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Texas Gulf Sulphur at Fifty—A Contemporary and Historical Perspective

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ABSTRACT

Fifty years ago, the Second Circuit decided perhaps the most important case under the U.S. securities laws – Securities and Exchange Commission v. Texas Gulf Sulphur. This decision focused on several landmark issues, including insider trading, company disclosure obligations, and the concept of materiality. Although a number of its rulings subsequently were rejected by the U.S. Supreme Court, others remain good law today. Indeed, the significance of Texas Gulf Sulphur’s analysis in large measure is evidenced by its continued vitality in the federal courts and SEC enforcement practice. From a comparative law perspective, Texas Gulf Sulphur also is an important decision. Many of the principles enunciated in that decision today have been adopted by developed securities markets outside of the United States.

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Decided fifty years ago, Securities and Exchange Commission v. Texas Gulf Sulphur Co. (hereinafter referred to as Texas Gulf Sulphur or TGS) constitutes one of the preeminent federal securities law decisions. Its significance remains vibrant today, impacting fundamental principles underlying the securities laws. Indeed, a sound assertion may be proffered that TGS justifiably may be viewed as the most important federal securities law decision handed down to date.

To commemorate the 50th Anniversary of this seminal decision, the SMU Law Review is honored to publish this Symposium Issue. The contributions in this Issue are authored by premier securities law academicians in this country. The participation of these outstanding academicians in this Symposium Issue reflects both the continued importance of Texas Gulf Sulphur and its ramifications. With its long tradition of excellence in the business associations and securities law fields, as reflected by the scholarship of Professor Alan R. Bromberg, the SMU Law Review is a superb forum to host this commemorative publication.

1. See generally SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (en banc).
2. For example, these principles, discussed in this article, include those implicating insider trading, materiality, scienter, and affirmative disclosure.
3. Unquestionably, there have been several important U.S. Supreme Court decisions in the federal securities law area. As a generality, these decisions focused on a specific issue that had significant impact. See, e.g., Halliburton Co. v. Erica P. John Fund, Inc., 134 S.Ct. 2398 (2014) (reaffirming the continued validity of the fraud-on-the-market theory for § 10(b) class actions); Morrison v. Nat’l Austl. Bank Ltd., 561 U.S. 247 (2010) (holding that in a private action, § 10(b) reaches only securities listed on a U.S. exchange and other purchases or sales made in the United States); Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994) (holding no aiding and abetting liability in private § 10(b) actions); Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977) (holding that § 10(b) does not reach breach of fiduciary conduct absent deception or manipulation); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (holding that in a private § 10(b) action, a plaintiff must be a purchaser or seller of the subject securities in connection with the alleged misconduct in order to have standing to bring suit for damages); SEC v. W.J. Howey Co., 328 U.S. 293 (1946) (interpreting the term investment contract in a flexible manner to bring the subject transaction within the scope of the federal securities laws).
4. An excellent article commemorating the 50th Anniversary of Texas Gulf Sulphur has been authored by Professor Alan M. Weinberger. See generally Alan M. Weinberger, Forever Young: Texas Gulf Sulphur Rules at Fifty, 45 SEC. REG. L. J. 23 (Spring 2017).
5. Joining the SMU Law School faculty in 1956, Professor Alan Bromberg was a member of our faculty for well over 50 years. His seminal treatises include: SECURITIES LAW FRAUD: RULE 10b-5 (1967); BROMBERG AND LOWENFELS ON SECURITIES FRAUD (2d ed. 2012) (coauthored with Lewis D. Lowenfels and Michael J. Sullivan); CRANE AND BROMBERG ON PARTNERSHIP (1968) (coauthored with Professor Judson A. Crane); and BROMBERG & RIBSTEIN ON PARTNERSHIP LAW (2d ed. 2017) (coauthored with Professor Larry E. Ribstein). Note that the Second Circuit’s opinion in Texas Gulf Sulphur cited Professor Bromberg’s Rule 10b-5 treatise. See 401 F.2d at 859.
I. KEY ISSUES ADDRESSED BY TEXAS GULF SULPHUR

Texas Gulf Sulphur’s focus on insider trading may well be the foremost subject that has generated attention throughout the decades. By applying the Securities Exchange Act’s broad antifraud statute—§ 10(b)6 (and SEC Rule 10b-57 promulgated thereunder)—to insider trading that occurred on stock exchanges,8 TGS federalized the proscription against improper insider trading.9 This aspect of TGS, which continues to have domestic as well as international impact, is discussed later in this article.10

Significantly, TGS addressed several other key principles. These principles include, for example: materiality, issuer liability exposure for misleading disclosure, requisite mental culpability, and the timing of insider trades. While a number of the case’s holdings are no longer good law in this country, others remain applicable not only in the United States but have also been embraced by other countries.11

A. MATERIALITY

As discussed later in this article, TGS’s adoption of the access principle or parity of information principle prevails today in countries that have developed securities markets.12 With respect to the concept of materiality, relying on the American Law Institute’s Restatement of Torts,13 the Second Circuit focused on whether a reasonable person would attach importance to the information misstated or omitted in making an investment decision with respect to the subject transaction.14 Applying this

