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Selective Disclosure and Insider Trading

Michael Guttentag

SELECTIVE DISCLOSURE AND INSIDER TRADING

Michael D. Guttentag[*]

Abstract

Determining when the selective disclosure of material nonpublic information should trigger insider trading liability is a deeply problematic aspect of insider trading doctrine.

The current rule is that a selective disclosure can only trigger insider trading liability if "the insider [making the selective disclosure] personally will benefit, directly or indirectly, from his disclosure." *Dirks v. SEC* introduced this "personal benefit" test in 1983 to balance four competing rationales for determining when a tip should trigger insider trading liability. Two developments since *Dirks* have made problems with this personal benefit test insurmountable. First, the SEC's enactment of Regulation Fair Disclosure in 2000 supplanted federal common law regulation of selective disclosures by public companies and, more pointedly, prohibited public companies from making precisely the types of selective disclosures to Wall Street analysts that the *Dirks* personal benefit test was designed to protect. Second, in *United States v. O'Hagan* the Supreme Court adopted the misappropriation theory, which greatly expanded the types of deceptive conduct that could trigger insider trading liability.

After Regulation FD and *O'Hagan*, only a test for when a selective disclosure triggers insider trading liability based directly on the statutory prohibition against deceptive conduct makes sense. Receipt of a personal benefit should be a sufficient, but not necessary, condition for finding that a selective disclosure is deceptive enough to trigger insider trading liability.

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INTRODUCTION

White collar crime tends to be a small group affair for both psychological and operational reasons. In terms of psychology, small groups often act in ways that go beyond limits individuals set for themselves.[1] In terms of operations, it is almost always easier to carry out a fraud when working in cahoots with others.[2]

The factors that encourage small group deviance in white collar crime generally are at work in the context of insider trading. Many, if not most, incidents of insider trading are carried out by small groups, rather than by

1. *See* John M. Darley, *The Cognitive and Social Psychology of Contagious Organizational Corruption*, 70 BROOK. L. REV. 1177, 1180–81 (2005); Michael D. Guttentag et al., *Brandeis' Policeman: Results from a Laboratory Experiment on How to Prevent Corporate Fraud*, 5 J. EMPIRICAL LEGAL STUD. 239, 245 (2008); Ronald R. Sims, *Linking Groupthink to Unethical Behavior in Organizations*, 11 J. BUS. ETHICS 651, 660 (1992); Cass R. Sunstein, *Deliberative Trouble? Why Groups Go to Extremes*, 110 YALE L.J. 71, 75 (2000).

2. Guttentag et al., *supra* note 1, at 245.

an individual acting alone.[3] Therefore, insider trading often involves not one, but two wrongs. The first is the improper selective disclosure of material nonpublic information, and the second is the act of trading based upon that information.[4] Unfortunately, the doctrine courts use to evaluate the legality of the first of these wrongs, the selective disclosure of material nonpublic information, is confused and increasingly obsolete.[5]

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3. For example, most of the insider trading prosecution and enforcement actions reported by the SEC for the 2016 fiscal year involved small groups, rather than an individual acting alone. SELECT SEC AND MARKET DATA: FISCAL 2016 (2017), https://www.sec.gov/files/2017-03/secstats2016.pdf (stating that less than 25% of the reported insider trading cases involved individuals acting alone). Of course, insider trading prosecution and enforcement actions may provide a biased representation of the underlying occurrence of insider trader violations, both because not all violations are detected and because not all detected violations are prosecuted.

4. Throughout this Article *selective disclosure* specifically refers to situations in which a disclosure of material nonpublic information is made absent any specific contractual or fiduciary obligation on the part of the recipient of the information to keep the information confidential or to refrain from trading based on the information.

5. Surprisingly few articles in the vast literature on insider trading consider how best to determine the wrongfulness of selectively disclosing information. In his treatise on insider trading law, Donald Langevoort acknowledges this shortcoming, and concludes after reviewing tipper and tippee liability in the misappropriation context that "[t]his entire subject of tipping without specific intent to enable trading—including the place of personal benefit in all this—deserves clarification, if not wholesale revision." 18 DONALD C. LANGEVOORT, INSIDER TRADING REGULATION, ENFORCEMENT, AND PREVENTION § 6:13, Westlaw (database updated Apr. 2016) (footnote omitted).

The most closely related literature is that which considers the practicalities of applying the personal benefit test in various scenarios. *See, e.g.*, Kathleen Coles, *The Dilemma of the Remote Tippee*, 41 GONZ. L. REV. 181 (2005/2006); Craig W. Davis, Comment, Misappropriators, Tippees and the Intent-to-Benefit Rule: What Can We Learn from Cady, Roberts, 35 SETON HALL L. REV. 263 (2004); Nelson S. Ebaugh, *Insider Trading Liability for Tippers and Tippees: A Call for the Consistent Application of the Personal Benefit Test*, 39 TEX. J. BUS. L. 265, 268 (2003); Jill E. Fisch, *Start Making Sense: An Analysis and Proposal for Insider Trading Regulation*, 26 GA. L. REV. 179, 213–14 (1991); Jeffrey Plotkin, *The Tipper Benefit Test Under the Misappropriation Theory*, 230 N.Y. L.J. 33 (August 15, 2003); Allison M. Vissichelli, Note, *Intent to Reconcile:* SEC v. Obus, *The Second Circuit's Edification of the Tippee Scienter Standard*, 62 AM. U. L. REV. 763, 767 (2013).

Recently, some of the more basic questions as to what makes selective disclosure a manipulative or deceptive practice have finally started to receive attention in light of a circuit split regarding what constitutes a personal benefit (discussed *infra* Section II.B.). *See* Richard A. Epstein, *Returning to Common-Law Principles of Insider Trading after* United States v. Newman, 125 YALE L.J. 1482, 1485 (2016); Jonathan R. Macey, *Beyond the Personal Benefit Test: The Economics of Tipping by Insiders*, 2 J.L. & PUB. AFF. 27 (2017); Donna M. Nagy, *Beyond* Dirks*: Gratuitous Tipping and Insider Trading*, 42 J. CORP. L. 1, 1 (2016) [hereinafter Nagy, *Beyond* Dirks]; A.C. Pritchard, Dirks *and the Genesis of Personal Benefit*, 68 SMU L. REV. 857, 859 (2015) [hereinafter Pritchard on *Dirks*]; Mark Hayden Adams, Note, *Insider Trading Law that Works: Using* Newman *and* Salman *to Update* Dirks*'s Personal Benefit Standard*, 49 LOY. L.A. L. REV. 575 (2016); Katherine Drummonds, Note, *Resuscitating* Dirks*: How the* Salman *"Gift Theory" of Tipper-Tippee Personal Benefit Would Improve Insider Trading Law*, 53 AM. CRIM. L. REV. 833, 835 (2016).

The rule that determines when a selective disclosure triggers insider trading liability has important policy ramifications. Too lax a rule makes it simple to circumvent the prohibition against insider trading by passing information along among a small group of confederates.[6] Too strict a rule might criminalize legitimate efforts to share corporate information with those outside the firm.[7]

Much of the challenge in identifying wrongful selective disclosure arises because current doctrine is increasingly obsolete. What is the cause of this obsolescence? One reason is that the prohibition against insider trading in the United States is largely a creation of federal common law, derived from the statutory prohibition against using a "manipulative or deceptive device or contrivance" in connection with the purchase or sale of a security.[8] It therefore falls to the federal judiciary to update rules for

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6. For example, the Second Circuit in *United States v. Newman* dismissed the case against defendants Anthony Chiasson and Tod Newman in part because neither defendant had knowledge of the personal benefit, if any, received by those who first selectively disclosed the nonpublic information. 773 F.3d 438, 443, 448 (2d Cir. 2014). For a discussion of this aspect of the *Newman* holding, see Nagy, *Beyond* Dirks, *supra* note 5, at 14. One implication of the holding in *Newman* is that to avoid insider trading liability one could simply pass material nonpublic information through a series of at least two tippees, without providing the person who ultimately trades information about the motivation of the party who was the original source. *See* Donald C. Langevoort, Newman *and Selective Disclosure*, CLS BLUE SKY BLOG (Jan. 28, 2015), http://clsbluesky.law.columbia.edu/2015/01/28/newman-and-selective-disclosure/ (expressing concern that the *Newman* decision reads "almost as a roadmap for selective disclosure"). *See generally* Joan MacLeod Heminway, *Willful Blindness, Plausible Deniability and Tippee Liability: SACs, Steven Cohen, and the Court's Opinion in* Dirks, 15 TRANSACTIONS 47 (2013).

7. The possibility of criminal liability arises under Section 32(a) of the Exchange Act, which also requires that the violation be knowing and willful:

> Any person who willfully violates any provision of this chapter . . . or any rule or regulation thereunder . . . shall upon conviction be fined not more than $5,000,000, or imprisoned not more than 20 years, or both . . . ; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

15 U.S.C. § 78ff(a) (2012).

8. Section 10(b) of the Exchange Act as amended provides in pertinent part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> . . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as

determining when the selective disclosure of material nonpublic information is sufficiently deceptive to constitute a violation of federal securities law.[9]

Judges have generally looked to common law precedent to determine what constitutes a deceptive practice in securities markets. For example, to answer the question of when trading based on material nonpublic information can be deceptive, the Supreme Court relied on the common law doctrine that silence is deceptive only when one party in a transaction owes a fiduciary duty to the other.[10] However, no obvious common law

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> necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b). For a comprehensive review of this Section of the Exchange Act, see generally Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385 (1990) (providing a review of the events leading up to Section 10(b)'s enactment).

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
>
> (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.

Employment of Manipulative and Deceptive Devices, 17 C.F.R. § 240.10b-5 (2015).

With respect to the federal common law nature of insider trading jurisprudence, see, for example, United States v. Whitman, 904 F. Supp. 2d 363, 369 (S.D.N.Y. 2012) ("*Dirks*, and indeed all the Supreme Court cases dealing with insider trading, have implicitly assumed that the relevant fiduciary duty is a matter of federal common law . . . ."); A.C. Pritchard, *Justice Lewis F. Powell, Jr., and the Counterrevolution in the Federal Securities Laws*, 52 DUKE L.J. 841, 930 (2003) ("Powell saw Rules 10b-5's jurisprudence as a species of 'federal common law.'").

9. As evidenced by the decision in *Salman v. United States*, 137 S. Ct. 420 (2016), the Supreme Court has shown a decided lack of interest in carrying out such an updating in the context of determining when a selective disclosure might trigger insider trading liability. *See* Michael D. Guttentag, *Salman Insider-Trading Case a Hollow Win for Prosecutors*, CLS BLUE SKY BLOG (Dec. 14, 2016), http://clsbluesky.law.columbia.edu/2016/12/14/salman-insider-trading-case-a-hollow-win-for-prosecutors/. For a discussion of the Supreme Court avoiding updating securities regulation more generally, see Eric C. Chaffee, *The Supreme Court as Museum Curator: Securities Regulation and the Roberts Court*, 67 CASE W. RES. L. REV. 847 (2017).

10. Chiarella v. United States, 445 U.S. 222, 228, 232–33 (1980) ("But one who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so. And the duty to disclose arises when one party has information 'that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and

precedent suggests how to determine when the selective disclosure of material nonpublic information constitutes a deceptive practice.[11]

Dirks v. SEC,[12] the one Supreme Court case to consider at length the relationship between selective disclosure and insider trading, might appear to have resolved much of the uncertainty about when a selective disclosure may trigger insider trading liability. The Court in *Dirks* held that a selective disclosure by an insider will only trigger insider trading liability if "the insider personally will benefit, directly or indirectly, from his disclosure."[13] Most courts and scholars interpret the *Dirks* opinion as resolving the question of how to determine when a selective disclosure is wrongful.[14] The Supreme Court affirmed the continuing validity of the *Dirks* personal benefit test in *Salman v. United States*.[15]

But the personal benefit test, even in 1983, was an imperfect effort to balance four different and in many ways competing rationales for determining when a selective disclosure should trigger insider trading liability.[16] Two developments since *Dirks* have made problems with the personal benefit test insurmountable.[17] First, the SEC's enactment of Regulation Fair Disclosure in 2000 largely supplanted the federal common law regulation of selective disclosures by public companies and, more pointedly, prohibited public companies from making precisely the types of selective disclosures to Wall Street analysts the *Dirks* personal benefit test was designed to protect.[18] Second, the adoption of the misappropriation theory of insider trading in *United States v. O'Hagan*[19] greatly expanded the types of deceptive conduct that might lead to insider

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confidence between them.'" (alteration in original) (quoting RESTATEMENT (SECOND) OF TORTS § 551(2)(a) (AM. LAW INST. 1976))).

