Who is the Insider?
O'Hagan and Other Cases in the U.S. Supreme Court

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Abstract

The law against trading in security markets with the benefit of material, nonpublic information has been developed case-by-case under the Article 10b of the Securities Exchange Act of 1934. The Act defines insider trading as security fraud. However, who is "eligible" to be a fraudster/insider in insider trading has been a controversial issue. The U.S. Supreme Court in *Chiarella* applied a fiduciary theory to define insiders. Then in 1997, in *O'Hagan*, the Court applied misappropriation theory, holding that if an individual breaches a duty within a pre-existing relationship of trust or confidence with the source of the inside information, he is to be considered an insider. The Court, on the one hand, adopted a broader definition of insiders; on the other hand, it emphasized that *O'Hagan* did not overrule the aforementioned fiduciary theory in *Chiarella*. Therefore, after *O'Hagan*, the SEC and lower courts tried to clarify the matter by asserting that in situations in which a "pre-existing relationship" exists, a fiduciary relationship is established between a tipper and a tipee. However, that issue is, as yet, unsettled despite a decade of argument.

This article focuses on the tension between these two different theories. By analyzing recent cases in the lower courts, this article seeks to determine how the theories have been applied and interpreted after *O'Hagan*, and how the courts and SEC have responded to the challenges posed by security fraud.

Key Words: insider trading, insider, misappropriation theory