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1. In 2015, the SMU Law Review published a Symposium Issue in honor of Professor Bromberg. The contributors to that Issue are the foremost academicians in the business associations and securities law fields in this country. See Symposium, Tributes to Professor Alan R. Bromberg, 68 SMU L. REV. 595 (2015).
4. See SEC v. Texas Gulf Sulphur Co., 401 F.2d at 847–57. See id. at 847–48 (citing List v. Fashion Park, Inc., 340 F.2d 457, 461–62 (2d Cir. 1965); Cochran v. Channing Corp., 211 F. Supp. 239, 243 (S.D.N.Y. 1962); 3 LOUIS LOSS, SECURITIES REGULATION 1455–56 (2d ed. 1961)) (stating that, pursuant to the Securities Exchange Act, Congress “purposed to prevent inequitable and unfair practices and to insure fairness in securities transactions generally, whether conducted face-to-face, over the counter, or on exchanges” and that “[t]he Act and the Rule apply to the transactions here, all of which were consummated on exchanges”).
6. See infra notes 62–85 and accompanying text.
7. See infra notes 23, 55, 81–85 and accompanying text. Of course, that other countries have adopted a number of TGS’s holdings does not necessarily signify that these countries explicitly focused on that decision and determined to embrace its principles. Nonetheless, such international approval supports the merit of the court’s holdings.
8. Note that the access principle and parity of information principle are two different principles. Interpreting Texas Gulf Sulphur’s language, each principle received the court’s approbation. See 401 F.2d at 848. See also discussion infra notes 70–72 and accompanying text.
9. See infra notes 23, 55, 81–85 and accompanying text. Of course, that other countries have adopted a number of TGS’s holdings does not necessarily signify that these countries explicitly focused on that decision and determined to embrace its principles. Nonetheless, such international approval supports the merit of the court’s holdings.
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13. 401 F.2d at 849, (citing Restatement (First) of Torts § 538(2)(a) (Am. Law Inst. 1938)).
14. See 401 F.2d at 849.
standard, the court utilized the probability/magnitude test, stating: “whether facts are material within Rule 10b-5 when the facts relate to a particular event and are undisclosed by those persons who are knowledgeable thereof will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.”

Hence, pursuant to this standard, a contingent event of high magnitude may be material even if its likelihood of occurrence is relatively remote. This standard has been adopted by the U.S. Supreme Court in the contexts of alleged deficient disclosure with respect to merger negotiations and adverse drug reports.

Nonetheless, more expansive language in TGS relating to materiality was subsequently rejected by the U.S. Supreme Court. In this regard, the TGS court referenced a fact as being material if it might reasonably affect the value of the subject company’s securities. Less than a decade later, the U.S. Supreme Court adhered to the “would” standard, concluding that the “might” standard was “too suggestive of mere possibility.” Hence, today, the applicable inquiry examines whether a substantial likelihood exists that adequate disclosure of the misstated or omitted information would have been perceived by a reasonable investor as having significantly altered the total mix of information that was made available.

15. Id. (quoting List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir. 1965)).
16. See, e.g., Basic Inc. v. Levinson, 485 U.S. 224, 238 (1988) (quoting SEC v. Geon Industries, Inc., 531 F.2d 39, 47–48 (2d Cir. 1976)) (“Since a merger in which it is bought out is the most important event that can occur in a small corporation’s life, to wit, its death, we think that inside[]r information, as regards a merger of this sort, can become material at an earlier stage than would be the case as regards lesser transactions—and this even though the mortality rate of mergers in such formative stages is doubtless high.”).
17. See Basic Inc., 485 U.S. at 238–39. Significantly, the U.S. Supreme Court in Basic addressed the materiality of the allegedly misstated information in a situation where the issuer elected to speak. The decision neither addressed the timing of disclosure nor a subject issuer’s duty to disclose. See id. at 235 (stating that “this case does not concern the timing of a disclosure; it concerns only its accuracy and completeness”) (emphasis added). For further discussion, see MARC I. STEINBERG, SECURITIES REGULATION: LIABILITIES AND REMEDIES § 2.03[5] (2017).
18. See generally Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27 (2011) (holding that the number of adverse drug reports received by a subject company need not reach the level of being statistically significant in order for such information to be deemed material under § 10(b) of the Securities Exchange Act).
19. See 401 F.2d at 849 (quoting List v. Fashion Park, Inc., 340 F.2d at 462; Kohler v. Kohler Co., 319 F.2d 634, 642 (7th Cir. 1963)) (stating that the test of materiality “encompasses any fact ‘which in reasonable and objective contemplation might affect the value of the corporation’s stock or securities.’”). See also Texas Gulf Sulphur, 401 F.2d at 850 (“might have affected the price of the stock”).
20. See TSC Industries, Inc. v. Northway, 426 U.S. 438, 449 (1976) (quoting Gerstle v. Gamble–Skogmo, Inc., 478 F.2d 1281, 1302 (2d Cir. 1973) (Friendly, J.)). Although this case involved materiality under Section 14(a) and SEC Rule 14a-9 with respect to the adequacy of disclosure in the proxy statement context, the rationale has been applied in cases implicating § 10(b) and Rule 10b-5. See cases cited supra notes 17–18.
21. See TSC Industries, Inc., 426 U.S. at 449 (holding that “[t]his standard . . . does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote [and that] [w]hat the standard does con-
B. Price Impact

