Chevron *Relevant to Federal Criminal Law?*, 110 HARV. L. REV. 469, 489 (1996) (internal quotation marks omitted) (noting that with securities law in particular, actors look to the law to guide their behavior, *id.* at 484).

103. *McGee*, 763 F.3d at 312–13.

persuaded and stated that Rule 10b5-2 was entitled *Chevron* deference because it "(1) has not been congressionally or judicially foreclosed, and (2) is based on a permissible reading of § 10(b)."[104]

At the first step of *Chevron*, the court found that § 10(b) was ambiguous and afforded the SEC broad rulemaking authority.[105] The statute was ambiguous because Congress neither defined "deceptive device" nor mentioned insider trading.[106] This omission signaled a delegation of authority to the SEC.[107] Agreeing with the Fifth Circuit in *Cuban*, the court stated that the Supreme Court did not define the exact form of relationships of trust or confidence.[108] Therefore, the existence of "a duty to disclose under Rule 10b5-2(b)(2) when parties have a history, pattern or practice of sharing confidences does not conflict with Supreme Court precedent."[109]

The court proceeded to step two of the *Chevron* framework: whether the SEC's construction was premised on a permissible interpretation of the statute.[110] The court found that "the SEC's broader approach was reasonable and 'buttressed by a thorough and careful consideration . . . of the ends of § 10(b), the state of the current insider trading case law' and 'the need to protect investors and the market.'"[111] Thus, the court held that Rule 10b5-2(b)(2) was an acceptable interpretation of "deceptive devices" pursuant to § 10(b).[112] The court subsequently noted that although it had reservations "concerning the breadth of misappropriation under Rule 10b5-2(b)(2)," it was leaving the task to Congress to either "limit its delegation of authority to the SEC or to limit misappropriation by statute."[113] Then the court stated in a footnote: "Like the Court in *O'Hagan*, we are reassured by the added protection for criminal liability under § 10(b), which requires that misappropriators *knowingly and willfully* violate the law."[114]

### *E.* Chevron *Deference Explained*

In *Chevron*, the Supreme Court established the concept of *Chevron* deference. This case concerned the Clean Air Act Amendments of 1977 and subsequent Environmental Protection Agency (EPA) regulations.[115] The Court

104. *Id.* at 313.
105. *Id.*
106. *Id.*
107. *Id.*
108. *Id.* at 314.
109. *Id.*
110. United States v. Corbin, 729 F. Supp. 2d 607, 617 (S.D.N.Y. 2010).
111. *McGee*, 763 F.3d at 315 (quoting *Corbin*, 729 F. Supp. 2d at 619).
112. *Id.* at 316.
113. *Id.*
114. *Id.* at 316 n.9 (emphasis added). But see *United States v. Parigian*, 824 F.3d 5, 14 (1st Cir. 2016), where the court noted in dicta that one could question the applicability of Rule 10b5-2 in a criminal context, given the "knows or reasonably should know" mens rea standard.
115. Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 839–40 (1984).

established the two-step test to address challenges to any agency's interpretation of its own administrative regulation.[116] In the first step, a court determines whether Congress's intent is clear on the issue; if it is, Congress's intent controls.[117] But if Congress does not discuss the issue or if a statute is ambiguous, a court moves to step two to determine whether the agency's interpretation was a permissible construction.[118] This second step requires deference to the agency—hence the term "*Chevron* deference."[119]

Once a court reaches step two, the agency's interpretation of the regulation is usually upheld.[120] On only a few occasions has the Supreme Court invalidated an agency's construction of a regulation.[121] For example, in *Utility Air Regulatory Group v. EPA*,[122] the Supreme Court found that the EPA exceeded its statutory authority, even after it applied *Chevron* deference.[123] The Court noted that the "question for a reviewing court is whether . . . the agency has acted reasonably and thus has stayed within the bounds of its statutory authority."[124] But in most cases, courts are deferential to the agency's interpretation at step two.[125]

### *F. The Rule of Lenity and Its Tension with* Chevron *Deference*

The rule of lenity requires a court to resolve any ambiguity in the interpretation of a criminal statute in favor of the defendant.[126] It applies identically to an administrative rule or regulation carrying a criminal penalty as it does to a criminal statute.[127] Thus, under the rule of lenity, when a criminal law is ambiguous and a choice must be made between two interpretations of a crime, a court must select the less severe interpretation, absent clear and definite

116. Alexander, *supra* note 1, at 638.

117. *Id.* at 638–39.

118. *Id.* at 639.

119. *Id.*

120. Elizabeth Magill, Step Two of *Chevron v. Natural Resources Defense Council* 2 (June 2001) (unpublished manuscript) (on file with the ABA Administrative Law Section).

121. *Id.*; *see, e.g.*, Util. Air Regulatory Grp. v. EPA, 134 S. Ct. 2427 (2014); AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366 (1999).

122. 134 S. Ct. 2427 (2014).

123. *Util. Air Regulatory Grp.*, 134 S. Ct. at 2449.

124. *Id.* at 2439 (quoting City of Arlington v. FCC, 133 S. Ct. 1863, 1868 (2013)) (internal quotation marks omitted).

125. Magill, *supra* note 120, at 2.

126. Note, *The New Rule of Lenity*, 119 HARV. L. REV. 2420, 2420 (2006) [hereinafter Note, *The New Rule of Lenity*]. There are several limits to the use of lenity in criminal cases. First, the ambiguity in the statute or regulation must be actual and substantial before lenity may be applied. Greenfield, *supra* note 1, at 14–15. It must be a last resort applied when reasonable doubt still exists after an effort to interpret the statute. *Id.* at 15. Finally, it applies only to criminal statutes. *Id.* at 16.

127. *See, e.g.*, M. Kraus & Bros. v. United States, 327 U.S. 614, 621 (1946) (noting that canons of construction that apply to criminal statutes also apply to administrative rules and regulations carrying criminal penalties).

language by Congress.[128]

The rule of lenity is in tension with *Chevron* deference with respect to administrative regulations that carry criminal penalties.[129] *Chevron* deference provides that when a regulation or statute is silent with respect to a certain issue resolved by an administrative agency, the court should defer to that agency's interpretation of the law as long as it is reasonable.[130] The rule of lenity, on the other hand, provides that an ambiguous law should be resolved in favor of the defendant.[131] Just as these approaches conflict statutorily, they conflict on a policy level.[132]

The rule of lenity has two policy objectives.[133] The first is that "a fair warning should be given to the world in language that the common world will understand, of what the law intends to do if a certain line is passed."[134] Second, because of the serious consequences of criminal convictions and their accompanying moral stigma, legislatures—rather than courts—should define crimes.[135] Therefore, lenity represents "the instinctive distaste against men languishing in prison unless the lawmaker has clearly said they should."[136]

On the other hand, *Chevron* deference respects Congress's delegation of authority to administrative agencies, allowing agencies to easily achieve their goals.[137] The rationale is that courts are generalists and should defer to the expertise of agency administrators.[138] But one scholar provided: "Just as courts require that a criminal defendant be found guilty of an offense beyond a reasonable doubt, courts should also require that there not be substantial ambiguity as to whether a defendant's actions were intended by Congress to come within the scope of its statute."[139] Thus, a tension exists between the two approaches to statutory interpretation.[140]

128. United States v. Bass, 404 U.S. 336, 347 (1971).

129. *See* Sunstein, *supra* note 1, at 2115 (explaining that canons of construction, such as interpreting criminal statutes in favor of the defendant, should not be overridden by deferring to agency interpretation).