But in grounding the insider trading prohibition in common law, the Court did not strictly abide by any particular fiduciary duty or common law precedent. Donna M. Nagy, *Insider Trading and the Gradual Demise of Fiduciary Principles*, 94 IOWA L. REV. 1315, 1337 (2009) ("From a doctrinal perspective, the Court's fiduciary foundation for insider trading liability under Rule 10b-5 was shaky from the start.").

11. *But see* Richard A. Epstein, *Returning to Common-Law Principles of Insider Trading After* United States v. Newman, 125 YALE L.J. 1482, 1507 (2016) (arguing that issues related to the wrongfulness of selective disclosure can be satisfactorily addressed by looking to common law principles developed to prohibit the use of ill-gotten property).

12. 463 U.S. 646 (1983).

13. *Id.* at 662.

14. *E.g.*, Pritchard, *supra* note 8, at 859.

15. 137 S. Ct. 420, 427 (2016).

16. *See infra* Section I.A.

17. *See infra* Part III.

18. General Rule Regarding Selective Disclosure, 17 C.F.R. § 243.100 (2015); *see infra* Section II.A.

19. 521 U.S. 642 (1997).

trading liability with important ramifications for how to identify tipper wrongdoing.[20]

A reconsideration of the four justifications that originally led to the adoption of the personal benefit test in *Dirks*, in light of changes wrought by Regulation FD and *O'Hagan*, shows why evidence of a personal benefit should no longer be a required element to find that a selective disclosure is sufficiently deceptive to trigger insider trading liability.[21]

Fortunately, there is a better way to determine when a selective disclosure might trigger insider trading liability. Federal courts can return to the underlying prohibition against deceptive practices in Section 10(b) of the Securities Exchange Act, the wellspring for the insider trading prohibition. Based on this statute, courts could specify several different ways—or multiple triggers—in which a selective disclosure could trigger insider trading liability.[22]

Directly linking the question of when a selective disclosure is wrongful to the statutory prohibition against deceptive conduct obviates the need to contort a personal benefit test to address an insider trading landscape that has significantly changed since the 1983 *Dirks* decision.

I. UNBUNDLING *DIRKS*

A careful reading of the *Dirks* decision is a useful starting point for evaluating how courts should determine when a selective disclosure should trigger insider trading liability. More specifically, identifying the justifications for the Court's adoption of the personal benefit test in *Dirks* is helpful in three ways. First, identifying these various, often competing, justifications helps to explain the *Dirks* opinion's differing descriptions as to what constitutes an impermissible personal benefit. Second, identifying these various justifications clarifies the reasons for the differences between the Second Circuit opinion in *United States v. Newman* and the Ninth Circuit opinion in *United States v. Salman* about what constitutes a personal benefit, as well as elucidating the reasons for the disagreement between the majority and dissent opinions in *United States v Martoma*.[23] Finally, identifying and separating out these various justifications suggests how best to update the *Dirks* precedent to reflect changes in securities markets disclosure practices and insider trading law.[24]

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20. *Id.* at 665 (applying the misappropriation theory); *see infra* Section II.B.
21. *See infra* Section III.A.
22. 15 U.S.C. § 78j(b) (2012); *see infra* Part IV.
23. *See infra* Section I.B.
24. *See infra* Part IV.

A. *Justifications for a Personal Benefit Test*

One of the central questions addressed in *Dirks* is when a selective disclosure of material nonpublic information may trigger insider trading liability.[25] The *Dirks* majority opinion introduced a new test to assist in making this determination. Justice Lewis F. Powell, Jr., in the majority opinion in *Dirks*, writes that a selective disclosure can only be sufficiently wrongful to trigger insider trading liability if "the insider personally will benefit, directly or indirectly, from his disclosure."[26]

This Section will show that the reasons offered in *Dirks* for adopting a personal benefit test are more complex than is generally recognized.[27] Specifically, four distinct justifications for adopting the personal benefit test appear at various points in the *Dirks* opinion. These are: (1) that requiring proof of a personal benefit establishes objective criteria, (2) that a personal benefit test allows company executives to continue to make selective disclosures for legitimate business purposes, (3) that receipt of a personal benefit shows that the person making the selective disclosure (the "tipper") was attempting to circumvent the prohibition against insider trading, and (4) that receipt of a personal benefit is a required element for finding either that a deception or a fiduciary duty breach has occurred.

In the discussion that follows regarding how the *Dirks* opinion develops each of these justifications for introducing a personal benefit test, consideration is given to how well each of these justifications: (1) addresses the statutory goal of prohibiting deceptive conduct, and (2) matches up with the specifics of the personal benefit test enunciated in *Dirks*.[28]

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25. For an identification and discussion of the three distinct legal issues addressed and holdings provided in *Dirks*, see *infra* Subsection III.B.2.

26. Dirks v. SEC, 463 U.S. 646, 662 (1983).

27. A few of the notable exceptions are Epstein, *supra* note 11, at 1504–10, and Macey, *supra* note 5.

28. This Article presupposes that *Dirks* unequivocally holds that the existence of a personal benefit is the exclusive basis on which a selective disclosure can be wrongful. Some of the best evidence that the Court intends the personal benefit to be a necessary element comes from the abbreviation used when specifying the content of the personal benefit test. In discussing the personal benefit test, the opinion states, "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." *Dirks*, 463 U.S. at 663. The opinion uses the abbreviation *i.e.* rather than *e.g.*, implying that only these specific types of evidence will suffice. *Id.*

However, one could question this assumption. For example, in several places the opinion refers to the operative test as being based on whether there was a fiduciary duty breach and not exclusively on whether there was a personal benefit. For example, the *Dirks* opinion emphasizes the centrality of evidence of a fiduciary breach in favorably citing *Chiarella* for the precedent that "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in

1. Objective Criteria

One justification *Dirks* offers for requiring a personal benefit element to find tipper wrongdoing is that such a requirement guarantees that judges and prosecutors can "focus on objective criteria."[29] The *Dirks* opinion notes that relying on objective criteria means that "[i]n determining whether the insider's purpose in making a particular disclosure is fraudulent, the SEC and the courts are not required to read the parties' minds."[30]

We know from Professor Adam Pritchard's review of Justice Powell's personal records, which include earlier drafts of the *Dirks* opinion and correspondence between the Justices regarding the *Dirks* decision, that using the personal benefit test to shift the analysis toward questions involving objective criteria was the product of a compromise between Justices Sandra Day O'Connor and Powell.[31] Pritchard reports that the personal benefit test was introduced into the final versions of the *Dirks* opinion at the suggestion of Justice O'Connor.[32] Justice O'Connor was concerned about the subjectivity involved in trying to determine the *purpose* for which a selective disclosure was made, which Powell's earlier drafts of the *Dirks* opinion had relied upon as the exclusive means to decide when a selective disclosure might trigger insider trading liability.[33]

Pritchard summarized the story of how Justice O'Connor's concern led to the personal benefit test in a 2003 *Duke Law Review* article:

> Justice O'Connor's second concern was more substantial. She worried that focusing on the insider's purpose in disclosing the information would require "the fact-finder . . . to determine the subjective state of mind of the

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the insider's breach of a fiduciary duty." *Id.* at 659 (quoting Chiarella v. United States, 445 U.S. 222, 230 n.12 (1980) (alteration in original)).

29. *Id.* at 663.

30. *Id.* Although not explicitly mentioned in the *Dirks* opinion, Langevoort observes that the personal benefit test can also provide objective criteria that the recipient of the information (the tippee) can observe. Langevoort writes that "the personal benefit requirement is imposed because it provides an objective test for determining whether there has been the requisite notice to the tippee." 18 LANGEVOORT, *supra* note 5, § 4:3 n.7.

31. *See* Pritchard on *Dirks*, *supra* note 5, at 866; Pritchard, *supra* note 8, at 942. For the personal records of Justice Powell, now available online, see *Lewis F. Powell, Jr. Archives*, WASH. & LEE SCH. L., http://law2.wlu.edu/powellarchives/ (last visited Dec. 30, 2016).

For a discussion of the questionable value of judicial history generally, see Adrian Vermeule, *Judicial History*, 108 YALE L.J. 1311, 1314 (1999) ("Nonetheless, that courts have at some times and under some circumstances consulted internal materials across all of these domains throws the puzzling exclusion of internal judicial history into sharp relief." (footnote omitted)).

32. Pritchard, *supra* note 8, at 941–42.

33. Pritchard on *Dirks, supra* note 5, at 865–68.

> insider," "an inherently difficult determination." She suggested omitting the discussion of purpose, a change that Powell was not willing to make. More promising was her proposed alternative, which looked to
>
> > "whether the insider derives a direct or indirect benefit from his disclosure, and that benefit is primarily of a pecuniary nature. An emphasis on benefit differs from your approach only insofar as it establishes a more objective indicia of liability. . . ."
>
> . . . The opinion accordingly was revised to reflect Justice O'Connor's "quite constructive" suggestions.[34]

There are advantages and disadvantages to using objective criteria, such as evidence of a personal benefit, to determine when a selective disclosure is a deceptive practice. One advantage, as the correspondence between Justices O'Connor and Powell highlights, is that objective criteria remove some of the uncertainty that might otherwise surround a determination of whether a selective disclosure was made for an inappropriate purpose.[35]

There are several disadvantages of using a test based on objective criteria to determine when a selective disclosure involves deceptive conduct. First, as with any test based on an extrapolation from statutory language, there is the likelihood of a mismatch between the objective criteria and the underlying language. Take, for example, a selective disclosure made for a personal benefit that was nevertheless sanctioned by the firm. In this situation, there would be evidence of a personal benefit from the selective disclosure, but no underlying deceptive conduct.[36] Second, requiring evidence of objective criteria may also be underinclusive, because of situations in which a selective disclosure constitutes the kind of deceptive practice that federal securities statutes prohibit, but where there is no objective evidence of a personal benefit.[37] As Pritchard observes, "[t]hese changes narrowed the scope of improper

34. Pritchard, *supra* note 8, at 941–42 (footnotes omitted). In a more recent article, Pritchard published more of the details of the correspondence between Justices O'Connor and Powell regarding the inclusion of the personal benefit test in the *Dirks* opinion. Pritchard on *Dirks*, *supra* note 5, at 866–67.

35. Pritchard on *Dirks*, *supra* note 5, at 865–66.

36. The possibility of firm-sanctioned selective disclosure raises the more general question of why insider trading is illegal when sanctioned by the firm. *See, e.g.*, John P. Anderson, *What's the Harm in Issuer-Licensed Insider Trading?*, 69 U. MIAMI L. REV. 795, 801 (2015).

37. For two specific examples of this under-inclusiveness, see *infra* Section IV.A.

purposes that the SEC could argue constituted breaches of fiduciary duty under Rule 10b-5."[38]

The objective criteria justification for adopting the personal benefit test also explains some but not all of the description of what constitutes a personal benefit in *Dirks*. For example, the opinion describes the test as including either a "direct or indirect personal benefit" and provides as examples "pecuniary gain or a reputational benefit that will translate into future earnings."[39] Including the word "indirect" in this sentence could raise questions about how attenuated acceptable evidence of objective criteria can be, and the ways in which a reputational benefit might translate into future earnings are certainly not as easy to objectively ascertain as the pecuniary gain test originally proposed by Justice O'Connor. Similarly, the Court notes that "a gift of confidential information to a trading relative or friend" could also evince a personal benefit, which further strains an effort to delineate strictly objective criteria for identifying an improper purpose, because issues might arise about who counts as a friend or relative.[40]

The desire to focus on objective criteria, despite its centrality in the judicial history of the *Dirks* opinion, is but one of several justifications for introducing evidence of a personal benefit test as a necessary element of wrongful selective disclosure.