Interestingly, with respect to ascertaining the materiality of the subject information, the Second Circuit in *TGS* focused on whether adequate disclosure of such information may be “reasonably certain to have a substantial effect on the market price of the security.”22 This correlation between price impact and materiality is contained in the securities laws of developed countries.23 In this country, however, price impact frequently is not invoked when ascertaining the materiality of the subject information.24 That is not to suggest that price impact is not an important criterion with respect to other elements of a securities cause of action. Indeed, price impact is a necessary condition for a class action based on an alleged violation of §10(b).25 In this regard, to rebut the presumption of reliance in a § 10(b) action based on the premise that the subject securities traded in an efficient market,26 a defendant can establish that the alleged misstatements did not in actuality affect the subject security’s market price.27 Similarly, proving that a defendant corporation’s corrective disclosure negatively impacted the price of the subject security, is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder”).

22. 401 F.2d at 848 (citing Arthur Fleischer, Jr., *Securities Trading and Corporate Information Practices: The Implications of the Texas Gulf Sulphur Proceeding*, 51 Va. L. Rev. 1271, 1289 (1965)).

23. See, e.g., Regulation (EU) No. 596/2014, of the European Parliament and of the Council of 16 April 2014 on Market Abuse Regulation, art. 7, para. 1(a), O.J. (L 173) 1 (defining inside information to encompass “information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments”); *Corporations Act 2001*, (Cth) §§ 1042C, 1042D, 1043A (Austl.) (focusing on whether the information, if it were generally available, would have a material effect on the price or value of the subject securities); *Province of Ontario Securities Act, R.S.O. 1990, c. S.5, §§ 1(1), 126.2(1)(b)* (setting forth that information is material if it “would reasonably be expected to have a significant effect on the market price or value of the securities.”).

24. See, e.g., cases cited supra notes 16–21 and accompanying textual discussion. *But see* Christine Asia Co. v. Ma, No. 16-2519-CV, 2017 WL 6003340, at *2 (2d Cir. Dec. 5, 2017) (“The importance of this information to investors is illustrated by the fact that, when [the allegedly concealed information] was revealed four months subsequent to the IPO, Alibaba’s stock dropped 13% in two days, erasing $33 billion in market capitalization.”).


26. As stated by the U.S. Supreme Court in *Halliburton*, “to invoke the *Basic* presumption, a plaintiff must prove that: (1) the alleged misrepresentations were publicly known, (2) they were material, (3) the stock traded in an efficient market, and (4) the plaintiff traded the stock between when the misrepresentations were made and when the truth was revealed.” 134 S.Ct. at 2413 (citing *Basic Inc. v. Levinson*, 485 U.S. 224, 248 (1988)).

27. See *Halliburton*, 134 S.Ct. at 2417 (holding that defendants “must be afforded an opportunity before class certification to defeat the presumption through evidence that an alleged misrepresentation did not actually affect the market price of the stock.”). *See also* Waggoner v. Barclays PLC, 875 F.3d 79, 99 (2d Cir. 2017) (concluding that “defendants must rebut the *Basic* presumption by disproving reliance by a preponderance of the evidence at the class certification stage.”).
employed by plaintiffs to show loss causation. Accordingly, price impact is a key issue in U.S. securities litigation. Nonetheless, departing from the approach espoused in *TGS* and adopted by other countries, price impact ordinarily is not a principal inquiry under the U.S. securities laws when assessing the materiality of the alleged disclosure deficiency.

C. Timing of Insiders’ Trades

Related to the holding that the results of the *TGS* discovery hole were material was the inquiry of when insiders and others subject to the insider trading prohibition legally could purchase *TGS* securities. Departing from the district court’s holding that the company’s announcement of the information was the point in time after which insiders could legally trade, the Second Circuit held that insider activity must await not only the formal announcement but also the adequate dissemination of such information. In this instance, dissemination of the announcement by *TGS* over the media of widest circulation—at that time, the Dow Jones broad tape—was required to be effected before insiders could have permissibly traded. In an accompanying footnote, the court elaborated that, when the subject information is not readily translatable, a reasonable waiting period may be required to enable investors to absorb and evaluate such information. This position’s soundness remains applicable

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29. See, e.g., cases cited supra notes 16–21 and accompanying textual discussion.

