UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 2309 / February 12, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16178

In the Matter of GREGORY T. BOLAN, JR. AND JOSEPH C. RUGGIERI	ORDER

In January 2015, Respondents each moved for summary disposition under Rule of Practice 250. Thereafter, the Division of Enforcement filed an opposition, and Respondents filed their replies. On February 11, 2015, I held oral argument on Respondents' motions. The two primary issues at stake are 1) whether, in an insider trading case brought under a misappropriation theory, the Division must establish that the tipper received a personal benefit for allegedly tipping material, non-public information; and 2) whether the Division's alleged evidence may satisfy that requirement.

On the first issue, I rule in favor of Respondents and GRANT their motions for summary disposition in part. Insider trading is not actionable under the antifraud provisions of the federal securities laws based on the mere disclosure or use of material, non-public information, but requires a breach of a duty to disclose, or abstain from disclosing, the information that "aris[es] from a relationship of trust and confidence between parties to a transaction." *Chiarella v. United States*, 445 U.S. 222, 230 (1980); *see id.* at 233-35. In *Dirks v. SEC*, the Supreme Court defined a breach of duty as follows:

> Whether disclosure is a breach of duty therefore depends in large part on the purpose of the disclosure. This standard was identified by the SEC itself in *Cady, Roberts*: a purpose of the securities laws was to eliminate "use of inside information for personal advantage." 40 S.E.C. 907, 912, n. 15 (1961). . . . Thus, the test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach.

463 U.S. 646, 662 (1983) (internal citation altered). "This requires courts to focus on objective criteria, *i.e.*, whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings." *Id.* at

663. By contrast, the Court stated that the SEC's position advanced in *Dirks*, which would have obviated the need for such a requirement, "would have no limiting principle." *Id.* at 664.

In a misappropriation case—the Division's theory for the present proceeding—the breach is not based on a duty owed by a corporate insider to shareholders, but on a duty owed to the source of the confidential information. *See SEC v. Obus*, 693 F.3d 276, 284 (2d Cir. 2012). In *Obus*, the Second Circuit made clear: "The Supreme Court's tipping liability doctrine was developed in a classical case, *Dirks*, but the same analysis governs in a misappropriation case." *Id.* at 285-86. The court then applied the *Dirks* personal benefit requirement. *Id.* at 291-92 & 293 n.5. Thus, contrary to the Division's position, when the Second Circuit reconfirmed this principle in *United States v. Newman*, it was not mere dicta, but citing established law. *See* 773 F.3d 438, 446 (2d Cir. 2014) ("The elements of tipping liability are the same, regardless of whether the tipper's duty arises under the 'classical' or the 'misappropriation' theory." (citing *Obus*, 693 F.3d at 285-86)). Although the Division points to dicta from cases indicating that the personal benefit requirement is either not firmly established in misappropriation case-law or that it does not apply, no controlling authority has held as such. Moreover, such a proposition would conflict with controlling authority—*Dirks* and *Obus*.

Turning to the second issue, certain indicia—such as evidence of a close friendship—may be enough for a fact-finder to infer a personal benefit, so as to survive summary disposition. *See, e.g.*, *Obus*, 693 F.3d at 291 ("[T]he undisputed fact that Strickland and Black were friends from college is sufficient to send to the jury the question of whether Strickland received a benefit from tipping Black."), 292 ("Based on the evidence that Black worked for Obus and that Wynnefield traded in SunSource stock, a jury could find that by passing along what he was told by Strickland, Black hoped to curry favor with his boss."). However, such evidence, without more, does not necessarily establish that the personal benefit element has been met. *Newman* provided the following guidance:

> We have observed that "[p]ersonal benefit is broadly defined to include not only pecuniary gain, but also, *inter alia*, any reputational benefit that will translate into future earnings and the benefit one would obtain from simply making a gift of confidential information to a trading relative or friend." *United States v. Jiau*, 734 F.3d 147, 153 (2d Cir. 2013) (internal citations, alterations, and quotation marks deleted). This standard, although permissive, does not suggest that the Government may prove the receipt of a personal benefit by the mere fact of a friendship, particularly of a casual or social nature. If that were true, and the Government was allowed to meet its burden by proving that two individuals were alumni of the same school or attended the same church, the personal benefit requirement would be a nullity. To the extent *Dirks* suggests that a personal benefit may be inferred from a personal relationship between the tipper and tippee, where the tippee's trades "resemble trading by the insider himself followed by a gift of the profits to the recipient," *see* 463 U.S. at 664, we hold that such an inference is impermissible in the absence of proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature. In other words, as Judge Walker noted in *Jiau*, this requires evidence of "a

> relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the [latter]." *Jiau*, 734 F.3d at 153.
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> While our case law at times emphasizes language from *Dirks* indicating that the tipper's gain need not be *immediately* pecuniary, it does not erode the fundamental insight that, in order to form the basis for a fraudulent breach, the personal benefit received in exchange for confidential information must be of some consequence.

773 F.3d at 452 (internal citation altered; other alterations in original).

I ORDER the Division to make a factual proffer by **February 13, 2015,** stating with sufficient detail: 1) the allegations on which it intends to base its personal benefit theory; and 2) the evidence it has or expects to establish at a hearing on the personal benefit element. The format of the factual proffer should be numbered by each fact the Division expects to prove. The proffer should not exceed ten pages in length, and each factual contention shall be supported by evidence. Evidence may be incorporated, by reference to previous filings in this action, or may be attached to the proffer; such attachments are not subject to the ten-page limit. For expected testimony that was not previously memorialized, the Division shall describe the testimony that it believes it will elicit at a hearing. Respondents shall have an opportunity to respond to the Division's factual proffer by **February 20, 2015**. Each response should follow the same numbering as the Division's proffer, and shall not exceed ten pages, with the exception of attachments. In responding to each of the Division's factual representations, in addition to pointing out any potential deficiencies in those factual contentions, Respondents may explain why a particular fact is not legally pertinent to the legal issue described above. Based on the parties' submissions, I will make a further determination.

Separately, by **February 23, 2015**, each party may, but is not required to, submit a letter of up to three pages, expressing its view of the desirability and feasibility of an evidentiary hearing on the issue of personal benefit. To the extent that a party takes the position that such a hearing may be productive, it should address the expected amount of time it would need to present its case, and the earliest that such an evidentiary proceeding could proceed.

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Jason S. Patil
Administrative Law Judge