2. Policy Concerns

A second justification in the *Dirks* opinion for requiring evidence of a personal benefit is that doing so establishes a test that allows firms to continue to make selective disclosures for legitimate business purposes.[41]

This second justification, which is a policy consideration aimed at protecting the ability of public firms to disseminate information in a reasonable and, at times, selective manner, appears twice in the *Dirks* opinion. First, the opinion states that "[i]mposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting

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38. Pritchard, *supra* note 8, at 942.

39. Dirks v. SEC, 463 U.S. 646, 663 (1983). For the original language Justice O'Connor offered in an effort to make the test more objective, see *supra* note 34 and accompanying text. Justice O'Connor's original suggestion did include the word "indirect" but also focused on the benefit being "primarily of a pecuniary nature." *See supra* text accompanying note 34.

40. *Dirks*, 463 U.S. at 664. For a discussion of the possibility of ambiguity about the meaning of these terms, see Brief of the NYU Center on the Administration of Criminal Law as Amicus Curiae in Support of Neither Party at 10–12, Salman v. United States, 137 S. Ct. 420 (2016) (No. 15-628); Nagy, *Beyond* Dirks, *supra* note 5, at 30 (citing to a SEC report, which found that the Court's opinion in *Bateman Eicher* clarified "some of the principles underlying *Dirks* and 'removing certain potential ambiguities'").

41. *Dirks*, 463 U.S. at 663.

influence on the role of market analysts."[42] Later, Justice Powell writes that the Court's failure to establish a clear test for market participants as to when a selective disclosure might trigger insider trading liability "could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market."[43] In 1983, the Court could also write with some certainty that "[i]t is the nature of this type of information, and indeed of the markets themselves, that such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally."[44]

Weighing the policy ramifications of adopting a particular standard to identify wrongdoing is not unusual for the judiciary when undertaking statutory interpretation, even if courts might prefer deference to the other branches of government when these kinds of policy determinations need to be made.[45] Moreover, it is particularly apt for a court to weigh the policy implications of its decisions when applying the federal securities statutes to the insider trading prohibition for two reasons. First, this is an area of the law where the underlying statutory language is quite broad.[46] Second, Congress has repeatedly indicated its desire to delegate to federal courts the task of filling in the details of when insider trading constitutes the type of manipulative or deceptive practice prohibited by the federal securities statutes.[47] However, there are also a multitude of challenges that courts face in making these kinds of policy determinations.[48]

3. Prevent Circumvention

A third justification in *Dirks* for adopting a personal benefit test is that such a test is necessary to prevent insiders from circumventing the

42. *Id.* at 658.

43. *Id.*

44. *Id.* at 659.

45. *But see* Eric Berger, *Deference Determinations and Stealth Constitutional Decision Making*, 98 IOWA L. REV. 465, 468 (2013) ("The Supreme Court's deference determinations in a wide range of constitutional contexts are often inchoate and under-theorized.").

46. *See supra* note 8.

47. For a review of this aspect of the Stock Trading on Congressional Knowledge (STOCK) Act of 2012, see Nagy, *Beyond* Dirks, *supra* note 5, at 34–35. For a review of this aspect of the 1984 Insider Trading Sanctions Act and the 1988 Insider Trading and Securities Fraud Enforcement Act, see Nagy, *Beyond* Dirks, *supra* note 5, at 27–33; Nagy, *supra* note 10, at 1366–68; Richard W. Painter et al., *Don't Ask, Just Tell: Insider Trading After* United States v. O'Hagan, 84 VA. L. REV. 153, 200–03 (1998); *see also* Stephen M. Bainbridge, *Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud*, 52 SMU L. REV. 1589, 1616–18 (1999) (providing that "under *Central Bank*, . . . the courts must infer how the 1934 Congress would have addressed the issue if Rule 10b-5 had been included as an express provision of the 1934 Act").

48. *See infra* Subsection III.A.2.

prohibition against insider trading by indirectly benefiting from activities they may not carry out directly.[49] In the simplest example, without an anti-circumvention prohibition, rather than trade based on inside information, an insider could simply sell selective access to material nonpublic information and reap a pecuniary gain without actually engaging in insider trading.[50]

In raising this concern, Justice Powell writes in the *Dirks* majority opinion:

> The need for a ban on some tippee trading is clear. Not only are insiders forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they also may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain.[51]

In further support of this anti-circumvention justification for a personal benefit test, Justice Powell cites Section 20(b) of the Exchange Act, which makes "it unlawful to do indirectly 'by means of any other person' any act made unlawful by the federal securities laws."[52]

There are two ways to implement the anti-circumvention justification for requiring evidence of a personal benefit. One could implement this anti-circumvention goal in a narrow way. A narrow implementation would prohibit someone making a selective disclosure from receiving money from the sale of selective access to material nonpublic information. The *Dirks* opinion offers as a justification for this narrow implementation Professor Victor Brudney's observation "that the insider, by giving the information out selectively, is in effect *selling the information* to its recipient for cash, reciprocal information, or other things of value for himself."[53]

49. *Dirks*, 463 U.S. at 659, 662.

50. *See generally* Kevin S. Haeberle & M. Todd Henderson, *Making a Market for Corporate Disclosure* 12 (Univ. of Chi. Coase-Sandor Inst. for Law & Econ., Working Paper No. 769, 2016), http://ssrn.com/abstract=2814125 (arguing that firms should be able to sell the right to receive selective disclosures of material nonpublic information: "many firms may in reality be fine with allowing their insiders to earn trading profits based on the firm's information—meaning that they are unlikely to police themselves").

51. *Dirks*, 463 U.S. at 659.

52. *Id.* (quoting 15 U.S.C. § 78t(b) (1976)). This anti-circumvention justification for some kind of anti-tipping rule also appears in a discussion in *Dirks* regarding the SEC opinion *Cady, Roberts & Co.*, 40 S.E.C. 907 (1961). *Id.* at 654. The *Dirks* opinion notes that "[t]ipping thus properly is viewed only as a means of indirectly violating the *Cady, Roberts* disclose-or-abstain rule." *Id.* at 661.

53. *Id.* at 664 (emphasis added) (citing Victor Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322, 348 (1979)).

This narrow implementation of the anti-circumvention objective is consistent with the Court's description of the personal benefit test as involving a determination of "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."[54]

An alternative, broader implementation of the anti-circumvention objective would prohibit not only selling information, but also providing information instead of cash or some other good to a third party. One might characterize this as a prohibition on improperly "spending" the benefits from insider trading. In this broader implementation there need not be any cash or cash-equivalent coming back to the tipper; the tipper may receive a benefit from giving the information where she might have achieved a similar result by "spending" cash.[55]

This broader implementation of the anti-circumvention rationale animates at least some of the Court's formulation of what constitutes a personal benefit in *Dirks*. For example, this broader implementation explains why a personal benefit arises "when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient."[56] In this situation, rather than generating cash from insider trading and using the proceeds, the wrongdoer simply provides valuable information in lieu of cash. The end result is the same but without the tipper having to buy or sell shares.

It is noteworthy that while the broader implementation of the anti-circumvention goal explains why "a gift of confidential information to a trading relative or friend"[57] could constitute a personal benefit, it is not self-evident why the broader implementation of the anti-circumvention goal should only prohibit tips to these particular people.[58]

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54. *Id.* at 663. It should be noted that the *Dirks* opinion explains this example not as an anti-circumvention measure, but as a breach of a fiduciary duty. For a discussion of this aspect of the justifications for the personal benefit test, see *infra* Subsection III.A.4. Also, this narrower perspective on the personal benefit test is consistent with Justice O'Connor's suggested language for such a test in her correspondence with Justice Powell, stating that the issue should be whether "that benefit is primarily of a pecuniary nature." *See supra* note 34 and accompanying text.

55. Concern about this broader type of anti-circumvention was mentioned in the *Salman* opinion where Justice Samuel Alito observed: "Making a gift of inside information to a relative like Michael is little different from trading on the information, obtaining the profits, and doling them out to the trading relative." Salman v. United States, 137 S. Ct. 420, 428 (2016).

56. *Dirks*, 463 U.S. at 664. Note that by including this sentence the opinion appears to accept this broader perspective on the anti-circumvention goal, despite the fact that Justice O'Connor's proposed language with respect to the personal benefit test only appears to embrace the narrower perspective. *See supra* note 54.

57. *Dirks*, 463 U.S. at 664.

58. The Court limits the broader implementation of the anti-circumvention goal without explanation. Perhaps the Court is implicitly relying on the doctrine in corporate law which treats

Whether the personal benefit test is the best way to either narrowly (by prohibiting "selling" selective access to material nonpublic information) or broadly (by prohibiting "spending" selective access to material nonpublic information) prevent circumvention of the insider trading prohibition is less clear. One problem with a narrow implementation is that such a rule would not treat giving valuable inside information to friends and family as a securities law violation, so long as no cash remuneration was received in exchange, regardless of whether deception occurred. On the other hand, a broad implementation of the anti-circumvention goal might outlaw efforts to circumvent the prohibition against insider trading, but could render the personal benefit test a "nullity."[59] This is because, at the extreme, evidence of a personal benefit could be deduced simply from the fact that a person chose to make a selective disclosure at all. Even a gift of information to an absolute stranger could provide the donor a personal benefit under the broad anti-circumvention justification, if the tipper might otherwise have given that stranger cash that was generated from insider trading.[60]

If the goal is to prevent circumvention, then the better approach would be to simply follow the common law rule that prohibits any gifting or personal use of another's chattel or land. Professor Richard Epstein summarizes the relevant doctrine as follows: "no person is allowed to make gifts to his friends of property that is owned by another,"[61] and argues that the source of this rule can be found in Roman Law, which held "that any knowingly unauthorized use of a chattel constituted a form of theft."[62] Under such a rule any selective disclosure without consent would be prohibited regardless of whether there is evidence that the donor received a personal benefit. If the goal is solely to prevent circumvention, then there would seem to be no need to check for personal benefit.

4. Element of a Fraud or a Fiduciary Breach

A fourth justification for the personal benefit test in *Dirks* links evidence of a personal benefit directly to the fraud prohibition in the

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certain transactions, such as those between the firm and certain relatives of the firm's directors, as requiring heightened scrutiny. *See, e.g.*, DEL. CODE ANN. tit. 8, § 144 (2016); MODEL BUS. CORP. ACT § 8.60 (2010).

59. *See, e.g.*, United States v. Newman, 773 F.3d 438, 452 (2d Cir. 2014).

60. This difficulty was a concern raised by the dissent in *Dirks*. *Dirks*, 463 U.S. at 676 n.13 (Blackmun, J., dissenting). Justice Blackmun wrote: "The distinction between pure altruism and self-interest has puzzled philosophers for centuries; there is no reason to believe that courts and administrative law judges will have an easier time with it." *Id.*

61. Epstein, *supra* note 11, at 1507.

62. *Id.* at 1501. Epstein goes on to make the observation that he does not see why the "the analysis ought to change when what passes between parties is not property but information." *Id.* at 1507.

statute. Sprinkled throughout the *Dirks* opinion, there are quotes drawn from earlier insider trading cases that suggest that the presence of a personal benefit is a necessary element for finding that insider trading is fraudulent.