30. See also *Council Regulation 596/2014*, supra note 23, at art. 7, para. 4 (providing that “information which, if it were made public, would be likely to have a significant effect on the prices of financial instruments . . . shall mean information a reasonable investor would be likely to use as part of the basis of his or her investment decisions”).

31. See SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 850 (2d Cir. 1968) (en banc) (“Our survey of the facts found below conclusively establishes that knowledge of the results of the discovery hole, K-55-1, would have been important to a reasonable investor and might have affected the price of the stock.”).

32. See SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262, 288–89 (S.D.N.Y. 1966), aff’d and rev’d, 401 F.2d 833 (2d Cir. 1968) (en banc). The district court reasoned that, if a waiting period after a material corporate announcement is to be required, that determination should be made by the SEC pursuant to its rulemaking authority or by Congress. See id. at 289.

33. See *Texas Gulf Sulphur*, 401 F.2d at 853–54.

34. See id. at 854 (“Assuming that the contents of the [TGS] official release could instantaneously be acted upon, at the minimum [the insider] should have waited until the news could reasonably have been expected to appear over the media of widest circulation, the Dow Jones broad tape, rather than hastening to insure an advantage to himself . . . .”).
today, as evidenced by customary corporate insider trading policies that mandate a specified waiting period after the issuance of a quarterly earnings announcement, as well as the pre-clearance of trades by Section 16 insiders (and members of their immediate families), even if the contemplated transactions are to occur outside of a black-out period.

D. COMPANY LIABILITY FOR MISLEADING DISCLOSURE IN THE SECONDARY TRADING MARKETS

With respect to an alleged materially false press release issued by Texas Gulf Sulphur, the question was posed as to whether the company could be held liable under § 10(b) if it was not engaged in related securities transactions or had not acted with wrongful intent. Disagreeing with the narrow construction adopted by the district court, the Second Circuit interpreted the statute’s “in connection with the purchase or sale of any security” language in a more flexible manner. Holding that a corporation may be subject to § 10(b) liability when it disseminates materially misleading information “in a manner reasonably calculated to influence the investing public” and that such liability may be premised on negligence, the court greatly expanded a corporation’s exposure in the secondary markets.

35. See Marc I. Steinberg & William K.S. Wang, Insider Trading 807 n.3 (3d ed. Oxford Univ. Press 2010) (referencing the use by publicly-held companies of trading windows permitting trades by insiders, depending on the subject company’s policy, of three to twelve trading days subsequent to a quarterly earnings announcement).

36. Section 16 insiders include a subject company’s directors, officers, and shareholders who beneficially own more than ten percent of a class of a subject issuer’s equity securities. See 15 U.S.C. § 78p(a)–(b) (2012). Pursuant to SEC rule, in determining whether a person is an officer, the key inquiry is whether such person performs significant policy-making functions (rather than being based on such person’s title alone). See Rule 16a-1(f), 17 C.F.R. § 240.16a-1(f) (2017). See generally Marc I. Steinberg & Daryl L. Lansdale, Jr., The Judicial and Regulatory Constriction of Section 16(b) of the Securities Exchange Act of 1934, 68 Notre Dame L. Rev. 33 (1992).

37. See, e.g., Insider Trading and Confidentiality Policy, News Corp., at p. 5 (June 2016), https://newscorp.com/corporate-governance/insider-trading-and-confidentiality-policy/ ("If a Section 16 Reporting Person, Designated Individual or member of such person’s immediate family or household is contemplating a transaction in the Company’s securities, the proposed transaction must be pre-cleared with either the News Corporation General Counsel or his or her designee, even if the proposed transaction is to take place outside of the Black-Out Period."). Today, insiders may legally sell their securities pursuant to Rule 10b5-1 plans, provided that the requirements of the rule are satisfied. See Rule 10b5-1(c), 17 C.F.R. § 240.10b5-1(c) (2017). The rule has been met with criticism. See, e.g., Allan Horwich, The Legality of Opportunistically Timing Public Company Disclosures in the Context of SEC Rule 10b5-1, 71 Bus. Law. 1113 (2016).

38. See Texas Gulf Sulphur, 401 F.2d at 857–64.

39. See SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262, 293 (S.D.N.Y. 1966), aff’d and rev’d, 401 F.2d 833 (2d Cir. 1968) (en banc) (stating that “the issuance of a false and misleading press release may constitute a violation of § 10(b) and Rule 10b-5 if its purpose is to affect the market price of a company’s stock to the advantage of the company or its insiders”).