130. *See* Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 844 (1984),

131. *Bass*, 404 U.S. at 347.

132. Greenfield, *supra* note 1, at 61. The rule of lenity is a canon of statutory interpretation and not a "constitutional command." Alexander, *supra* note 1, at 616 n.29. The rule itself cannot force a court to abstain from applying deference, but it does provide a justification for abandoning deference when administrative crimes are at issue. *Id.*

133. *Bass*, 404 U.S. at 347–48.

134. *Id.* at 348 (quoting McBoyle v. United States, 283 U.S. 25, 27 (1931) (Holmes, J.)).

135. *Id.*

136. *Id.* (quoting HENRY J. FRIENDLY, MR. JUSTICE FRANKFURTER AND THE READING OF STATUTES (1964), *reprinted in* BENCHMARKS 196, 209 (1967)).

137. Greenfield, *supra* note 1, at 61.

138. Sanford N. Greenberg, *Who Says It's a Crime?:* Chevron *Deference to Agency Interpretations of Regulatory Statutes that Create Criminal Liability*, 58 U. PITT. L. REV. 1, 9 (1996).

139. Greenfield, *supra* note 1, at 60.

140. *See* Sunstein, *supra* note 1, at 2115–16 (explaining that deference to agency interpretation should not override certain canons of construction, including interpreting criminal statutes in favor of

## *G. Administrative Crime*

Many administrative regulations hold criminal penalties if violated.[141] Though not the first, the case that truly confirmed the constitutionality of administrative crimes was *United States v. Grimaud*,[142] which involved a prosecution for allowing sheep to graze in violation of regulations promulgated by the Secretary of Agriculture.[143] Since *Grimaud*, administrative crimes have become a widespread mechanism for present-day regulation.[144]

### 1. Prosecution of Insider Trading as an Administrative Crime

Some consider Rule 10b-5 and other rules promulgated pursuant to § 10(b) the most prominent administrative crimes.[145] Criminal liability for insider trading requires willfulness,[146] and willful violations of SEC regulations can result in very harsh sentences.[147] Indeed, the actors in the securities context function in a heavily regulated environment with severe sanctions.[148] Under 15 U.S.C. § 78ff(a), which provides the penalties for insider trading, willful violations can result in $5,000,000 in fines, imprisonment of not more than twenty years, or both.[149]

Over the past few decades, Congress has amended 15 U.S.C. § 78ff(a) to increase both the maximum fine and the maximum sentence for willful violations.[150] In 1988, Congress amended 15 U.S.C. 78ff(a) "(1) by striking '$100,000' and inserting '$1,000,000;' (2) by striking 'five years' and inserting '10 years.'"[151] Then, in 2002, Congress made further amendments "by striking

---

the defendant).

141. Alexander, *supra* note 1, at 613. *In re Kollock*, 165 U.S. 526 (1897), was the first case to approve a criminal conviction for the violation of an administrative rule, specifically the Oleomargarine Act. *See Kollock*, 165 U.S. at 537. Israel Kollock, was prosecuted for violating a provision of the Act that required margarine to be stamped and branded in accordance with the proscription of the Commissioner of Internal Revenue. *Id.* at 532.

142. 220 U.S. 506 (1911).

143. *Grimaud*, 220 U.S. at 513–14.

144. Logan Sawyer, *Grazing,* Grimaud*, and Gifford Pinchot: How the Forest Service Overcame the Classical Nondelegation Doctrine to Establish Administrative Crimes*, 24 J. L. & POL. 169, 170 (2008).

145. *See, e.g.*, Alexander, *supra* note 1, at 612 n.3 (describing Rule 10b-5 as perhaps the "most prominent administrative crime").

146. See *supra* notes 61–63 and accompanying text for a discussion of the willfulness requirement for criminal liability.

147. *See, e.g.*, Alexander, *supra* note 1, at 612 n.3.

148. Alexandre Padilla, *How Do We Think About Insider Trading? An Economist's Perspective on the Insider Trading Debate and Its Impact*, 4 J. L. ECON. & POL'Y 239, 240 (2008).

149. Securities Exchange Act of 1934, 15 U.S.C. § 78ff(a) (2012).

150. White-Collar Crime Penalty Enhancement Act of 2002, Pub. L. No. 107-204, § 1106, 116 Stat. 745, 810 (codified as amended at 15 U.S.C. § 78ff(a) (2012)); Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, § 4, 102 Stat. 4677, 4680 (codified as amended at 15 U.S.C. § 78ff(a) (1988)).

151. § 4, 102 Stat. at 4680.

'$1,000,000, or imprisoned not more than 10 years' and inserting '$5,000,000, or imprisoned not more than 20 years.'"[152]

The most recent enforcement efforts against insider trading have been severe, producing some of the longest sentences since the government began prosecuting the crime.[153] For example, in 2014, Mathew Martoma, a portfolio manager convicted of insider trading, was sentenced to nine years in prison.[154] Before that, in 2012, Matthew Kluger was sentenced to twelve years, which marked the longest insider trading sentence in U.S. history.[155] During a five-year period ending in December 2013, the length of sentences imposed for insider trading increased by 31.8%.[156] Additionally, the more money an individual gains from insider trading, the more years she receives as a sentence.[157] Therefore, prosecutors hold defendants responsible for the highest amount of money they can justify to achieve a longer sentence, regardless of whether the defendant actually profited by that amount.[158]

Insider trading is unique among other types of corporate accounting fraud because it does not have an equivalent impact on individual investors, even though the government argues that insider trading harms the integrity of the markets.[159] Insider trading "has little direct consequence for investors because the transactions take place on anonymous markets."[160] For example, unlike the individual people who fall victim to a Ponzi scheme and may never be repaid,[161] the only victim of insider trading is the market itself.[162] Some defendants even argue that it is a victimless crime because no one person is individually

152. § 1106, 116 Stat. at 810.