For example, the opinion in *Dirks* includes quotations from two of the seminal SEC insider trading opinions, *Merrill Lynch, Pierce, Fenner & Smith, Inc.*[63] and *Cady, Roberts & Co.*,[64] suggesting that receipt of a personal benefit is at the heart of the insider trading prohibition.[65] In fact, the phrase "personal benefit" first appears in *Dirks* in a quote from the 1968 SEC *Merrill Lynch* decision: "In an insider-trading case this fraud derives from the 'inherent unfairness involved where one takes advantage' of 'information intended to be available only for a corporate purpose and not for the *personal benefit* of anyone.'"[66]

The *Cady, Roberts* quotation similarly emphasizes the importance of personal gain in making insider trading fraudulent: "[A]n insider will be liable under Rule 10b–5 for inside trading only where he fails to disclose material nonpublic information before trading on it and thus makes 'secret profits.'"[67] *Cady, Roberts* also appears in a footnote in *Dirks* to support the proposition that "[a] significant purpose of the Exchange Act was to eliminate the idea that use of inside information for *personal advantage* was a normal emolument of corporate office."[68]

Logically, if a personal benefit is a necessary element to trigger the prohibition against insider trading generally, then receipt of a personal benefit in exchange for a selective disclosure is fraudulent for the same reason that insider trading itself is fraudulent. In this respect, the Court's favorable citation of an article by Professor Michael Dooley for the proposition that "inside trading *for personal gain* is fraudulent, and is a violation of the federal securities laws" is highly suggestive.[69]

However, it would require a misreading of the cited insider trading decisions to conclude that the fraudulent nature of insider trading is solely the result of an insider personally benefiting from the use of material nonpublic information. For example, in the *Merrill Lynch* decision cited

63. 43 S.E.C. 933 (1968).

64. 40 S.E.C. 907 (1961).

65. *Dirks*, 463 U.S. at 654.

66. *Id.* (emphasis added) (quoting *Merrill Lynch*, 43 S.E.C. at 936).

67. *Id.* (quoting *Cady, Roberts*, 40 S.E.C. at 916 n.31).

68. *Id.* at 653 n.10 (alteration in original) (emphasis added) (quoting *Cady, Roberts*, 40 S.E.C. at 912 n.15). It is interesting to observe that even here the *Dirks* opinion is not claiming that deterring personal benefits is the only purpose served by the securities laws. *Id.* The Court writes that this objective was "a" significant purpose, not "the" significant purpose of federal securities statutes. *Id.*

69. *Id.* at 667 n.27 (emphasis added) (citing Michael P. Dooley, *Enforcement of Insider Trading Restrictions*, 66 VA. L. REV. 1, 39–41, 70 (1980)).

in *Dirks*, the SEC held that facilitating unequal access to material nonpublic information, and not the existence of a personal benefit, made selective disclosure of information a violation of federal securities statutes.[70] And in *Chiarella v. United States*,[71] decided just three years before *Dirks*, the Supreme Court held that the deception involved in insider trading arises from a breach of fiduciary duty, and did not identify a personal benefit as a required element in that context.[72]

Closely related to the claim that the receipt of a personal benefit makes selective disclosure deceptive is the argument that evidence of a personal benefit is evidence that there was a breach of a fiduciary duty. Then, in turn, following the logic of *Chiarella*, it is this fiduciary duty breach that creates the insider trading violation. Several places in the *Dirks* opinion treat evidence of a personal benefit and of a fiduciary duty breach as synonymous. For example, the quote that precedes the introduction of the personal benefit test reads: "But to determine whether the disclosure itself 'deceive[s], manipulate[s], or defraud[s]' shareholders, the initial inquiry is whether there has been a breach of duty by the insider."[73] Elsewhere, the *Dirks* opinion cites *Chiarella* for the holding that "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty."[74] Finally, *Dirks* favorably cites *Chiarella* for the proposition that a breach of fiduciary duty is the main element of an insider trading violation, noting that in "determining whether a tippee is under an obligation to disclose or abstain, it thus is necessary to determine whether the insider's 'tip' constituted a breach of the insider's fiduciary duty."[75]

But there are problems with treating evidence of a personal benefit as synonymous with a breach of a fiduciary duty and therefore a deceptive act. First, there is the doctrinal issue raised in *Santa Fe Industries, Inc. v. Green*[76] that even if a personal benefit were synonymous with a fiduciary

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70. *Merrill Lynch*, 43 S.E.C. at 935 ("The advance disclosure of such information to a select group who could utilize it for their own benefit, and to the detriment of public investors to whom the information was not known, constituted an act, practice, or course of business which operated or would operate as a fraud or deceit upon such investors.").

71. 445 U.S. 222 (1980).

72. *Id.* at 228. One could argue that the *Chiarella* opinion did not need to mention the existence of a personal benefit, since it was a self-evident feature of the insider trading involved in that case.

73. *Dirks*, 463 U.S. at 663 (alterations in original) (citation omitted) (quoting Aaron v. SEC, 446 U.S. 680, 686 (1980)).

74. *Id.* at 659 (alteration in original) (quoting *Chiarella*, 445 U.S. at 230 n.12). Similarly, the Court in *Dirks* observes that "a tippee assumes a fiduciary duty to the shareholder of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee." *Id.* at 660.

75. *Id.* at 661.

76. 430 U.S. 462 (1977).

duty breach, it is not necessarily true that every fiduciary duty breach involves the type of deception that is prohibited by the federal securities statutes.[77] Presumably, the implicit argument is that a personal benefit reveals a breach of the duty of loyalty, and that a breach of the duty of loyalty involves "feigned fidelity" and an act of deception.[78] But, as Professor Stephen Bainbridge nicely observes, "The question thus arises as to which of the various duties to which corporate insiders are subject is the relevant one in this context. Unfortunately, the Supreme Court once again was not very precise on this score."[79]

Perhaps some legitimate basis can be developed for defining when a fiduciary breach is deceptive, but there will likely remain some mismatch between these criteria and a personal benefit test. As Professor Donald Langevoort observes, "If there is one thing clear about the common law of fiduciary responsibility, it is that 'intent to benefit' is not an essential element of a case against the fiduciary."[80]

Differences between a personal benefit and a fiduciary duty breach were already clear when *Dirks* was decided. Justice Harry Blackmun in his dissent in *Dirks* highlights this point with an example from *Mosser v. Darrow*,[81] a case also cited by the majority in *Dirks*.[82] Blackmun observes that in *Mosser* the Court did not require a showing of a personal benefit received by a fiduciary (nor was there evidence of such a benefit), and yet the Court still reached the conclusion that there was not only a breach

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77. *Id.* at 474–76.

78. This link between a personal benefit test and a duty of loyalty is one of the explanations Langevoort provides for the Court's adoption of the personal benefit test in *Dirks*:

> Tipping occurs when an insider passes on information which he knows is material and nonpublic to an outsider, in violation of a fiduciary duty to the issuer. . . . *But by superimposing* the *personal benefit requirement*, the Dirks Court seemingly limited the class of breaches that bring into play the abstain or disclose requirement to those that are essentially breaches of the "duty of loyalty" . . . rather than the "duty of care."

18 LANGEVOORT, *supra* note 5, § 4:6.

Nagy also endorses making the link between a breach of the duty of loyalty and the deceptive conduct involved in making a selective disclosure explicit, writing: "The *Salman* Court now has the opportunity to advance the law even further by holding explicitly that breaches of loyalty in connection with securities trading trigger for tippers a Rule 10b-5 disclosure obligation . . . ." Nagy, *Beyond* Dirks, *supra* note 5, at 51.

79. STEPHEN M. BAINBRIDGE, INSIDER TRADING LAW AND POLICY 50–51 (2014). For example, the common law rule that silence by a fiduciary is a deceptive act does not require evidence of a personal benefit to reach the conclusion that such silence is deceptive. *See Chiarella*, 445 U.S. at 228.

80. 18 LANGEVOORT, *supra* note 5, § 4:5.

81. 341 U.S. 267 (1951).

82. Dirks v. SEC, 463 U.S. 646, 659 (1983).

of a fiduciary duty, but specifically a breach of the duty of loyalty.[83]

There are four different justifications the Supreme Court offered when it held in *Dirks* that a selective disclosure by an insider will only trigger insider trading liability if "the insider personally will benefit, directly or indirectly, from his disclosure."[84] These four distinct justifications match somewhat imperfectly with the statutory prohibition against deceptive conduct, the personal benefit test enunciated in *Dirks*, and even with each other.

B. Newman, Salman, *and* Martoma

Unbundling the *Dirks* opinion's justifications for requiring evidence of a personal benefit to find tipper wrongdoing does much to explain differences between the Second Circuit's application of the personal benefit test in *United States v. Newman*[85] and the Ninth Circuit's application of the same test in *Salman*.[86] Understanding the competing justifications for adopting the personal benefit test in *Dirks* also illuminates the reasons for the sharp disagreement between the majority and dissent in *United States v. Martoma*[87] in determining whether *Salman* justified reconsidering the *Newman* precedent. These various differences arise in large part from an unstated disagreement about which of the four justifications offered in *Dirks* for adopting the personal benefit test should be paramount.[88] In its brief affirmation of the *Salman* decision, the Supreme Court did nothing to resolve the tensions between these four rationales for adopting the personal benefit test.[89]

The *Newman* case involved situations in which an inside source passed along selectively disclosed information through several intermediaries until the defendants, Anthony Chiasson and Todd Newman, used the information to trade for a profit.[90] In reversing the convictions in *Newman*, the Second Circuit held that to convict a tippee there must be evidence of "a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain [to the tipper] of a pecuniary or similarly valuable

83. *Id.* at 675.

84. *Id.* at 662.

85. 773 F.3d 438, 442, 448 (2d Cir. 2014).

86. United States v. Salman, 792 F.3d 1087, 1092 (9th Cir. 2015).

87. 869 F.3d 58 (2d Cir. 2017).

88. *But see* John C. Coffee, Jr., *News from California: The 9th Circuit and the SEC Challenge New York*, CLS BLUE SKY BLOG (July 20, 2015), http://clsbluesky.law.columbia.edu/2015/07/20/news-from-california-the-9th-circuit-and-the-sec-challenge-new-york/ ("In my humble judgment, most (but possibly not all) Second Circuit panels would have reached the same outcome as did the Ninth Circuit in *Salman* . . . .").

89. Salman v. United States, 137 S. Ct. 420 (2016). The opinion is only seven pages long.

90. *Newman*, 773 F.3d at 443.

nature."[91] Only under these circumstances, according to the *Newman* panel, can a selective disclosure be equivalent to "trading by the insider himself followed by a gift of the profits to the recipient."[92] The Second Circuit opinion in *Newman* relies primarily on the role the personal benefit test can play in providing objective criteria for determining when a selective disclosure is wrongful.[93]

The *Newman* court, in its effort to ensure that judges and prosecutors can rely on objective criteria, is unwilling to accept an interpretation of the personal benefit test that edges away from a focus on objective evidence.[94] In a recent article, Pritchard argues that the interpretation of the personal benefit test by the *Newman* panel correctly interprets the *Dirks* personal benefit test.[95] But Pritchard's reading of the *Dirks* precedent may be unduly influenced by his familiarity with the judicial history surrounding the inclusion of the personal benefit test in *Dirks*. As Pritchard first uncovered, the personal benefit test was included in the final drafts of the *Dirks* opinion to address Justice O'Connor's concern about the lack of objective criteria for determining when a selective disclosure is wrongful.[96] But, as discussed above, the evidence in its entirety does not support the conclusion that establishing objective criteria was the sole reason for the adoption of the personal benefit

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91. *Id.* at 452.

92. *Id.* (quoting Dirks v. SEC, 463 U.S. 646, 664 (1983)).

93. This focus on the objective criteria justification is evident from the sections of the *Dirks* opinion that the Second Circuit opinion in *Newman* chooses to cite. *See, e.g.*, *Newman*, 773 F.3d at 450 ("But a breach of the duty of confidentiality is not fraudulent unless the tipper acts for personal benefit, that is to say, there is no breach unless the tipper 'is in effect selling the information to its recipient for cash, reciprocal information, or other things of value for himself . . . .'" (quoting *Dirks*, 463 U.S. at 664)).

Conversely, the Second Circuit opinion in *Newman* does not cite the language in the *Dirks* opinion characterizing the personal benefit test in ways more influenced by alternative justifications, such as the statement that wrongful selective disclosure occurs when an insider makes a "gift of confidential information to a trading relative or friend." *Dirks*, 463 U.S. at 664.