40. Texas Gulf Sulphur, 401 F.2d at 862.

41. See id. at 862–63 (holding that a violation of § 10(b) based on a company’s materially misleading statement would be appropriate if such statement was the result of a lack of
ondary trading markets.42

Subsequently, the Supreme Court rejected negligence as the requisite culpability level in § 10(b) actions, holding instead that intentional or knowing misconduct must be shown.43 Nonetheless, the negligent dissemination of information to the securities markets by companies today may be addressed under other provisions by the SEC44 and, to some extent, by private claimants.45 More importantly, the “reasonably calculated to influence the investing public” standard enunciated in Texas Gulf Sulphur remains pertinent today when assessing a company’s liability exposure in its dissemination of alleged materially misleading information.46

E. COMPANY AFFIRMATIVE DISCLOSURE OBLIGATIONS

Although not directly addressing the topic, language in Texas Gulf Sulphur may be interpreted to favor the implementation of affirmative disclosure obligations upon publicly-traded corporations. As stated by the court: “We do not suggest that material facts must be disclosed immediately; the timing of disclosure is a matter for the business judgment of the corporate officers entrusted with the management of the corporation within the affirmative disclosure requirements promulgated by the exchanges and by the SEC. . . .”47 While the national securities exchanges today, absent the presence of a valid business reason, require a listed company to timely disclose material information,48 the SEC lags behind.

42. In his concurring opinion, Judge Friendly expressed his concern with the application of a negligence standard: “The consequences of holding that negligence in the drafting of a press release . . . may impose civil liability on the corporation are frightening.” Id. at 866 (Friendly, J., concurring). See David S. Ruder, Texas Gulf Sulphur—The Second Round: Privity and State of Mind in Rule 10b-5 Purchase and Sale Cases, 63 NW. U.L. REV. 423 (1968).
43. See Aaron v. SEC, 446 U.S. 680, 690–94 (1980) (holding that the SEC must prove scienter in its enforcement actions alleging violation of § 10(b)); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 201 (1976) (holding that scientist must be proven in private actions for damages alleging violation of § 10(b)).
44. For example, the SEC may seek recovery based on negligent violation of such provisions as Sections 17(a)(2) and 17(a)(3) of the Securities Act, 15 U.S.C. 77q(a)(2)–(a)(3) (2012), and Section 13(a) of the Securities Exchange Act, 15 U.S.C. 78m(a) (2012).
46. See Donald C. Langevoort, From Texas Gulf Sulphur to Chiarella: A Tale of Two Duties, 71 SMU L. REV. (2018) (stating that “the ‘reasonably calculated’ standard survived and flourished” and that cases subsequent to TGS have “insist[ed] only that reliance by investors be foreseeable given the medium of dissemination that was chosen”).
47. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 850 n.12 (2d Cir. 1968) (en banc).
Indeed, it was not until the enactment of the Sarbanes–Oxley Act of 2002\(^49\) that Congress mandated that the Commission adopt “a rapid and current” reporting regime regarding material changes in a subject company’s financial condition or operations.\(^50\) Prior to that time, except for certain clearly fundamental matters,\(^51\) the SEC declined to require that Exchange Act reporting companies disclose current material information during the time interval between the filing of their periodic reports.\(^52\) Over a year after receiving this mandate from Congress, the Commission amended Form 8-K to provide for the current reporting by subject companies of a far greater number of events.\(^53\) Nonetheless, key deficiencies remain, such as the SEC’s failure to require a subject company to disclose the loss of a major contract until such company’s next quarterly report—even if no valid business purpose exists for justifying such delay.\(^54\) The SEC’s approach departs from that of other developed securities markets.
that require, absent meritorious business reason, the prompt disclosure by a subject company of material information to investors and the securities markets.55

F. **TGS—Far More Than an Insider Trading Case**

The foregoing discussion highlights that *Texas Gulf Sulphur* is far more than an insider trading case. Coverage of such a large number of key subjects, particularly when several of these subjects were in their infancy, is rare in a single legal opinion. Addressing such fundamental concepts as materiality, the “in connection with” requirement of § 10(b), a company’s liability exposure for disseminating materially false information in the secondary trading markets, the timing of an insider’s securities trades, and the mental culpability standard, *TGS* has made an impressive contribution to the development of the securities laws. While some of the decision’s holdings are no longer good law, others have endured and flourished. Nonetheless, the legacy of *TGS* is largely based on its analysis of § 10(b)’s insider trading prohibition.

II. **The Federalization of Insider Trading**

A. **The Securities Exchange Act—Section 16**

Implicating the duties of care and loyalty, improper insider trading by corporate fiduciaries seemingly would comprise a fundamental component of state corporation law.56 Yet, the states largely declined to address this practice, particularly in the impersonal stock market insider trading context.57 Federal law has filled this void. Indeed, to some extent, Congress did so with the enactment of Section 16 of the Securities Exchange Act.58

55. See Steinberg, *supra* note 52, at 670 (stating that, in other developed securities markets, “absent sufficient business justification, publicly-held issuers on a continuous basis must promptly and timely disclose material matters to the securities marketplace”). For examples of such jurisdictions, see, e.g., *Corporations Act 2001* (Cth) § 674(2) (Austl.); Province of Ontario Securities Act, R.S.O. 1990, c. S. 5, § 75 (Can.); Council Regulation (EU) No. 596/2014, supra note 23, at art. 17. For example, pursuant to Regulation No. 596/2014, at Article 17, Paragraph 4, the subject company, in addition to having justifiable reason for delaying disclosure, must also show that such delay likely will not mislead the public and that the confidentiality of the specified information will be maintained.