153. *See* Chad Bray, *Insider Case Gets Longest Sentence*, WALL ST. J. (June 4, 2012, 9:01 PM), http://www.wsj.com/news/articles/SB10001424052702303918204577446982337564066 [http://perma.cc/H3NH-3MSW].

154. Peter J. Henning, *Punishments for Insider Trading Are Growing Stiffer*, N.Y. TIMES (Sept. 9, 2014, 10:44 AM), http://dealbook.nytimes.com/2014/09/09/punishments-for-insider-trading-are-growing-stiffer/ [http://perma.cc/67YD-QTFN] [hereinafter Henning, *Punishments for Insider Trading*].

155. Bray, *supra* note 153.

156. Nate Raymond, *Insider Traders in U.S. Face Longer Prison Terms, Reuters Analysis Shows*, REUTERS (Sept. 2, 2014, 7:52 AM), http://www.reuters.com/article/2014/09/02/us-insider-trading-prison-insight-idUSKBN0GX0A820140902#I5kOVsIOLhwy1vz2.97 [http://perma.cc/B6DW-AZCG].

157. Walter Pavlo, *Insider Trading Shows Absurdity of Sentencing Guidelines*, FORBES (July 29, 2013, 12:01 PM), http://www.forbes.com/sites/walterpavlo/2013/07/29/the-over-criminalization-of-insider-trading/ [http://perma.cc/F7RG-EH58].

158. *Id.*

159. Henning, *Punishments for Insider Trading*, *supra* note 154.

160. *Id.*

161. *See* David A. Gradwohl & Karin Corbett, *Equity Receiverships for Ponzi Schemes*, 34 SETON HALL LEGIS. J. 181, 183 (2010) (stating that victims of Ponzi schemes, like the Madoff Ponzi scheme, will never be provided full recovery by equity receivership).

162. *See* Jason M. Breslow, *Preet Bharara: Insider Trading Is "Rampant" on Wall Street*, FRONTLINE (Jan. 7, 2014), http://www.pbs.org/wgbh/frontline/article/preet-bharara-insider-trading-is-rampant-on-wall-street/ [http://perma.cc/6V8M-VNF6] ("[T]he market is a victim . . . .").

harmed.[163] In fact, at his sentencing, Raj Rajaratnam argued that insider trading was a victimless crime, less harmful than other varieties of securities fraud.[164] Some scholars have even argued for the legalization of insider trading, submitting that among other benefits, it would promote the efficient incorporation of information into the price of securities.[165]

Many academics have suggested that courts should treat administrative regulations carrying criminal penalties differently than administrative regulations carrying only civil penalties.[166] Some have argued that certain SEC provisions should not pass both steps of the *Chevron* two-step analysis because they are arbitrary and capricious—and that in such cases, courts therefore should not defer to agency interpretation.[167] One scholar went on to argue that Rule 10b5-2(b)(1) "does not explicitly address the question of what types of relationships breed a duty that can lead to the requisite deception."[168]

Professor Dan Kahan explained that when Congress writes a statute with broad, general language, it transfers the responsibility of creating law onto courts and prosecutors, resulting in federal common law.[169] Although Kahan argued that there is no tension between federal common law and fair warning, he conceded that notice is indeed important when the law is drawing the line between socially desirable and undesirable conduct.[170] He specifically pointed out that in securities law, actors must look to the law to guide their actions.[171] In fact, many scholars consider insider trading a classic example of a *malum prohibitum* crime.[172] Because *malum prohibitum* crimes are by definition crimes

163. Tabetha Martinez, *Amending Rule 10b-5: SAC Capital and the Willfully Blind Financial Executive*, 37 T. JEFFERSON L. REV. 447, 465 (2015) (stating that while defendants of insider trading claim that it is victimless, it is not).

164. Peter J. Henning, *How Serious a Crime Is Insider Trading?*, N.Y. TIMES (Aug. 10, 2011, 3:30 PM), http://dealbook.nytimes.com/2011/08/10/how-serious-a-crime-is-insider-trading/ [http://perma.cc/5ZR2-SQGG].

165. *See* Mercer Bullard, *Insider Trading in a Mannean Marketplace*, 88 TEMP. L. REV. 223, 224 (2016) (citing HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET 99–103 (1966)).

166. *E.g.*, Alexander, *supra* note 1, at 646 (arguing that policies in favor of deference to agency interpretations call for less consideration in the criminal law context).

167. *See, e.g.*, Joseph Pahl, Note, *A Heart as Far from Fraud as Heaven from Earth:* SEC v. Cuban *and Fiduciary Duties Under Rule 10b5-2*, 106 NW. U. L. REV. 1849, 1877 (2012) (arguing that Rule 10b5-2(b)(1) is arbitrary and capricious and should not pass the second step of *Chevron*).

168. *Id.*

169. Kahan, *supra* note 102, at 475.

170. *Id.* at 484.

171. *See id.* But Kahan believes that "persons who self-consciously search out gaps between common morality and law are engaged in a culpable form of loopholing, which ambiguity can justly be used to discourage." *Id.* Thus, concluding that there is no tension between notice and common lawmaking, he directs courts to remain sensitive to social context, especially as statutory applications approach the border between socially desirable and undesirable conduct. *Id.*

172. *E.g.*, Daniel T. Ostas, *Legal Loopholes and Underenforced Laws: Examining the Ethical Dimensions of Corporate Legal Strategy*, 46 AM. BUS. L.J. 487, 502 (2009). A *malum prohibitum* crime is defined as "[a]n act that is a crime merely because it is prohibited by statute, although the act itself is not necessarily immoral." *Malum Prohibitum*, BLACK'S LAW DICTIONARY (10th ed. 2014).

only because they are prohibited, a person unaware of the contours of the prohibition would not have notice of potential liability.[173]

Kahan noted the limits associated with federal common lawmaking, namely the limited expertise of federal judges with respect to criminal law.[174] He again pointed out the uniqueness of securities law in that courts have been ineffective at resolving the tension between socially desirable and undesirable behavior.[175] Misled by scandalous facts, "courts have fashioned a body of formless doctrines that create unacceptably high risks of overdeterrence and unfair surprise when applied generally."[176] This is especially problematic when players consult securities law to guide their actions.[177]

2. Insider Trading and Other Administrative Criminal Penalties

The 1934 Act provides penalties for willful violations of insider trading regulations.[178] In another realm of law, the Endangered Species Act of 1973[179] (ESA) provides another example of a statute with criminal penalties administered by an agency; the penalties are provided in 16 U.S.C. § 1540(b).[180] This section provides that "[a]ny person who knowingly violates any provision of this chapter . . . shall, upon conviction, be fined not more than $50,000 or imprisoned for not more than one year, or both."[181]

Another administrative regulation that carries criminal penalties is the Occupational Safety and Health Act of 1970[182] (OSHA). The criminal penalties for OSHA violations are set forth in 29 U.S.C. § 666.[183] Section 666(e) provides in relevant part:

> Any employer who willfully violates any standard, rule, or order promulgated pursuant to section 655 of this title . . . and that violation caused death to any employee, shall, upon conviction, be punished by a fine of not more than $10,000 or by imprisonment for not more than six

173. Note, *The New Rule of Lenity*, *supra* note 126, at 2438.

174. Kahan, *supra* note 102, at 485.

175. *Id.*

176. *Id.*

177. *See id.* ("Full legislative (or even judicial) specification of these statutes would be infeasible . . . . At the same time, analysts, arbitrageurs, corporate executives, and market participants must consult the law to guide legitimate economic activity.").