94. *Newman*, 773 F.3d at 451–53.

95. Pritchard on *Dirks*, *supra* note 5, at 874 ("*Newman*'s interpretation of personal benefit is consistent with, if not compelled by, Powell's purpose in *Dirks*."); *see also* Stephen Bainbridge, US v. Newman*: A Big Win for Coherence and Fairness in Insider Trading Law*, PROFESSORBAINBRIDGE.COM (Dec. 11, 2014, 12:49 PM), http://www.professorbainbridge.com/professorbainbridgecom/2014/12/us-v-newman-a-big-win-for-coherence-and-fairness-in-insider-trading-law.html ("Yesterday, the Second Circuit did the right thing and reversed the convictions . . . ."); Coffee, *supra* note 87 ("Understandably, the Second Circuit found this professional courtesy to be insufficient to amount to the requisite 'personal benefit.'"). *But see* Nagy, *Beyond* Dirks, *supra* note 5, at 6 ("My own views coincide with those of scholars including Professors Michael Perino, Jay Brown, and James Cox, who each regard *Newman* as a blatant misapplication of *Dirks* . . . ." (footnotes omitted)).

96. *See supra* notes 31–34 and accompanying text.

requirement.[97]

In the *Salman* case, investment banker Maher Kara repeatedly passed confidential information garnered through his position at Citigroup to his brother, Michael Kara, who, in turn, passed the information along to Bassam Salman, who traded using this information.[98] The Ninth Circuit *Salman* opinion emphasizes the statement in *Dirks* that the "exploitation of nonpublic information also exist[s] when an insider makes a gift of confidential information to a trading relative or friend."[99] For the Ninth Circuit in *Salman*, therefore, it is a simple matter to conclude that passing information from one brother to another created a personal benefit for the tipper, in this case Maher, even without evidence of "a potential gain of a pecuniary or similarly valuable nature."[100] As discussed above, the source of the presumption of a personal benefit when a gift is made to a "trading friend or relative" was concern about using a tip to circumvent the insider trading prohibition.[101]

Thus, it is ambiguity in *Dirks* about *why* to require evidence of a personal benefit—and the differing characterizations throughout the *Dirks* opinion as to what constitutes a personal benefit—that best explains the Circuit split regarding what is needed to establish receipt of a personal benefit.[102] The *Newman* panel focuses on the language in the *Dirks* opinion emphasizing the importance of establishing objective criteria,[103] while the *Salman* panel focuses on language in the *Dirks* opinion preventing tip use to circumvent the insider trading prohibition.[104]

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97. *See supra* Section I.A. For example, it is hard to reconcile the *Newman* panel's statement of the personal benefit test requiring "a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain [to the tipper] of a pecuniary or similarly valuable nature," *Newman*, 773 F.3d at 452, with the statement in *Dirks* that a personal benefit results "when an insider makes a gift of confidential information to a trading relative or friend." *Dirks*, 463 U.S. at 664.

98. United States v. Salman, 792 F.3d 1087, 1088–89 (9th Cir. 2015).

99. *Id.* at 1092 (emphasis omitted) (quoting *Dirks*, 463 U.S. at 664).

100. *Id.* at 1093 (emphasis omitted) (quoting *Newman*, 773 F.3d at 452). The Ninth Circuit *Salman* opinion also notes the holding in *Newman* that evidence of a personal benefit requires finding 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," and concludes that "[t]o the extent *Newman* can be read to go so far, we decline to follow it." *Id.* (emphasis omitted) (quoting *Newman*, 773 F.3d at 452).

101. *See supra* Subsection I.A.3.

102. For a prescient discussion of uncertainty about what might constitute a sufficient personal benefit to trigger liability under *Dirks*, see Donald C. Langevoort, *The Demise of* Dirks*: Shifting Standards for Tipper-Tippee Liability*, INSIGHTS, June 1994, at 23, 24.

103. *See supra* Subsection I.A.1.

104. *See supra* Subsection I.A.3.

In affirming *Salman* and rejecting at least part of *Newman*, the Supreme Court did little to resolve this ambiguity in *Dirks*.[105] The Supreme Court opinion did recognize the anti-circumvention goal of prohibiting gifts to friends or relative, observing that: "In such situations, the tipper benefits personally because giving a gift of trading information is the same thing as trading by the tipper followed by a gift of the proceeds."[106] But the larger tensions inherent in the personal benefit test were entirely ignored. This unwillingness in the Supreme Court's *Salman* opinion to address doctrinal confusion regarding the link between selective disclosure and the insider trading prohibition is problematic given how much has changed in the regulation of selective disclosure and insider trading since *Dirks* was decided.

The *Martoma* case involved an appeal from an insider trading conviction entered in September 2014.[107] In the original case the defendant, Mathew Martoma, was convicted based on a claim that he was a tippee who knew that the tipper, Dr. Sidney Gilman, from whom he received material nonpublic information, received a personal benefit in exchange for providing the information. Martoma's appeal of that conviction was initially based on the holding in *Newman* and then was reheard to address the Supreme Court subsequent decision in *Salman*.

The majority in *Martoma* upheld the original insider trading conviction. In doing so, the majority held "that *Salman* fundamentally altered the analysis underlying *Newman*'s 'meaningfully close personal relationship' requirement such that the 'meaningfully close personal relationship' requirement is no longer good law."[108] To reach this conclusion, the majority in *Martoma* repeatedly noted and observed that the *Salman* opinion specifically mentioned the extent which "making a gift of insider information to a relative . . . is little different from trading on the information, obtaining the profits, and doling them out."[109] The *Martoma* court's rejection of *Newman* was almost exclusively based on its acceptance of preventing circumvention as the primary and seemingly exclusive goal of the personal benefit test in *Dirks*.[110]

105. In the *Salman* opinion, the Supreme Court specifically rejects the *Newman* panel's statement of the personal benefit test as requiring "a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain [to the tipper] of a pecuniary or similarly valuable nature." Salman v. United States, 137 S. Ct. 420, 428 (2016) (quoting United States v. Newman, 773 F. 3d 438, 452 (2d Cir. 2014)).

106. *Salman*, 137 S. Ct. at 428.

107. United States v. Martoma, 869 F.3d 58, 61 (2d Cir. 2017).

108. *Id.* at 69.

109. *Id.* at 69 (quoting *Salman*, 137 S. Ct. at 428).

110. *See supra* Subsection I.A.3. for a discussion of the goal of preventing circumvention of the insider trading prohibition as a justification for the *Dirks*' personal benefit test.

On the other hand, the dissent in *Martoma* emphasizes other justifications that appear in *Dirks* for adopting a personal benefit test, and in doing so reaches the opposite conclusion about whether the *Newman* precedent should be reversed based on the holding in *Salman*. The dissent in *Martoma* emphasizes the role that the personal benefit test plays in providing objective facts to determine whether the selective disclosure was wrongful.[111] The dissenting opinion observes that "[w]ithout the personal benefit rule, many insider-trading cases would require the government to show few objective facts,"[112] and concludes that the *Newman* restatement of the *Dirks* personal benefit test was an appropriate way to achieve the underlying objective of keeping the focus on objective facts.

Confusion in the *Dirks* opinion about why to require evidence of a personal benefit thus continues to feed disagreement and uncertainty about how to determine when a selective disclosure is sufficiently wrongful to trigger insider trading liability.

II. CHANGES SINCE *DIRKS*

Two developments in particular have fundamentally altered the relationship between selective disclosure and the prohibition against insider trading since *Dirks* was decided in 1983. First, with the enactment of Regulation FD by the SEC in 2000, selective disclosure by public companies moved from being a practice largely shaped by federal common law to being a practice controlled by administrative rulemaking.[113] Second, the acceptance by the Court of the misappropriation theory of insider trading in *United States v. O'Hagan* appropriately expanded the types of conduct that might trigger insider trading liability to include not only deceptive practices in impersonal trading markets, but also conduct that deceives the source from which material nonpublic information is misappropriated.[114] These developments are discussed in further detail below.

A. *Enactment of Regulation FD*

With the enactment of Regulation FD in 2000 the SEC put in place disclosure requirements that regulated the selective disclosure practices of public companies.[115] The essence of Regulation FD is the requirement

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111. *See supra* Subsection I.A.1. for a discussion of the goal of establishing objective criteria in the *Dirks*' personal benefit test.

112. *Martoma*, 869 F.3d at 76 (Pooler, J., dissenting).

113. SEC Regulation FD, 17 C.F.R. § 243.100 (2014).

114. United States v. O'Hagan, 521 U.S. 642, 650 (1997).

115. 17 C.F.R. § 243.100. For an overview of Regulation FD, see Jill Fisch, *Regulation FD: An Alternative Approach to Addressing Information Asymmetry*, *in* RESEARCH HANDBOOK ON

that:

> [w]henever [a public company], or any person acting on its behalf, discloses any material nonpublic information regarding that [company] or its securities to any person [who is a market professional or might buy or sell company shares], the [company] shall make public disclosure of that information [that is reasonably designed to provide broad, non-exclusionary distribution of the information to the public] . . . .[116]

Several considerations informed the SEC decision to engage in this new mode of disclosure regulation. First, the declining cost of information dissemination made it possible for public companies to regularly disclose information simultaneously to as wide an audience as desired.[117] Second, the SEC viewed the selective disclosure of material nonpublic information as inconsistent with ordinary investors' concept of what constituted fair play in securities markets.[118] As the introductory paragraph of Regulation FD's Proposing Release stated, the "proposals are designed to promote the full and fair disclosure of information by issuers."[119] The Proposing Release goes on to explain that "we do not believe that allowing issuers to disclose material information selectively to analysts is in the best interests of investors or the securities markets generally. Instead, to the maximum extent practicable, we believe that all investors should have access to an issuer's material disclosures at the same time."[120]

In regulating the selective disclosure of material nonpublic information with Regulation FD, the SEC limited the scope of the prohibition against selective disclosure in several ways to minimize unwelcome side effects. First, the rule recognized the possibility of an inadvertent selective disclosure of material nonpublic information, and

INSIDER TRADING 112, 112–14 (Stephen M. Bainbridge ed., 2013). For recent articles questioning the optimality of Regulation FD, see Epstein, *supra* note 11, at 1507; Kevin S. Haeberle & M. Todd Henderson, *Information-Dissemination Law: The Regulation of How Market-Moving Information Is Revealed*, 101 CORNELL L. REV. 1373, 1385–86 (2016); Joseph A. Grundfest, *Regulation FD in the Age of Facebook and Twitter: Should the SEC Sue Netflix?* 7 (Rock Ctr. for Corp. Governance, Working Paper No. 131, 2013), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2209525.

116. 17 C.F.R. § 243.100(a).

117. Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,593 (proposed Dec. 28, 1999) (to be codified at 17 C.F.R. §§ 243.100–.103).

118. *Id.* at 72,592.

119. *Id.* at 72,590.

120. *Id.* at 72,591.

included a provision that explained how to respond if this happened.[121] Second, the SEC included a provision that prevented investors from bringing a private right of action against a public company for that company's failure to comply with Regulation FD.[122] Third, Regulation FD only applies its prohibition to senior officials of the firm or others in the firm who regularly communicate with outside investors, and only prohibits making selective disclosures to those who are likely to use the information for securities trading.[123] Finally, Regulation FD excludes from its coverage insiders who selectively disclose material nonpublic information "in breach of a duty of trust or confidence to the issuer," presumably so that issuers do not face liability for violations carried out by rouge employees.[124]

Bringing the enactment of Regulation FD in to a discussion about insider trading jurisprudence can lead to an objection that the SEC designed Regulation FD to avoid influencing determinations about what constitutes insider trading.[125] This objection usually stems from Rule 102 of Regulation FD, which states that "[n]o failure to make a public disclosure required solely by [Regulation FD] shall be deemed to be a violation of Rule 10b-5 . . . under the Securities Exchange Act."[126] Pritchard, for example, writes in reference to this Rule 102 of Regulation FD that: "Notably, Regulation FD was adopted by the SEC pursuant to its authority to regulate disclosures by public companies. The rule specifically disclaims defining selective disclosure as fraudulent. This is by necessity; under *Dirks*' personal benefit standard, simple breaches of confidentiality are not deceptive."[127]

But a careful review of the details of Section 102 of Regulation FD shows that it is a mistake to conclude that Regulation FD was designed to be kept separate from insider trading jurisprudence. It is more likely that Section 102 was included to insulate public companies from

121. 17 C.F.R. 243.100(a)(2) ("Promptly, in the case of a non-intentional disclosure."); SEC Regulation FD, 17 C.F.R. § 243.101(d) (2014) (defining the word "promptly" in the context of this rule).