Note that Canada has no federal securities law. Rather, each of that nation’s provinces and territories regulate its subject securities markets. Because the Ontario securities laws are viewed as the most significant in Canada, they are discussed where appropriate in this article.


Act of 1934, which calls for insiders to disgorge their profits made from purchases and sales or sales and purchases of equity securities within a six-month period. Additionally, Section 16 prohibits these individuals from entering into short-sale transactions in their company’s equity securities. Going beyond disclosure and directly regulating corporate fiduciary conduct, Section 16 is significant as it illustrates Congress’s receptiveness, dating back to 1934, to federalize a key aspect of corporate governance that was perceived to be within the sole realm of state company law.

B. THE SEC SPEAKS—IN RE CADY, ROBERTS

Nonetheless, Section 16 is limited in its scope. A more far-reaching federal prohibition against insider trading was perceived as necessary by then SEC Chairman William Cary. On his agenda when he assumed the SEC Chairmanship in 1961 was for the Commission to pro-actively remedy the state law permissiveness regarding open-market insider trading by corporate fiduciaries. The opportunity to do so arose in an administrative proceeding, In re Cady, Roberts & Company. In a decision authored by Chairman Cary, the Commission held that the exchange-based insider trading that transpired was violative of the federal securities

58. Under Section 16, 15 U.S.C. § 78p (2012), insiders include a subject company’s directors, officers, and shareholders who beneficially own more than ten percent of a class of a subject issuer’s equity securities. See note 36 supra.

59. See Section 16(b), 15 U.S.C. § 78p(b) (2012). The subject corporation or shareholder bringing suit on such corporation’s behalf may recover irrespective of the insider’s exercise of due diligence. Thus, an insider who engages in such transactions thus is held strictly liable and must disgorge his or her profits. See, e.g., Whiting v. Dow Chem. Co., 523 F.2d 680 (2d Cir. 1975); Bershad v. McDonough, 428 F.2d 693 (7th Cir. 1970). Note that Section 16(a), 15 U.S.C. § 78p(a), requires these insiders to file reports with the SEC and with the applicable stock exchange reporting their stockholdings and transactions in the subject securities.


61. As Section 16(b)’s language makes clear, the provision’s objective is “preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer.” 15 U.S.C. § 78p(b) (2012). See Marc I. Steinberg, The Federalization of Corporate Governance 119 (Oxford Univ. Press 2018).


The importance of the proceeding was eminently clear to the Commission, as its opinion begins by reflecting: "This is a case of first impression and one of signal importance in our administration of the Federal securities acts." Applying the "access" theory, the SEC held that "insiders must disclose material facts which are known to them by virtue of their position but which are not known to persons with whom they deal and which, if known, would affect their investment judgment." Hence, by holding that the exchange-based trading that was transacted constituted securities fraud, the Commission sought to federalize the law of insider trading.

Being an administrative decision, uncertainty existed regarding the precedential value or impact of Cady, Roberts. Neither the language of § 10(b) nor any other provision of the federal securities laws mandated that a broad insider trading prohibition be recognized. Approbation by an esteemed court was essential to provide adequate certainty to the SEC's position. Hence, the importance of Texas Gulf Sulphur becomes clear.

64. See id. at 907–17. The Commission found that the defendants violated Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a) (2012), and Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b) (2012).
66. Id. at 911. According to the Commission: "[T]he obligation rests on two principal elements: first, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing." Id. at 912 (citing 3 LOUIS LOSS, SECURITIES REGULATION 1450–51 (2d ed. 1961)).
67. See STEINBERG, supra note 61, at 121. See also Cady, Roberts, 40 S.E.C. at 912 n. 15 (stating that “[a] significant purpose of the Exchange Act was to eliminate the idea that the use of inside information for personal advantage was a normal emolument of corporate office”).

In Cady, Roberts, the Commission asserted that “the securities acts may be said to have generated a wholly new and far-reaching body of Federal corporation law.” Id. at 910. For support, the SEC quoted from a federal appellate decision containing expansive language. As stated by the Third Circuit in McClure v. Borne Chem. Co., 292 F.2d 824 (3d Cir. 1961):

In the present case we are construing two Sections [10, 29] of the Securities Exchange Act of 1934. That Act deals with the protection of investors, primarily stockholders. It creates many managerial duties and liabilities unknown to the common law. It expresses federal interest in management-stockholder relationships which theretofore had been almost exclusively the concern of the states. Section 10(b) imposes broad fiduciary duties on management vis-a-vis the corporation and its individual stockholders. As implemented by Rule 10b-5 and Section 29(b), Section 10(b) provides stockholders with a potent weapon for enforcement of many fiduciary duties. It can be said fairly that the Exchange Act, of which Sections 10(b) and 29(b) are parts, constitutes far reaching federal substantive corporation law.