178. 15 U.S.C. § 78ff(a) (2012).

179. 16 U.S.C. §§ 1531–1544 (2012). 50 C.F.R. §§ 17.1–17.108 was promulgated pursuant to the ESA, and violations of these regulations result in penalties provided in 16 U.S.C. § 1540. In fact, the Supreme Court in *Babbitt v. Sweet Home Chapter of Communities for a Great Oregon*, 515 U.S. 687 (1995), stated that in enacting the ESA, Congress "delegated broad administrative and interpretive power to the Secretary." *Babbitt*, 515 U.S. at 708. As such, the Court, citing *Chevron*, stated that it was "reluctant to substitute [its] views" for that of the agency. *Id.*

180. 16 U.S.C. §1540(b).

181. *Id.* § 1540(b)(1).

182. 29 U.S.C. §§ 651–678 (2012). 29 C.F.R. §§ 1975.1–1975.6 was promulgated pursuant to OSHA, and penalties for violations of these regulations are listed in 29 U.S.C. § 666.

183. 29 U.S.C. § 666.

months, or by both . . . .[184]

Additionally, § 666(g) provides that "[w]hoever knowingly makes any false statement, representation, or certification . . . pursuant to this chapter shall, upon conviction, be punished by a fine of not more than $10,000, or by imprisonment for not more than six months, or by both."[185] Similarly, the Toxic Substances Control Act[186] (TSCA) provides that a person who knowingly or willingly violates the TSCA is subject to a fine of not more than $50,000 per day of violation, up to one year in prison, or both.[187] Thus, as compared with penalties for violations of the ESA, OSHA, or TSCA, insider trading punishments are much more severe.[188]

### *H. Justice Scalia on Lenity and Insider Trading*

Justice Scalia discussed the tension between lenity and deference as it relates to insider trading in his commentary denying certiorari in *Whitman v. United States*[189] and in his dissenting opinion in *O'Hagan*.[190] In *Whitman*, the defendant had been convicted of securities fraud.[191] He appealed based on various evidentiary grounds and based on the jury instructions,[192] but the Second Circuit affirmed.[193] Whitman applied to the Supreme Court for certiorari.[194] The Court, including Justice Scalia, denied his petition.[195] But Justice Scalia added his own comments regarding the application of *Chevron* deference to this statute and SEC rule, an issue not specifically before the court.[196] He noted that a court does not owe deference to the prosecutor or, as here, to the SEC's interpretation of a statute or regulation in a criminal case.[197]

Although many courts have applied *Chevron* deference to this statute and

184. *Id.* § 666(e).

185. *Id.* § 666(g).

186. 15 U.S.C. §§ 2601–2629 (2012). 40 C.F.R. § 795.120 was promulgated pursuant to the TSCA, and violations of this regulation result in the penalties provided in 15 U.S.C. § 2615(b).

187. 15 U.S.C. § 2615(b).

188. *Compare* Securities Exchange Act of 1934, 15 U.S.C. § 78ff(a) (2012) (imposing a maximum penalty of $5,000,000 in fines, or twenty years of imprisonment, or both for insider trading violations), *with* 15 U.S.C. § 2615(b) (TSCA), 16 U.S.C. §1540(b) (2012) (ESA), *and* 29 U.S.C. § 666(e), (g) (OSHA).

189. 135 S. Ct. 352 (2014) (mem.), *denying cert. to* 555 F. App'x 98, 107 (2d Cir. 2014) (affirming the district court's judgment that defendant was guilty of insider trading).

190. United States v. O'Hagan, 521 U.S. 642, 679 (1997) (Scalia, J., concurring in part and dissenting in part). Justice Scalia's dissent in *O'Hagan* noted that the Court's explanation of § 10(b) and Rule 10b-5's scope was inconsistent with the rule of lenity in criminal law. *Id.*

191. United States v. Whitman, 555 F. App'x 98, 100 (2d Cir. 2014).

192. *Id.* at 101.

193. *Id.* at 107.

194. Petition for a Writ of Certiorari, *Whitman*, 135 S. Ct. 352 (No. 14-29), 2014 WL 3401635.

195. *Whitman*, 135 S. Ct. at 352, *denying cert. to* 555 F. App'x 98 (2d Cir. 2014).

196. *See id.* at 353–54.

197. *Id.* at 352–53.

its associated SEC rules, deference actually conflicts with criminal law.[198] Justice Scalia explained that "legislatures, not executive officers, define crimes."[199] He went on to say that by applying deference to an agency's interpretation of a provision that holds criminal liability, "federal administrators can in effect create (and uncreate) new crimes at will, so long as they do not roam beyond ambiguities that the laws contain."[200] He noted that it is one thing for Congress to have the ability to make it a crime to violate a regulation, but it is a very different thing to presume that Congress has allowed agencies to resolve ambiguities in regulations that contain criminal penalties.[201] Justice Scalia relied on *Carter v. Welles-Bowen Realty, Inc.*[202] The government in *Carter* argued that without requiring Congress to speak clearly and distinctly when defining criminal conduct, whenever a gap existed in a criminal statute, courts could assume there was a congressional delegation of authority.[203] The Sixth Circuit refuted this argument: "A presumption does not a clear statement make."[204]

Justice Scalia explained that deferring to the SEC in criminal cases conflicts with the rule of lenity.[205] He highlighted one example of the Supreme Court deferring to an administrative agency's interpretation of a law with criminal penalties.[206] But he quickly discounted this example, explaining that it contradicts many other cases, which hold that "if a law has both criminal and civil applications, the rule of lenity governs its interpretation in both settings."[207] He reiterated that the legislature is the only body that can define crimes and that the presence of ambiguity does not transfer this task to the courts and administrative agencies.[208] When a petition properly presents the question of deference in criminal law, Justice Scalia said, "I will be receptive to granting it."[209]

## III. DISCUSSION

Given the heterogeneous array of administrative crimes, each subjected to *Chevron* deference if the rulemaking authority of an agency faces a challenge, the core question becomes: why should insider trading be treated differently? What makes it unique and deserving of special treatment? This Section argues

198. *Id.* at 353.