122. SEC Regulation FD, 17 C.F.R. § 243.102 (2014). For further discussion of this provision, see *infra* notes 125–21 and accompanying text.

123. *See* 17 C.F.R. §§ 243.100(b)(1), 243.101(c).

124. 17 C.F.R. § 243.101(c).

125. Some courts may implicitly accept this argument. *See generally* United States v. Newman, 773 F.3d 438 (2d Cir. 2014) (an insider trading case decided after Regulation FD was adopted that never mentions Regulation FD).

126. 17 C.F.R. § 243.102.

127. Pritchard on *Dirks*, *supra* note 5, at 870 (footnote omitted); *see also* Epstein, *supra* note 11, at 1511 ("Regulation FD flies in the face of *Dirks*, which stated the exact opposite conclusion with respect to communications between analysts and insiders."); Nagy, *Beyond* Dirks, *supra* note 5, at 40 n.304 (discussing Larry E. Ribstein and other authors' concerns about Regulation FD as an unwarranted intrusion into insider trading regulation).

shareholders who might want to bring private rights of action based on Regulation FD violations.

Some statements in the Proposing Release of Regulation FD do suggest that the SEC intended the effects of Regulation FD to be excluded when considering issues related to insider trading liability. For example, the Proposing Release states that:

> The approach we propose does not treat selective disclosure as a type of fraudulent conduct or revisit the insider trading issues addressed in *Dirks*. Rather, we propose to use our authority to require full and fair disclosure from issuers, primarily under Section 13(a) of the Exchange Act, as a basis for proposed Regulation FD.[128]

However, there are direct statements in both the Proposing Release and the Final Rule Release explaining that Rule 102 was included in Regulation FD solely to prevent public company shareholders from bringing a private right of action based on purported violations of Regulation FD. For example, the Final Rule Release explains that "to remove any doubt that private liability will not result from a Regulation FD violation, we have revised Regulation FD to make absolutely clear that it does not establish a duty for purposes of Rule 10b-5 under the Securities Exchange Act of 1934 ('Exchange Act')."[129]

Similarly, the discussion issued along with the Final Rule Release observes that:

> [W]e are mindful of the concerns about chilling issuer disclosure; we agree that the market is best served by more, not less, disclosure of information by issuers. Because any potential 'chill' is most likely to arise—if at all—from the

128. Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,594 (Dec. 28, 1999) (codified at 17 C.F.R. pts. 230, 240, 243, 249). In a similar vein: "In addition, Regulation FD does not affect or undermine any existing bases of liability under Rule 10b-5. Thus, for example, liability for 'tipping' under Rule 10b-5 may still exist if a selective disclosure is made in circumstances that meet the *Dirks* 'personal benefit' test." *Id.* at 72,598.

129. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,718 (Aug. 24, 2000) (codified at 17 C.F.R. pts. 240, 243, 249).

> Regulation FD is an issuer disclosure rule that is designed to create duties only under Sections 13(a) and 15(d) of the Exchange Act and Section 30 of the Investment Company Act. It is not an antifraud rule, and unlike other Section 13(a) and 15(d) reporting requirements, it is not intended to create duties under Section 10(b) of the Exchange Act or any other provision of the federal securities laws. *As a result, no private liability will arise from an issuer's failure to file or make public disclosure.*

Selective Disclosure and Insider Trading, 64 Fed. Reg. at 72,598 (emphasis added).

> fear of legal liability, we included in proposed Regulation FD significant safeguards against inappropriate liability.[130]

The exclusive goal of eliminating a private right of action for violations of Regulation FD is also consistent with the actual text of Rule 102. Rule 102 only mentions Rule 10b-5, not Section 10(b) of the Exchange Act.[131] Rule 10b-5 is the rule under which federal courts have established the private right of action under federal securities statutes, whereas Section 10(b) (which is not excluded by Rule 102) provides the basis for the prosecution of a deceptive or manipulative practice in violation of federal securities rules or regulations generally.[132]

The enactment of Regulation FD has had a wide-ranging impact on public company practices and policies with respect to the selective disclosure of material nonpublic information. Professor Jill Fisch, in a recent discussion of the research on the effects of Regulation FD, reports that: "There is substantial evidence that Regulation FD reduced selective disclosure and information asymmetries."[133] Regulation FD has also affected employee policies at public companies. Virtually all public companies now have employee policies that prohibit any unauthorized selective disclosure of material nonpublic information.[134] The adoption of a prohibition against any kind of employee selective disclosure also appears to have spread to firms that advise or work with public firms.[135]

B. United States v. O'Hagan

The 1997 Supreme Court decision in *United States v. O'Hagan*[136] is the second development since *Dirks* that has fundamentally altered the

130. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,718.

131. SEC Regulation FD, 17 C.F.R. § 243.102 (2014) ("No failure to make a public disclosure required solely by § 243.100 shall be deemed to be a violation of Rule 10b-5 . . . under the Securities Exchange Act.").

132. For a discussion of Section 10(b) and its relationship to Rule 10b-5, see generally Steve Thel, *Taking Section 10(b) Seriously: Criminal Enforcement of SEC Rules*, 2014 COLUM. BUS. L. REV. 1 ("Rule 10b-5 does not implement section 10(b); section 10(b) implements Rule 10b-5.").

133. Fisch, *supra* note 115, at 125 (footnote omitted).

134. At least for Delaware corporations and other jurisdictions that follow the *In re Caremark International Inc. Derivative Litigation* precedent, failure to put in place a system to ensure compliance with Regulation FD would constitute a breach of director fiduciary duty. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 969 (Del. Ch. 1996). In the Proposing Release, the SEC stated: "[W]e expect that most issuers will consider implementing appropriate disclosure policies to guard against selective disclosure." Selective Disclosure and Insider Trading, 64 Fed. Reg. at 72,598 n.57; *see also* Nagy, *Beyond* Dirks, *supra* note 5, at 40 ("Moreover, virtually all publicly traded companies now have stringent policies and procedures in place to guard against Regulation FD violations.").

135. *See* Epstein, *supra* note 11, at 1497.

136. 521 U.S. 642 (1997).

landscape for determining when a selective disclosure is wrongful. *O'Hagan* involved a lawyer, James Herman O'Hagan, who used material nonpublic information about an upcoming tender offer to trade for a profit in Pillsbury Company securities.[137] O'Hagan did not gain access to information about the upcoming tender offer because he was an insider of Pillsbury.[138] Rather, O'Hagan received the information about the tender offer from the law firm he worked at, Dorsey & Whitney, which represented Grand Metropolitan PLC ("Grand Met"), the company that initiated the tender offer for Pillsbury.[139]

The Supreme Court in *O'Hagan* held that "criminal liability under § 10(b) may be predicated on the misappropriation theory."[140] "The 'misappropriation theory' holds that a person commits fraud 'in connection with' a securities transaction, and thereby violates § 10(b) and Rule 10b-5, when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information."[141]

The misappropriation theory represents an important extension of the prohibition against insider trading. Prior to the decision in *O'Hagan*, the only locus for deception that the Supreme Court had affirmed could lead to an insider trading violation were transactions involving the actual purchase or sale of securities.[142] Because these transactions typically occur on impersonal securities markets, there is unlikely to be communication between the person possessing the material nonpublic information and the person who is on the other side of the transaction. As a result, prior to *O'Hagan*, the only type of deceptive conduct that could trigger insider trading liability on a public securities exchange was silence.

With *O'Hagan*, the Court recognized a second locus for deception that could lead to insider trading liability, namely dealings between the misappropriator and the source of the information.[143] The types of deceptive conduct that a misappropriator might engage in when taking information from the source are far more numerous than the silence that constitutes the only type of deception that can take place on an impersonal securities market.[144] As but one simple example, the misappropriator

137. *Id.* at 647.

138. *Id.*

139. *Id.*

140. *Id.* at 650.

141. *Id.* at 652.

142. *See, e.g.*, Dirks v. SEC, 463 U.S. 646, 650–51 (1983).

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

144. Professor Gregory Klass recently observed the importance of distinguishing different ways in which deception might be carried out. Gregory Klass, *Meaning, Purpose, and Cause in the Law of Deception*, 100 GEO. L.J. 449 (2012). Of particular interest is the contrast Klass draws

might make an affirmative misrepresentation in order to gain access to a company's material nonpublic information.

Three additional aspects of the *O'Hagan* decision are noteworthy when evaluating how the holding in this case compels an updating of our understanding of the relationship between selective disclosure and insider trading. First, the Court in *O'Hagan* is unwavering in its conclusion that the "in connection with" language in the statute does not require that the deceptive conduct occur only when and where securities are traded.[145] The opinion observes, for example, that "[t]he statute thus proscribes (1) using any deceptive device (2) in connection with the purchase or sale of securities, in contravention of rules prescribed by the Commission. The provision, as written, does not confine its coverage to deception of a purchaser or seller of securities."[146]

Second, the *O'Hagan* opinion does not directly address how the misappropriation theory might alter the determination of when a selective disclosure should trigger insider trading liability. There is no discussion in *O'Hagan*, for example, of how to evaluate a chain of events where there is first a misappropriation of material nonpublic information, and then a selective disclosure of that misappropriated information, and finally a trade based upon that selective disclosure. After *O'Hagan*, an open question therefore remains as to whether or how the "in connection with" language would apply to a scenario combining misappropriation and tipping. Lower courts are split on how to evaluate this chain of events.[147] The Supreme Court in *Salman* explicitly declined to address

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between deception by action and deception by silence. According to Klass the test for a deceptive act carried out by action is relatively simple, whereas the test that needs to be applied when a deception is carried out by inaction is necessarily a more nuanced test. Klass observes that "there is a deep error in the common law tendency to conflate fraud by misrepresentation, fraud by concealment, and fraud by nondisclosure, which in fact involve different regulatory approaches and therefore require attention to different aspects of a transaction." *Id.* at 450.

145. *Id.* at 656.

146. *Id.* at 651.

147. The majority view expressed, for example, in *United States v. Newman*, appears to be that the personal benefit test is an added element to find wrongdoing if the person who misappropriated the information did not trade on the information directly but instead chose to selectively disclose the misappropriated information. *Compare* United States v. Newman, 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 SEC v. Obus, 693 F. 3d 276, 285–86 (2d Cir. 2012))), *and* SEC v. Yun, 327 F.3d 1263, 1274–80 (11th Cir. 2003) (applying the personal benefit test to misappropriating tipper), *with* SEC v. Musella, 748 F. Supp. 1028, 1038 n.4 (S.D.N.Y. 1989) ("The misappropriation theory of liability does not require a showing of a benefit to the tipper . . . ."), *and* United States v. Whitman, 904 F. Supp. 2d 363, 370 (S.D.N.Y. 2012) ("Thus, the tippee's knowledge that disclosure of the insider information was unauthorized is sufficient for liability in a misappropriation case.").

this issue.[148]

Third, the *O'Hagan* opinion does not consider whether the only type of deceptive conduct that could trigger misappropriation insider trading liability is the breach of a fiduciary duty.[149] This ambiguity in *O'Hagan*

There are reasonable arguments on both sides of this divide. For example, some argue that to exclude the personal benefit test requirement in misappropriation insider trading cases would allow prosecutors to avoid the personal benefit test altogether by always charging classical insider trading cases as misappropriation cases instead. *See, e.g.*, 18 LANGEVOORT, *supra* note 5, § 6:13 ("To allow a prosecutor or plaintiff to avoid the impact of the personal benefit approach simply by pleading the misappropriation theory would in effect operate to overrule the *Dirks* decision, a questionable step absent legislative reform.").