C. **TGS—Adoption of a Broad Insider Trading Prohibition**

The Second Circuit’s decision in *TGS* made eminently clear that an expansive federal insider trading prohibition was applicable in the impersonal securities market setting.69 Adopting the SEC’s position, the Second Circuit in *TGS* prescribed a broad “disclose or abstain” mandate. Interestingly, the decision’s language leaves some uncertainty which standard the court in fact adopted: the parity of information standard, or the equal access test. Indeed, these two standards are enunciated in the same paragraph of the court’s opinion. Advancing an expansive parity-of-information standard, the *TGS* court stated:

> Anyone in *possession* of material inside information must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such information remains undisclosed.70

On the other hand, earlier in that same paragraph, quoting approvingly from the SEC’s decision in *Cady, Roberts*, the *TGS* court set forth the access standard.71 Subsequent Second Circuit decisions clarified that the access standard prevailed, stating: “Anyone corporate insider or not who *regularly receives* material nonpublic information may not use this information to trade in securities without incurring an affirmative duty to disclose.”72

D. **U.S. Supreme Court Decisions**

Nonetheless, twelve years after *TGS*, the Supreme Court rejected both the parity of information and access standards, premising insider trading liability under § 10(b) on an insider’s or other subject person’s breach of fiduciary duty or relationship of trust and confidence.73

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70. 401 F.2d at 848 (emphasis added).

71. The Second Circuit stated that the disclose-or-abstain rule:

> [I]t is based in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information. . . . The essence of the Rule is that anyone who, trading for his own account in the securities of a corporation, has “access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone” may not take the advantage of such information knowing it is unavailable to those with whom he is dealing,” 1[e], the investing public.

*Id.* (quoting *Cady, Roberts*, 40 S.E.C. at 912).


73. See Chiarella v. United States, 445 U.S. 222, 222–23, 230 (1980) (holding that silence may incur § 10(b) liability where a duty to disclose exists arising from a fiduciary relationship or a relationship of trust and confidence). Accord Salman v. United States, 137
sider trading prohibition thus has been narrowed by the U.S. Supreme Court as compared to the standards set forth in *TGS*, the federalization of this prohibition today is firmly established. Hence, it should not be minimized that the proscription against insider trading has been recognized by the U.S. Supreme Court as coming within the purview of the federal securities laws and, more particularly, § 10(b) and Rule 10b-5. Although critics may be dismayed regarding the High Court’s restrictive approach, it should be kept in focus that federal, rather than state, law reigns supreme in this setting, and that this outcome in good measure is due to the Second Circuit’s decision in *Texas Gulf Sulphur*.

**E. Continued Validity of Parity and Access Standards**

With frequency, it is posited that the parity of information and access standards no longer survive. Such an assertion is misplaced. Certainly, these standards no longer apply with respect to insider trading liability under § 10(b) and Rule 10b-5. But what at times is overlooked is that, in promulgating Rule 14e-3 which governs insider trading in the tender offer context, the SEC adopted the parity of information standard. Limited to the tender offer setting, this rule contains no breach of fiduci-

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74. This author is one such critic. See, e.g., Marc I. Steinberg, *The Ramifications of Recent U.S. Supreme Court Decisions on Federal and State Securities Regulation*, 70 NOTRE DAME L. REV. 489 (1995).
75. See *Treadway Cos. v. Care Corp.*, 638 F.2d 357, 375 n. 35 (2d Cir. 1980) (stating that “a director’s common law liability for trading on inside information has been largely mooted by the advent of a federal cause of action under § 10(b) and Rule 10b-5”); *Steinberg*, supra note 61, at 123–25.
77. Generally, a tender offer may be defined as:
A means frequently used to acquire control of a corporation characterized by active solicitation to purchase a substantial percentage of the target’s stock from the target’s shareholders at a premium over the market price, offered for a limited period of time and that may be contingent upon the tender of a specific number of shares.

*MARC I. STEINBERG, UNDERSTANDING SECURITIES LAW* 500 (7th ed. 2018).
78. Hence, with certain exceptions, Rule 14e-3 prohibits:
[Insider and tippee trading in the tender offer context by applying the disclose-or-abstain provision where an individual is in possession of material information relating to a tender offer when he/she knows or has reason to know that such information is nonpublic and was obtained directly or indi-
ary duty element, and thus far, its validity has been upheld by the federal courts.79 Hence, harkening back to the days of yesteryear—namely, its glorious triumph in TGS—the SEC reinvigorated the insider trading prohibition to the maximum degree feasible in the tender offer setting—perhaps the foremost setting in which huge insider trading profits are generated.80

Indeed, another significant contribution that Texas Gulf Sulphur has made to the law of insider trading is its widespread acceptance in developed securities markets outside of the United States. For example, to some degree, the parity of information standard has been adopted by the European Union.81 Likewise, Australia adheres to the parity of informa-

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81. See Council Regulation (EU) No. 596/2014, supra note 23, at arts. 7, 8, 10, 14, 17 (setting forth, inter alia, insider trading and tipper-tippee prohibitions as well as disclosure obligations). Article 8 (Insider Dealing) of that Regulation provides:

1. For the purposes of this Regulation, insider dealing arises where a person possesses inside information and uses that information by acquiring or disposing of, for its own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates . . . .
2. For the purposes of this Regulation, recommending that another person engage in insider dealing, or inducing another person to engage in insider dealing, arises where the person possesses inside information and:
   (a) recommends, on the basis of that information, that another person acquire or dispose of financial instruments to which that information relates, or induces that person to make such an acquisition or disposal, or
   (b) recommends, on the basis of that information, that another person cancel or amend an order concerning a financial instrument to which that information relates, or induces that person to make such a cancellation or amendment.
3. The use of the recommendations or inducements referred to in paragraph 2 amounts to insider dealing within the meaning of this Article where the person using the recommendation or inducement knows or ought to know that it is based upon inside information.
4. This Article applies to any person who possesses inside information as a result of:
   (a) being a member of the administrative, management or supervisory bodies of the issuer or emission allowance market participant;
   (b) having a holding in the capital of the issuer or emission allowance market participant;
   (c) having access to the information through the exercise of an employment, profession or duties; or
   (d) being involved in criminal activities.
This Article also applies to any person who possesses inside information under circumstances other than those referred to in the first subparagraph where that person knows or ought to know that it is inside information.
5. Where the person is a legal person, this Article shall also apply, in accordance with national law, to the natural persons who participate in the decision to carry out the acquisition, disposal, cancellation or amendment of an order for the account of the legal person concerned.
tion approach.82 By comparison, the access test has been adopted by such jurisdictions as Canada (Ontario)83 and China.84 Not surprisingly, the restrictive and vague “fiduciary duty” approach adopted by the U.S. Supreme Court has not been accepted outside of this country.85 Although one cannot state with assurance the extent that TGS has impacted the adoption of insider trading standards abroad, it is reasonable to conclude that, in view of that decision’s prominence, it has served as a persuasive source for effecting such implementation.

III. A TRULY SEMINAL DECISION

Texas Gulf Sulphur truly is a seminal decision. Its analysis and holdings continue to be pertinent today in this country and abroad. The presence of a continuous disclosure framework, with the attendant application of a flexible materiality standard, is firmly established in this country and other developed securities markets. The proscription against improper insider trading in the impersonal stock exchange market setting is within the purview of U.S. federal law—largely due to TGS and the widespread acceptance following that decision of such federalization. Although the Supreme Court rejected both the parity of information and access standards under § 10(b), the Court clearly recognized the propriety of such federalization.

Indeed, the SEC’s embracement of the parity of information approach under Rule 14e-3, as well as the acceptance of the TGS standards by countries abroad, evidence the continued vitality of this decision. Hence, it may well be accurate to identify the Second Circuit’s en banc decision

Id. at art. 8. See also Directive 2014/57/EU of the European Parliament and Council of 16 April 2014 on Criminal Sanctions for Market Abuse, art. 3, para. 3, 2014 O.J. (L 173) 179–89 (providing, inter alia, that a person engages in improper insider dealing when one has access to material nonpublic information by means of one’s profession, employment, or duties or otherwise “has obtained [such] inside information under [other] circumstances where that person knows that it is inside information”); id., at art. 3, para. 1–8, art. 4, para. 1–5. See generally MARKET ABUSE REGULATION—COMMENTARY AND ANNOTATED GUIDE (Marco Ventoruzzo & Sebastian Mock eds. Oxford Univ. Press 2017).

82. See Corporations Act 2001 (Cth) § 1043A (Austl.) (setting forth prohibited conduct for person in possession of material inside information).

83. See Province of Ontario Securities Act, R.S.O. 1990, c S. 5, § 76 (Can.). See also, note 55 supra.


85. This lack of acceptance of U.S. Supreme Court standards in the insider trading context by countries abroad is addressed in a number of my other publications. See, e.g., MARC I. STEINBERG, INTERNATIONAL SECURITIES LAW—A CONTEMPORARY AND COMPARATIVE ANALYSIS 105–48 (Kluwer Law Int’l 1999); Marc I. Steinberg, Insider Trading Regulation—A Comparative Analysis, 37 INT’L LAW. 153, 162–71 (2003). As stated by this author:

U.S. regulation of insider trading is far from perfect. Without sufficient justification, ambiguity, complexity, and disparate treatment of similarly situated market participants, at times, prevail. Perhaps cognizant of these shortcomings, nations with developed securities markets have declined to follow U.S. standards in the insider trading context . . . .

37 INT’L LAW at 171.
in *Texas Gulf Sulphur* as the most important judicial decision in the history of the U.S. securities laws. Although it has certainly incurred some “hits” to its armor, *TGS* reigns supreme. Accordingly, it is fitting that we commemorate the 50th year anniversary of this seminal decision by the publication of this Symposium Issue. I thank the SMU Law Review and the esteemed academicians who have contributed to this Issue for bringing this worthwhile endeavor to fruition.