199. *Id.*

200. *Id.*

201. *Id.*

202. 736 F.3d 722 (6th Cir. 2013); *see also Whitman*, 135 S. Ct. at 353 (referencing *Carter* in Justice Scalia's statement).

203. *Carter*, 736 F.3d at 733.

204. *Id.*

205. *Whitman*, 135 S. Ct. at 353.

206. *Id.* Justice Scalia was referring to the Supreme Court's opinion in *Babbitt v. Sweet Home Chapter of Communities for a Great Oregon*, 515 U.S. 687 (1995). *Whitman*, 135 S. Ct. 353.

207. *Whitman*, 135 S. Ct. at 353–54.

208. *Id.* at 354.

209. *Id.*

that § 10(b), Rule 10b-5, and Rule 10b5-2 are more ambiguous than other administrative regulations that carry criminal penalties.[210]

The language of insider trading law is broad and ambiguous,[211] the penalties are harsher than those of other administrative crimes,[212] and actors need clear rules in this highly regulated environment.[213] Thus, *Chevron* deference is inappropriate to apply to insider trading regulations when the liability is criminal rather than civil. This Section argues that courts should not apply *Chevron* deference in criminal prosecutions—they should carve out this exception. Further, it proposes application of the rule of lenity to insider trading. In the alternative, it argues that courts should be more willing to find that insider trading regulations "fail" step two of the *Chevron* framework.

Part III.A discusses how insider trading is different from other administrative crimes. This Part also explains why, in light of this, it is problematic to apply *Chevron* deference to criminal insider trading cases. And Part III.B proposes a lenity exception for criminal insider trading where application of a regulation is ambiguous. This Part also proposes, alternatively, that at step two of the *Chevron* framework, courts should be more willing to find that an agency has unreasonably interpreted a regulation. The lenity exception advocated by this Comment protects insider trading defendants from the harsh consequences of judicial deference to agency interpretations.

### A. *Insider Trading Is Unique Among Administrative Crimes*

Section 10(b), Rule 10b-5, and Rule 10b5-2 are different from other administrative regulations that result in criminal liability. These laws do not even contain the phrase "insider trading" and do not define it.[214] Compounding the adverse effects of this ambiguity, there is a special need for notice and fair warning in insider trading because actors closely conform their conduct to what the law permits.[215] Insider trading penalties are harsher than those for other administrative crimes and have become incrementally more severe.[216] Finally, it is unfair to apply *Chevron* deference to laws that are implemented and defined by common law. Specifically, and because of the very nature of criminal insider trading, *Chevron* deference should not apply because its application in this realm is plainly unfair.

210. *See, e.g.*, Kahan, *supra* note 102, at 485 (arguing that courts have been especially unsuccessful at resolving tensions in insider trading and securities).

211. See *supra* Part II.A.1 for a discussion of the statutory framework of insider trading law.

212. See *supra* Part II.G.1 for a comparison of the penalties for willful violation of insider trading law to willful violation of other administrative crimes.

213. See *supra* note 171 and accompanying text for the assertion that actors need the law to guide their trading.

214. United States v. Newman, 773 F.3d 438, 445 (2d Cir. 2014), *abrogated by* Salman v. United States, 137 S. Ct. 420 (2016).

215. Kahan, *supra* note 102, at 484.

216. See *supra* notes 150–58 and accompanying text for a discussion of the increase in sentence severity for insider trading.

### 1. Insider Trading Law Lacks Guidance for Defendants Despite a Special Need for Notice

First, the language of § 10(b) and its associated regulations provide virtually no guidance as to what conduct qualifies as insider trading. Their meaning and applications have been derived almost exclusively from case law.[217] In fact, Rule 10b-5 existed for approximately nineteen years before courts decided that it applied to insider trading.[218] Tasked with interpreting Rule 10b-5—one of the broadest, if not the broadest, criminal administrative regulation—courts have created extensive common law insider trading jurisprudence.[219]

Nonetheless, the phrase "insider trading" still does not appear in any provision of § 10(b) or any rule promulgated pursuant to it.[220] Although other administrative regulations are indeed ambiguous, the omission of "insider trading," the crime itself, asks courts to create the law entirely.[221] Consequently, although this Comment presumes three theories of insider trading, other scholars cannot agree whether there are two types—classical and misappropriation—or whether there are indeed three.[222] This further illustrates the lack of clarity among the rules, regulations, and common law.

The actors in this context function in a heavily regulated environment with the threat of severe sanctions;[223] a comprehensive understanding of the law is paramount. Even with this backdrop of heavy regulation, § 10(b) is so broad and ambiguous and has evolved so significantly over time that courts have been forced to create meaning from virtually nothing.[224] For traders, this has meant a highly regulated environment shaped by indefinite and ambiguous laws. This inconsistency produces risk because of the special need investors have for notice to shape their behavior in this environment.[225] And this ambiguity, despite a critical need for guidance, makes it all the more troubling for courts to defer to agency interpretations in this realm. Professor Kahan has noted that courts have inadequately resolved the gray area between socially desirable and undesirable

---

217. *See, e.g.*, Cady, Roberts & Co., Exchange Act Release No. 6668, 40 S.E.C. 907, 910–11 (Nov. 8, 1961) (making Rule 10b-5 the definitive Rule for insider trading almost twenty years after the creation of the Rule); United States v. O'Hagan, 521 U.S. 642, 665–66 (1997) (holding that the misappropriation theory of insider trading is included in the conduct prohibited by Rule 10b-5); SEC v. Cuban, 620 F.3d 551, 557–58 (5th Cir. 2010) (analyzing how courts should define "duty of trust and confidence" provided by Rule 10b5-2).

218. Bacastow, *supra* note 19, at 105.

219. See *supra* Part II.D for a discussion of the common law created following the promulgation of Rule 10b5-2.

220. *See supra* notes 16 and accompanying text.

221. See *supra* note 17 for the assertion that ambiguity exists in another administrative regulation.

222. See *supra* note 27 for examples of scholars who believe that there are truly two, not three, theories of liability for insider trading.

223. Padilla, *supra* note 148, at 240.

224. *See supra* notes 15–18 and accompanying text.

225. *See supra* notes 170–71 and accompanying text.

behavior as defined by securities law.[226] Courts have essentially failed to create coherent law, which has led to a "risk[] of overdeterrence and unfair surprise."[227] Considering all of this, insider trading uniquely deserves different treatment from that of other administrative crimes.