Others argue that selective disclosures involving the misappropriation theory should be evaluated differently, because the elements necessary to determine if a misappropriation has occurred are different from those required to determine if classical insider trading has occurred. *See, e.g.*, United States v. Libera, 989 F.2d 596, 600 (2d Cir. 1993); SEC v. Materia, 745 F.2d 197, 202 (2d Cir. 1984). As the Department of Justice observed:

> The distinct duties underlying the classical and misappropriation theories give rise to different types of breaches of those duties . . . .
>
> . . . A misappropriation case requires no showing of a personal benefit to the tipper, because the breach is inherent in the tipper's theft of confidential information. The theft alone, in violation of the source of information's property right to the information, is a breach of the person's duty to the source of the information.

Plaintiff SEC's Opposition to Defendants' Motion to Dismiss at 4, SEC v. Payton, 97 F. Supp. 3d 558 (S.D.N.Y. 2015) (No. 14-CV-04644-JSR), 2015 WL 3799400; *see also* Merritt B. Fox & George Tepe, *Insider Trading: Personal Benefit Has No Place in Misappropriation Tipping Cases*, CLS BLUE SKY BLOG (July 25, 2017), http://clsbluesky.law.columbia.edu/ 2017/07/25/ insider-trading-personal-benefit-has-no-place-in-misappropriation-tipping-cases/.

A straightforward reading of *Dirks* will not resolve this dispute. The sentence that best summarizes its test for tipper/tippee liability reads:

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

Dirks v. SEC, 463 U.S. 646, 660 (1983). This statement assumes that there is only one reason selective disclosure by an insider can lead to an insider trading violation: a breach of a "fiduciary duty to the shareholder." *Id.* Therefore, *Dirks* is silent as to whether to apply the personal benefit test when the relevant breach of fiduciary duty is owed to a party other than the firm's shareholders.

148. 137 S. Ct. 420, 425 n.2 (2016).

149. *O'Hagan* refers to the crucial test as involving whether there was deception as often as it refers to the crucial test as involving whether there was a breach of a fiduciary duty. *Compare O'Hagan*, 521 U.S. at 656 ("A misappropriator who trades on the basis of material, nonpublic information, in short, gains his advantageous market position through deception . . . ."), *with id.*

is not surprising: the Court was addressing a situation where the misappropriator's deceptive conduct involved a breach of a fiduciary duty, so a discussion about other types of deceptive conduct was not germane to the decision.[150]

The question left open by *O'Hagan*, whether only a breach of a fiduciary duty or some other types of deceptive conduct as well might constitute misappropriation, is the converse of the issue the Court addressed in *Santa Fe Industries, Inc., v. Green*.[151] In *Santa Fe* the Court held that as long as an investor's "choice was fairly presented, and [investors] were furnished with all relevant information on which to base their decision," then a fiduciary duty breach would not involve the type of deceptive conduct necessary to trigger Section 10(b) liability.[152] The question here is not whether there can be a fiduciary duty breach without deception (the issue in *Santa Fe*), but whether there can be deception without a fiduciary duty breach.

The possibility of a situation where there is misappropriation and deception but no fiduciary breach is not just a theoretical curiosity. *SEC v. Dorozhko*[153] raised precisely this issue. In that case, a computer hacker, Oleksandr Dorozhko, allegedly hacked into the computers of Thomson Financial, Inc. to access material nonpublic information about a forthcoming earnings announcement from IMS Health, Inc., a public company.[154] Dorozhko, a resident of Ukraine, had no fiduciary relationship with either Thomson Financial or IMS Health.[155] Dorozhko, therefore, could not have breached a fiduciary duty either to the source from which he misappropriated the information or to the company the information was about.[156] Yet he still might have gained access to information about the forthcoming IMS Health earnings report through deceptive conduct, depending on the details of how he hacked into the Thomson Financial computers.[157]

In *Dorozhko*, the Second Circuit held that Dorozhko's deceptive conduct could trigger insider trading liability under the misappropriation

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at 652 ("[T]he misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information.").

150. *Id.* at 647. For that matter, nor would a discussion of tipper liability be relevant to the particular facts of *O'Hagan*, where there was no tipping involved.

151. 430 U.S. 462, 473–75 (1977).

152. *Id.* at 474.

153. 574 F.3d 42 (2d Cir. 2009).

154. *Id.* at 44.

155. *Id.* at 44–45.

156. *Id.* at 45.

157. *Id.* at 44 (providing that "an anonymous computer hacker attempted to gain access to the IMS earnings report by hacking into a secure server at Thomson prior to the report's official release").

theory, even though he did not have a fiduciary relationship with the source of the information.[158] The *Dorozhko* court concluded:

> *Chiarella, O'Hagan*, and *Zandford* all stand for the proposition that nondisclosure in breach of a fiduciary duty "satisfies § 10(b)'s requirement . . . [of] a 'deceptive device or contrivance.''' However, what is sufficient is not always what is necessary . . . .
>
> In this case . . . the SEC argues that defendant affirmatively misrepresented himself in order to gain access to material, nonpublic information, which he then used to trade. We are aware of no precedent of the Supreme Court or our Court that forecloses or prohibits the SEC's straightforward theory of fraud. Absent a controlling precedent that ''deceptive'' has a more limited meaning than its ordinary meaning, we see no reason to complicate the enforcement of Section 10(b) by divining new requirements.[159]

Langevoort, for one, agrees with the *Dorozhko* panel's conclusion that deceptive conduct need not involve a breach of a fiduciary duty, writing that:

> If one accepts the court's characterization of hacking, we have real deception here, and do not need to resort to constructive fraud. Rather this poses the opposite question: is there any reason to consider the two fiduciary-based theories exclusive statements of insider trading's scope? The Second Circuit could think of no good reason to, and neither can I.[160]

The *Dorozhko* holding suggests that *O'Hagan* may not limit misappropriation insider trading violations to deceptive conduct arising from a fiduciary duty breach, but *Dorozhko* does not address how this conclusion affects our understanding of the relationship between selective disclosure and insider trading. The important question left unanswered by *Dorozhko* and *O'Hagan* is how to evaluate a selective disclosure when the original misappropriation involves deceptive conduct other than the breach of a fiduciary duty. Suppose, for example, that rather than trade himself Dorozhko had sold the information he misappropriated from Thomson Financial to a third party for that third party to use for securities trading. What role, if any, a personal benefit

158. *Id.* at 51.

159. *Id.* at 49 (alteration in original) (footnote omitted) (citation omitted).

160. Donald C. Langevoort, *"Fine Distinctions" in the Contemporary Law of Insider Trading*, 2013 COLUM. BUS. L. REV. 429, 459.

test would play in this context is unclear.

In 1997, the acceptance of the misappropriation theory of insider trading in *O'Hagan* expanded the types of deceptive conduct that could trigger insider trading liability to include deceiving the source of that information. In 2000, the enactment of Regulation FD moved the regulation of selective disclosure from federal courts to the SEC and prohibited public firms from selectively disclosing material nonpublic information to Wall Street analysts.[161] For the reasons detailed below, both of these developments have fundamentally altered the calculus of how to determine when a selective disclosure should trigger insider trading liability.

III. THE DEMISE OF THE PERSONAL BENEFIT TEST

After the enactment of Regulation FD and the *O'Hagan* decision, it is logical to ask to what extent the various justifications the Court relied on for adopting the personal benefit test in *Dirks* continue to support requiring evidence of a personal benefit to find that a selective disclosure is sufficiently wrongful to trigger insider trading liability.

A. *Justifications for the Personal Benefit Test Reconsidered*

The four justifications that appear in *Dirks* for adopting the personal benefit test are: (1) establishing objective criteria, (2) insulating legitimate corporate communications from liability, (3) preventing circumvention of the insider trading prohibition, and (4) identifying when a sufficiently serious fiduciary duty breach has occurred.[162]

In light of the enactment of Regulation FD and the *O'Hagan* decision, these justifications no longer provide support for making evidence of a personal benefit a necessary requirement for proving tipper wrongdoing. First, if the goal of the personal benefit test is to provide objective criteria, then the more reliable approach in today's securities markets would be to adopt a rebuttable presumption that repeated selective access to material nonpublic information indicates that deceptive conduct is occurring.[163] Second, federal courts no longer need to create a common law rule to protect legitimate public company selective disclosure practices, because with the advent of Regulation FD such disclosures are now prohibited.[164]

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161. *See supra* Section II.A.

162. *See supra* Section I.A.

163. *See infra* Subsection III.A.1.

164. *See infra* Subsection III.A.2. For a similar observation, see Nagy, *Beyond* Dirks, *supra* note 5, at 42 ("Regulation FD leaves corporate insiders, particularly those in investor relations or finance departments, with little room for a credible claim that selective disclosures about earnings information were prompted by a mistaken belief about whether it 'already has been disclosed or

Third, if the goal of the personal benefit test is to prevent people from using selective disclosures to circumvent the prohibition against insider trading, then the common law rule prohibiting any sharing of chattel or land that belongs to another is the more appropriate model to follow.[165] Finally, evidence of deceptive conduct no longer needs to hinge exclusively on whether someone receives a personal benefit.[166] For these reasons, as detailed below, after the enactment of Regulation FD and the *O'Hagan* decision, it no longer makes sense to try to shoehorn the various rationales offered in *Dirks* for prohibiting some types of selective disclosures into a personal benefit test.

1. Objective Criteria

One justification offered in *Dirks* for requiring evidence of a personal benefit is that such a test allows judges and prosecutors to focus on objective criteria.[167] This objective criteria justification remains the most plausible reason for continuing to require evidence of a personal benefit, despite the changes highlighted above since the 1983 *Dirks* decision.

There are, however, countervailing considerations that suggest, particularly after the enactment of Regulation FD and the *O'Hagan* decision, that there are now better ways to establish objective criteria of tipper wrongdoing for judges and prosecutors.[168] Courts could adopt a rebuttable presumption that the repeated selective disclosure of material nonpublic information about a public company is evidence that the information is being disclosed deceptively.[169]

Such a presumption would have made little sense in 1983 when *Dirks* was decided, because the repeated selective disclosure of public company material nonpublic information appears to have been a common

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that it is not material enough to affect the market.'" (quoting Dirks v. SEC, 463 U.S. 646, 662 (1983))).

165. *See infra* Subsection III.A.3.

166. *See infra* Subsection III.A.4.

167. *See supra* Subsection I.A.1.

168. Also, it is helpful to note that establishing objective criteria for determining tipper wrongdoing was never the exclusive justification for requiring evidence of a personal benefit. If establishing objective criteria is the only goal, then a rule establishing no liability or strict liability is a simpler solution. The goal of establishing objective criteria is necessarily a second-order consideration when attempting to implement the statutory purpose of prohibiting deceptive conduct.

169. Since only repeated practice may trigger this presumption, it is unlikely to come into play when selective disclosure is not intentional. For the basis of this observation, see Nagy, *Beyond* Dirks, *supra* note 5, at 46.

practice.[170] But it is hard to imagine today circumstances where the repeated selective disclosure of material nonpublic information would be acceptable. In almost all situations, systematic selective disclosure would violate both Regulation FD and company policy.[171] In this new environment, the rebuttable presumption establishes an objective standard that reflects the extent to which the dividing line between what constitutes an acceptable and unacceptable selective disclosure has shifted since *Dirks* was decided in 1983.

Another reason to doubt that a personal benefit test will deliver the objective certainty sought by the *Dirks* Court is the judicial experience in trying to apply the personal benefit test over the last thirty-plus years.[172] This is in part due to the inherently ambiguous nature of determining what does or does not constitute a personal benefit. Applying the personal benefit test, at least as delineated in *Dirks*, raises difficult issues in application that may have been unforeseen in 1983.[173]

Both changed practices and thirty-five years of experience suggest that requiring evidence of a personal benefit is no longer a particularly useful tool for providing judges and prosecutors objective evidence of tipper wrongdoing.