Next, there is a heightened need for notice with respect to insider trading, compared with other administrative crimes, because insider trading is a textbook example of a *malum prohibitum* crime.[228] *Malum prohibitum* crimes are only considered punishable because they are prohibited by statute or regulation, in this case § 10(b).[229] In other words, unlike murder or assault, there is nothing overtly immoral about insider trading that would naturally put someone on notice that what she is doing is inherently wrong. Because insider trading is a *malum prohibitum* crime, actors must rely on the statute to know that it is a crime.[230] Thus, when a regulation or rule is ambiguous regarding a *malum prohibitum* crime, it is virtually impossible for a defendant to know in advance whether her conduct is criminal.[231] It follows that ambiguity should therefore be resolved in the defendant's favor. An opposing viewpoint would emphasize that a defendant must willfully violate the law to face criminal liability for insider trading.[232] But it is a slippery slope for courts to continue to defer to the SEC's interpretation and allow tenuous applications to actions that may or may not fit the definition of insider trading. And continuing a tradition of deferral could expand the definition of conduct considered insider trading.[233]

Corporate insiders and other actors should have the ability to conform their behavior to securities law so that they can successfully compete in business while remaining confident that their actions are legal. For example, the defendant in *McGee* argued that Rule 10b5-2 was invalid because "it allows for misappropriation liability absent a fiduciary relationship between a misappropriator of inside information and its source."[234] Although the jury found that McGee had committed a willful violation, and the Third Circuit affirmed,[235] this rule had only recently been enacted;[236] prior to the decision,

226. See *supra* notes 174–77 and accompanying text for a reference to Kahan's position regarding the courts' performance in dealing with this tension in securities law.

227. Kahan, *supra* note 102, at 485.

228. *See* Ostas, *supra* note 172, at 502 (explaining that insider trading is a classic example of a *malum prohibitum* crime).

229. *Malum Prohibitum*, *supra* note 172.

230. *See* Ostas, *supra* note 172, at 502.

231. See *supra* Part III.A.1 for a discussion of the language of insider trading law and how it lacks guidance for defendants.

232. See *supra* notes 61–63 and accompanying text for an explanation of the willfulness requirement for insider trading violations.

233. *See* Joanna B. Apolinsky, *The Boundaries of Fraud Under the Insider Trading Rules*, 13 FL. ST. U. BUS. REV. 1, 4 (2014) ("[M]ore and more cases push the boundaries of what truly amounts to fraud sufficient for a section 10(b) violation.").

234. United States v. McGee, 763 F.3d 304, 308 (3d Cir. 2014).

235. *Id.* at 309–10, 318.

236. 17 C.F.R. § 240.10b5-2 became effective on October 23, 2000. *Final Rule: Selective*

parties like the defendant operated in uncertainty, not knowing what actions the rule encompassed.

Some have suggested that the willfulness requirement "would to some degree give effect both to lenity and to deference."[237] But although to be criminally liable for insider trading, the actor must have willfully violated the law (meaning that she knew that the law existed and knowingly violated it),[238] the contours of a broad and ambiguous law can be difficult to understand and apply. As such, "willfulness" contributes "virtually nothing to the government's burden in a criminal securities fraud case."[239]

This Comment argues that the "willfulness" requirement cannot protect defendants and is a mere formality in this context when courts defer to agency interpretation and a defendant must look to an ambiguous law. Even though a heightened notice requirement exists for criminal liability,[240] insider trading defendants like McGee need concrete rules to shape their behavior. "Insider trading is a classic 'gray-area' white collar crime, the boundaries of which are uncertain."[241] And even with a willfulness requirement, it is truly the court's interpretation of the law, or the court's deference to the agency interpretation, that is determinative.[242] The willfulness requirement and knowledge that the law exists are not enough when the law itself lacks meaning.

2. Harsh Penalties for Insider Trading Make It Unique

Finally, there is a special need for notice of insider trading rules because of their dire consequences, as compared with other administrative crimes that contain willfulness requirements.[243] The consequences of violating insider trading law are severe, especially considering that the conduct from a moral standpoint can be considered much less harmful than other conduct and administrative crimes. For example, *willful* violation of OSHA causing the death of an employee carries a maximum sentence of six months, a fine of not more than $10,000, or both.[244] Meanwhile, *willful* violation of an insider trading

*Disclosure and Insider Trading*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/rules/final/33-7881.htm (last modified Aug. 21, 2000) [http://perma.cc/M3UM-P3YR].

237. Hickman, *supra* note 1, at 939. In the tax shelter context, Hickman argues that "[t]here can be no question of notice or fair warning where the government must demonstrate actual subjective knowledge of a legal obligation," even when the court defers. *Id.*

238. See *supra* notes 61–63 and accompanying text for a discussion of the willfulness requirement for criminal liability.

239. Strader, *supra* note 17, at 1445.

240. Securities Exchange Act of 1934, 15 U.S.C. § 78ff(a) (2012).

241. *Id.*

242. *See* Hickman, *supra* note 1, at 940.

243. *Compare* 15 U.S.C. § 78ff(a), *with* 15 U.S.C. § 2615(b), 16 U.S.C. §1540(b) (2012), *and* 29 U.S.C. § 666(e), (g) (2012).

244. 29 U.S.C. § 666(e). See *supra* note 182 for reference to regulations, which if violated, result in penalties under 29 U.S.C. § 666(e).

regulation carries up to twenty years in prison, a fine of $5,000,000, or both.[245] It defies common sense that a person could cause the death of an employee through willful conduct yet face only a fraction of the penalty for insider trading.

Compared with the TSCA, which also involves knowing or willful intent, insider trading violations likely receive a harsher sentence.[246] Again, one may ask why a willful violation of regulations for toxic substances would carry a less severe penalty than insider trading, when a toxic substance can seriously harm a person or the environment.[247]

Similarly, tax evasion provides a comparison: a person who "*willfully* attempts in any manner to evade or defeat any tax" can be "fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution."[248] In both 1988 and 2002, 15 U.S.C. § 78ff was amended, each time increasing the sentence and the monetary penalty.[249] When defendants face such harsh sentences and when the trend indicates that penalties are continually increasing, notice and fair warning become all the more important.[250]

Compounding the lack of fair warning in insider trading is the fact that sentences are often computed using dollars earned from the trade, even if the defendant may not have personally profited the gross dollar amount,[251] and there has been a 31.8% increase in sentence length from 2008 to 2013.[252] For these reasons, criminal insider trading deserves a closer look and its own exception to *Chevron* deference.

3. Deference and Agency Creation of Common Law Is Unfair to Defendants

Because reading the regulations' language provides the defendant minimal, if any, guidance,[253] applying *Chevron* deference when she challenges the

245. 15 U.S.C. § 78ff(a).

246. *See* Thomas Duncombe, Joy Schnackenback & Kristen Henderson, *Environmental Crimes*, 45 AM. CRIM. L. REV. 381, 454 (2008) (noting that a person who knowingly or willingly violates this regulation is subject to a fine of not more than $25,000 per day of violation, up to one year in prison, or both).

247. See *supra* notes 186–88 and accompanying text for the penalties for violating the TSCA or the regulations promulgated pursuant to it.

248. 26 U.S.C. § 7201 (2012) (emphasis added).

249. See *supra* notes 150–52 and accompanying text for a summary of Congress's amendments over the years to 15 U.S.C. § 78ff.

250. *See* Henning, *Punishments for Insider Trading*, *supra* note 154 (explaining that sentences for insider trading are increasing, specifically noting that defendant Mathew Martoma received a sentence of nine years).

251. See *supra* notes 157–58 and accompanying text for an explanation of sentencing, which takes into account the amount of money earned from insider trading.

252. Raymond, *supra* note 156.

253. *See* Thel, *supra* note 18, at 30 (explaining that because of the way the regulation was written, it gives no notice to traders with material, nonpublic information of the requirements to trade legally).

regulation may blindside an individual who is merely confused. The rule of lenity, which resolves ambiguity in criminal statutes in favor of the defendant, and *Chevron* deference are in direct conflict on both a statutory interpretation level and a policy level.[254] Applying *Chevron* deference works against the rule of lenity in insider trading cases, resolving ambiguity in favor of the SEC and, as a result, in favor of the U.S. government. Deference to agency interpretation should not be used to convict a defendant because, in the criminal context, she can only be convicted if found guilty beyond a reasonable doubt.[255] Therefore, with an ambiguous law, courts should not be able to defer to agency interpretation in the criminal context because doing so conflicts with the standard of proof.[256]

The unfortunate result of the broad confusion is that courts have interpreted SEC regulations and rules in decisions that have unhinged them from the rules' language—because that language is vapid in an insider trading context.[257] Interestingly, in its preliminary note, Rule 10b5-2 states that other than what the rule provides, insider trading law is defined by judicial opinions that interpret Rule 10b-5.[258] It seems then that Rule 10b5-2 is deferring to the courts, and by applying *Chevron*, the courts are deferring back to the SEC. This is dangerous when criminal liability is involved because defendants' freedom is at stake.

Justice Scalia was correct when he asserted that by applying deference to an agency's interpretation of a provision of a regulation that holds criminal liability, "federal administrators can in effect create (and uncreate) new crimes at will, so long as they do not roam beyond ambiguities that the laws contain."[259] This exact phenomenon has happened in insider trading. As lower courts have interpreted insider trading and applied it to more and more situations, the Supreme Court has created new crimes, as it did in *O'Hagan*.[260] Accordingly, with insider trading regulation, if a law or regulation has a criminal application, the rule of lenity should govern its interpretation.[261]

254. *See* Greenfield, *supra* note 1, at 61 (explaining that the rule of lenity and *Chevron* deference conflict on a policy level); Sunstein, *supra* note 1, at 2115–16 (arguing that norms that require statutes to be interpreted in the criminal defendant's favor "should not be overridden simply because the agency wants them to be").

255. *See* Greenfield, *supra* note 1, at 60 (arguing that just as courts must find a defendant guilty beyond a reasonable doubt, courts should resolve ambiguity in a regulation in favor of the defendant).

256. *Id.*

257. In *McGee*, Rule 10b5-2(b)(2) contained a broad application of the misappropriation theory. United States v. McGee, 763 F.3d 304, 316 (3d Cir. 2014). However, the court applied it to a situation of friends in AA and left it to Congress to limit its delegation of authority. *Id.*

258. 17 C.F.R. § 240.10b5-2 (2017).

259. United States v. Whitman, 135 S. Ct. 352, 353 (2014) (mem.), *denying cert to* 555 F. App'x 98 (2d Cir. 2014).

260. *See, e.g.*, United States v. O'Hagan, 521 U.S. 642, 653 (1997) (holding that the misappropriation theory of insider trading was indeed covered by § 10(b)).

261. *See Whitman*, 135 S. Ct. at 353–54.

### *B. The Solution*

This Comment proposes an exception to the application of *Chevron* deference to criminal insider trading cases. Based on the language of insider trading laws, the need for traders to regulate their actions using the law, and the harsh penalties for engaging in insider trading, these laws deserve special treatment. There are those, like the late Justice Scalia, who have proposed that all administrative crimes be treated differently.[262] But that argument lies outside the scope of this Comment; the impracticality of modifying the application of *Chevron* deference to all administrative crimes and the urgent need for change in insider trading law demand a more immediate exception for insider trading.

#### 1. Create a *Chevron* Exception and Apply the Rule of Lenity

Courts should not apply *Chevron* deference to § 10(b), Rule 10b-5, and Rule 10b5-2 cases when a criminal insider trading defendant challenges the validity of the SEC regulation or asserts that the regulation does not apply to the case. Instead, courts should apply the rule of lenity when § 10(b) and its associated regulations are ambiguous. Of course, the ambiguity must be actual and substantial before lenity may be applied.[263] When the facts of a case raise a question as to whether the regulation would apply to specific conduct, and there has been an effort to interpret the law, courts must resolve that ambiguity in favor of the defendant.[264]

Many scholars advocate for a revival of the rule of lenity.[265] Specifically, one scholar advocated for the application of "the new rule of lenity," which would protect the innocent and would apply to ambiguous laws.[266] The new rule of lenity would "require[] that an ambiguous criminal statute be construed narrowly only when a broad interpretation would penalize 'innocent' conduct."[267] A statute would criminalize innocent behavior if it defined a strict liability crime or if the conduct at issue was a *malum prohibitum* crime.[268] For example, with *malum prohibitum* crimes, "[a] person who is unaware of the prohibition has no notice of potential liability."[269] This scholar then argued that the innocence-protecting rule would resolve tension between the rule of lenity

262. See *supra* Part II.H for a discussion of Justice Scalia's opinion on applying *Chevron* deference to administrative crimes.

263. Greenfield, *supra* note 1, at 14–15.

264. *Id.* at 15.

265. *E.g.*, Note, *The New Rule of Lenity*, *supra* note 126, at 2421 (arguing that the rule of lenity should be revived and advocating for a new rule of lenity that would protect innocent conduct).

266. *Id.*

267. *Id.*

268. *Id.* The note also argues that *malum prohibitum* crimes can only afford the defendant notice when the statute incorporates knowledge of illegality into the definition of the offense. *Id.* at 2435.

269. *Id.* 2438.

and other canons of construction, such as *Chevron* deference.[270]

Other scholars have suggested that a lenity exception to *Chevron* deference should apply generally to all administrative crimes.[271] Elliot Greenfield wrote that this lenity exception could apply in three ways: at step one of *Chevron*,[272] at step two of *Chevron*,[273] or to replace *Chevron* when a criminal law is at issue.[274] Greenfield noted that at step one, applying lenity would in most cases mean that it would trump *Chevron*.[275] At step two, applying lenity would have the drawback of still providing excessive discretion to the courts.[276] Thus, simply displacing *Chevron* deference with the rule of lenity for criminal insider trading would provide the cleanest and most defendant-friendly solution.

This Comment argues that the rule of lenity should apply to insider trading as an exception to *Chevron* deference when the following criteria are met. First, the defendant who allegedly committed insider trading must be facing criminal rather than civil liability.[277] Otherwise, lenity would be inapplicable. Next, there must have been an effort on the part of the court to interpret the relevant insider trading rule at issue.[278] Finally, if the insider trading rule remains ambiguous as applied to defendant's case, the ambiguity must be resolved in favor of the defendant.[279] Even if the defendant then goes free, this outcome would be appropriate. Just as courts must find a defendant guilty beyond a reasonable doubt, they must resolve ambiguity in a regulation in favor of the defendant.[280]

Though all administrative crimes present some similar issues for defendants,[281] insider trading law imparts comparatively harsh penalties;[282] this disparity is compounded by the ambiguity of the language and lack of guidance in the text.[283] As such, although many have advocated for an exception to *Chevron* deference for all administrative crimes,[284] it is impractical and unlikely that a complete overhaul will gain traction. Consequently, the most practical improvement with the greatest possible impact would be to make an exception

270. *Id.* at 2421.

271. *See, e.g.*, Whitman v. United States, 135 S. Ct. 352, 353–54 (2014), *denying cert. to* 555 F. App'x 98 (2d Cir. 2014); Greenfield, *supra* note 1, at 48.

272. Greenfield, *supra* note 1, at 48–51.

273. *Id.* at 51–53.

274. *Id.* at 53.

275. *Id.* at 48.

276. *Id.* at 53.

277. Greenfield, *supra* note 1, at 56–57.

278. *Id.* at 15.

279. *See* Note, *The New Rule of Lenity*, *supra* note 126, at 2421.

280. *See* Greenfield, *supra* note 1, at 60.

281. See *supra* note 17 for the assertion that ambiguity exists in another administrative regulation.

282. See *supra* Part II.G.2 for a discussion of insider trading as compared to other administrative criminal penalties.

283. See *supra* Part II.A.1 for a discussion of language and history of insider trading law.

284. For example, see Justice Scalia's opinion, *supra* Part II.H.

for the administrative crime of insider trading, given its dual issues of harsh penalties[285] and amorphous doctrine.[286]

### 2. Apply *Chevron* Deference and Invalidate the Regulation at Step Two

Although this Comment advocates against the application of *Chevron* deference to criminal insider trading regulations, if courts disagree, they alternatively should more readily find provisions of SEC regulations to be unreasonable at step two of the *Chevron* framework. The problem with this option is that just as applying the rule of lenity at step two of *Chevron* would give the court too much discretion,[287] so too would this option. A rule may be ambiguous, but under this method, a court could still find the agency's interpretation permissible.[288]

However, reaching step two of *Chevron* does not necessitate giving carte blanche to whatever interpretation the SEC decides. For example, in *Utility Air Regulatory Group*, the Supreme Court found that the EPA exceeded its statutory authority, even after applying *Chevron* deference.[289] The Court explained that the "question for a reviewing court is whether in doing so the agency has acted reasonably and thus has stayed within the bounds of its statutory authority."[290] For example, the court in *McGee* could have invalidated Rule 10b5-2(b)(2) at step two of the framework.[291] It could have held that the provision of Rule 10b5-2, conferring a duty to disclose upon people with a "history, pattern, or practice of sharing confidences,"[292] exceeded the SEC's rulemaking authority. The court could have found that the SEC's interpretation of the provision imposed liability even in the absence of a fiduciary relationship. In short, just as the Supreme Court in *Utility Air Regulatory Group* failed the EPA regulation at step two, courts could do the same with provisions of SEC regulations.[293]

Having courts more willingly invalidate provisions of SEC rules at step two of *Chevron* would stop the definition of insider trading from becoming increasingly more encompassing. It would rein in the SEC's application of its rules and the SEC's creation of new rules by promoting narrower, clearer

285. See *supra* Part II.G.1 for a discussion of the prosecution of insider trading and the recent sentences that have been imposed.

286. See *supra* Part II.A.1 for a discussion of the ambiguity of insider trading law.

287. *See* Greenfield, *supra* note 1, at 53.

288. See *supra* notes 117–25 and accompanying text for an explanation of the *Chevron* framework.

289. Util. Air Regulatory Grp. v. EPA, 134 S. Ct. 2427, 2449 (2014).

290. *Id.* at 2439 (quoting City of Arlington v. FCC, 133 S. Ct. 1863, 1868 (2013)).

291. *See* United States v. McGee, 763 F.3d 304, 316 (3d Cir. 2014) (concluding that the SEC's broader approach was reasonable considering the objectives of § 10(b): to protect investors and the market).

292. *See* 17 C.F.R. § 240.10b5-2(b)(2) (2017).

293. *See Util. Air Regulatory Grp.*, 134 S. Ct. at 2449 (holding that the EPA exceeded its rulemaking authority).

language aimed at avoiding ambiguity. In fact, scholars have correctly argued that Rule 10b5-2, specifically, is arbitrary and capricious and should not overcome *Chevron* step two.[294]

In short, courts should curtail the SEC's interpretation and application of rules to criminal insider trading. They can best accomplish this by applying the rule of lenity to insider trading rules and regulations, or in the alternative, by finding more readily at step two of *Chevron* that the SEC's interpretation exceeded its authority. Both of these approaches are tailored to protect defendants in the face of this nebulous area of law.

## IV. CONCLUSION

Individuals trading in securities operate in a highly regulated environment.[295] But what makes insider trading so different from other administrative crimes? History and statutory interpretation show that insider trading laws are ambiguous, and the requirement of guilt beyond a reasonable doubt in criminal law requires application of the rule of lenity when a law is ambiguous. Insider trading is unique in that its rules lack specifity yet impose harsh penalties, and its contours largely have been developed by common law. These factors make it unfair to apply *Chevron* deference in the criminal context. Defendants charged with insider trading deserve lenity when faced with ambiguous administrative laws, especially with such high stakes. These defendants deserve an exception—so that lack of clarity does not land them in prison because it is unclear exactly what the regulations mean and how they should be interpreted.[296]

294. See *supra* notes 166–68 and accompanying text for the opinion that Rule 10b5-2 should not pass both steps of *Chevron* deference.

295. Padilla, *supra* note 148, at 240.

296. *See* United States v. Bass, 404 U.S. 336, 348 (1993) (quoting FRIENDLY, *supra* note 136, at 209 (stating that lenity's policy represents "the instinctive distaste against men languishing in prison unless the lawmaker has clearly said they should")).