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170. In *Dirks*, for example, the Court noted that it was not only common practice for public companies to selectively disclose information to certain investors, especially Wall Street analysts, but also the SEC welcomed and even encouraged this practice:

> All disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders. In contrast to the extraordinary facts of this case, the more typical situation . . . is when insiders disclose information to analysts. In some situations, the insider will act consistently with his fiduciary duty to shareholders, and yet release of the information may affect the market.

Dirks v. SEC, 463 U.S. 646, 661–62 (1983) (citation omitted).

The *Dirks* opinion goes on to suggest in an example that selective disclosures would, in fact, only be acceptable if they were inadvertent, stating that, "[f]or example, it may not be clear—either to the corporate insider or to the recipient analyst—whether the information will be viewed as material nonpublic information." *Id.* at 662. This example, however, is essentially a non-sequitur. For an article justifying on economic terms the selective disclosure of material nonpublic information to Wall Street analysts, see generally Stephen J. Choi, *Selective Disclosure in the Public Capital Markets*, 35 U.C. DAVIS L. REV. 533, 540 (2002).

171. *See supra* notes 127–28 and accompanying text.

172. For a review of the difficulty courts have had in applying the personal benefit test, see Brief of the NYU Center on the Administration of Criminal Law as Amicus Curiae in Support of Neither Party, *supra* note 40, at 6–13.

173. *But see Dirks*, 463 U.S. at 676 n.13 (Blackmun, J., dissenting) ("The distinction between pure altruism and self-interest has puzzled philosophers for centuries; there is no reason to believe that courts and administrative law judges will have an easier time with it."). It also may be true that unequivocal acceptance of a formulation of the personal benefit test in a manner designed more directly to establish objective criteria, such as one requiring evidence of a pecuniary gain, could minimize some of these difficulties.

2. Policy Concerns

The second *Dirks* justification for requiring evidence of a personal benefit is that such a requirement represented the Court's best effort in 1983 to balance policy considerations.[174] The relevant policy considerations the Court identified in *Dirks* were, on the one hand, allowing the government to prosecute deceptive practices versus, on the other hand, allowing firms to selectively disseminate material nonpublic information to investors without fear of criminal prosecution.[175] But these policy concerns no longer justify requiring evidence of a personal benefit to determine when a selective disclosure constitutes a deceptive practice.

In 1983, when *Dirks* was decided, public firms may have had a legitimate interest in facilitating ongoing selective disclosures to certain market participants.[176] But public companies no longer have a legitimate interest in making these types of selective disclosures because of the enactment of Regulation FD.[177] More generally, after the enactment of Regulation FD, there is less of a need for federal judges to establish common law rules that balance policy interests in the context of the selective disclosure practices of public companies. This is now a practice governed by administrative rule-making.

The personal benefit test may have assisted courts in distinguishing between legitimate and illegitimate selective disclosures, but there is no longer a need for a common law rule protecting this demarcation.

3. Prevent Circumvention

The third justification offered in *Dirks* for requiring evidence of a personal benefit is that this test prevents people from circumventing the prohibition against insider trading by "selling" or "spending" their proprietary access to material nonpublic information to avoid illegally trading on inside information.[178]

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174. *See supra* Subsection I.A.2.

175. *Dirks*, 463 U.S. at 658–59 (recognizing a need for a ban on tippee trading while also noting the "inhibiting influence" such a ban could have on the role of market analysts).

There is an additional policy consideration relevant to a determination of whether a personal benefit test remains a useful common law construct. The Supreme Court in *O'Hagan* expanded the types of policy concerns it considered relevant to the analysis of when to impose insider trading liability. As Nagy points out, in the *O'Hagan* decision, "Justice Ginsburg framed the . . . misappropriation theory to advance the important policy objectives of ensuring 'honest securities markets' and promoting 'investor confidence.'" Nagy, *Beyond* Dirks, *supra* note 5, at 18 (quoting United States v. O'Hagan, 521 U.S. 642, 658 (1997)). This additional policy consideration, Nagy argues, suggests that a broader prohibition against selective disclosure makes sense. *Id.* at 40–41.

176. *Dirks*, 463 U.S. at 658–59.

177. *See supra* Section II.A.

178. *See supra* Subsection I.A.3.

This anti-circumvention goal does not justify limiting liability for selective disclosure to situations in which there is either an exchange for "a pecuniary gain" or "a gift of confidential information to a trading relative or friend."[179] If the goal is to prevent circumventing the prohibition against insider trading, then the appropriate rule should simply prohibit unauthorized selective disclosure of the information.[180]

The common law long ago recognized that an outright prohibition on gifting property that belongs to another without permission is the most efficient way to prevent agents from benefiting indirectly where direct benefits are prohibited. If preventing circumvention is the goal of a ban on selective disclosure, then there is no good reason to reject the common law prohibition on gifting someone else's property.

4. Element of a Fraud or a Fiduciary Breach

A fourth justification offered for the Court's adoption of the personal benefit test in *Dirks* was that only a personal benefit test could properly identify situations where an insider had either acted fraudulently or breached a fiduciary duty when making a selective disclosure.[181] But, as discussed above, common law precedent does not compel this conclusion. The common law does not treat evidence of a personal benefit as a necessary element to conclude that conduct is deceptive or that a fiduciary duty breach has occurred.[182]

This disconnect is even more pronounced in 2017 than it was in 1983. As Professor Donna Nagy has eloquently shown, since the *Dirks* decision, Delaware state courts have expanded the types of conduct that would constitute a breach of the duty of loyalty beyond just transactions that involve self-enrichment.[183] These developments in state fiduciary law mean that the connections between receipt of a personal benefit and the breach of a fiduciary duty, one of the justifications in *Dirks* for introducing a personal benefit test, are even more tenuous than when *Dirks* was decided.

In 1983 the Supreme Court was creating new federal common law in an effort to make subtle and challenging distinctions between legal and illegal selective disclosures by individuals working at public companies. Such distinctions are much easier to make in 2017. Not only does Regulation FD disallow virtually all selective disclosures made to someone who intends to trade based on the disclosed information, but also public companies now have policies that prohibit employees from

179. *Dirks*, 463 U.S. at 658–59; *see supra* text accompanying notes 61–62.
180. *See supra* notes 60–61 and accompanying text.
181. *See supra* Subsection I.A.4.
182. *See supra* text accompanying notes 76–83.
183. Nagy, *Beyond* Dirks, *supra* note 5, at 43–45.

making these kinds of disclosures.[184]

In 2017, one can be fairly certain that the intentional selective disclosure of material nonpublic information violates either Regulation FD, firm policy, or both. The rationales for requiring evidence of a personal benefit test to find that a selective disclosure is wrongful, offered in 1983, point in a new direction in 2017. Evidence of a personal benefit is no longer necessary to safely conclude that tipper wrongdoing has occurred.

B. *Is the Personal Benefit Test Binding Precedent?*

Even if the logic that justified requiring introduction of a personal benefit test in *Dirks* no longer justifies the same conclusion today, there is an alternative justification for continuing to require proof of a personal benefit. That justification comes not from the Court's reasoning about why a personal benefit test made sense, but simply from the fact that this was the holding in *Dirks*. The rule of *stare decisis* could provide a good enough reason for continuing to require proof of a personal benefit, notwithstanding major changes since the *Dirks* case was decided in 1983.[185]

This Section addresses the question of when, if ever, it is appropriate to reconsider a precedent simply because circumstances have changed. For two reasons, *stare decisis* does not apply to the *Dirks* personal benefit test. First, the *Dirks* personal benefit test, as a species of federal common law, is the type of precedent a court needs to reevaluate in the light of changed circumstances.[186] Second, as with much of the insider trading doctrine, the discussion of a personal benefit test in *Dirks* is dicta and not an actual holding in the case.[187] This Section discusses each of these reasons *stare decisis* should not apply to the *Dirks* personal benefit test.

1. *Stare Decisis* and Federal Common Law

Weighing the impact of changes in market practices and regulations since *Dirks* might seem inappropriate, because of the general principle of *stare decisis. Stare decisis* is the principle that "today's Court should

184. *See* Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,598 (Dec. 28, 1999) (codified at 17 C.F.R. pts. 230, 240, 243, 249); *supra* text accompanying notes 127–28.

185. Brief for the United States at 29, Salman v. United States, 137 S. Ct. 420 (2016) (No.15-628) ("Principles of *stare decisis* apply with special force here because Dirks—and its holding that a tipper personally benefits by giving a gift—has been the law for more than 30 years."). This appears to be adding a required element that is not clearly enunciated in either the *Dirks* or *O'Hagan* opinions, but which can logically be inferred from the combination of these two earlier opinions.

186. *See infra* Subsection III.B.1.

187. *See infra* Subsection III.B.2.

stand by yesterday's decisions."[188] But in certain situations, even a court committed to *stare decisis* should take into account changed circumstances. The *Dirks* personal benefit test, which combines statutory interpretation and federal common law, would appear to be such a situation.

On first impression, the *Dirks* decision, because it involves an interpretation of a federal securities statute, might seem entitled to a higher level of deference than other types of precedent. The Supreme Court has held that in cases involving statutory interpretation the Court is more forcefully bound by past precedent than in cases involving common law or constitutional matters.[189] The theory behind granting a higher level of deference to cases involving statutory interpretation is that Congress can step in and override a court's interpretation, if Congress is dissatisfied with the court's reading of the statute.[190] For example, in the Supreme Court decision *Kimble v. Marvel Entertainment, LLC*, the Court relied on this theory and refused to overturn a precedent that interpreted a patent statute, despite strong arguments that the statute was wrongly interpreted.[191]

However, not all cases involving statutory interpretation are shown equal deference by the Court. The Supreme Court also recognizes that in certain areas of statutory interpretation Congress has turned to the federal courts to fill in the interstices of the law necessary to achieve a general purpose established by the statute. In these situations, the Court is acting more as a court of common law, and the Court treats a precedent involving a statutory interpretation in this context as they would a common law precedent, which means that holdings need to be updated as circumstances change.[192]

This exception to the general rule of heightened deference to cases involving statutory interpretation comes into play in the area of antitrust law, for example. Justice Elena Kagan recognized this exception in her majority opinion in *Kimble*, writing: "This Court has viewed *stare decisis* as having less-than-usual force in cases involving the Sherman Act . . . . We have therefore felt relatively free to revise our legal analysis as economic understanding evolves and . . . to reverse antitrust

188. Kimble v. Marvel Entm't, LLC, 135 S. Ct. 2401, 2409 (2015).

189. Amy Coney Barrett, *Statutory Stare Decisis in the Court of Appeals*, 73 GEO. WASH. L. REV. 317, 319 (2005) ("The Supreme Court has accorded heightened deference to its statutory precedent for roughly a century."). *But see generally* William N. Eskridge, Jr., *Overruling Statutory Precedents*, 76 GEO. L. REV. 1361, 1363–64 (1988) (proposing a weakened standard to overrule statutory precedents).

190. *Kimble*, 135 S. Ct. at 2409.

191. *Id.* (citing Burnet v. Coronado Oil & Gas Co., 285 U.S. 393 (1932)).

192. *See* Eskridge, *supra* note 182, at 1364.

precedents that misperceived a practice's competitive consequences."[193]

Insider trading jurisprudence would appear to be similar to antitrust jurisprudence in this respect. Time and again Congress has shown its desire to delegate to the federal courts the task of delineating precisely what kind of behavior constitutes illegal insider trading. For example, when legislation in 1984 and in 1988 increased penalties for insider trading violations, Congress decided not to include provisions that would specify which particular types of conduct constitute illegal insider trading, preferring to continue to defer to the courts to make this determination.[194] Similarly, when the Stock Trading on Congressional Knowledge (STOCK) Act of 2012 restricted insider trading by members of Congress, the final bill included "explicit legislative recognition that the Exchange Act encompasses insider trading prohibitions that arise under Section 10(b) and Rule 10b-5."[195] Here again Congress chose to defer to the judiciary's determination of what constitutes insider trading.

If the analogy between antitrust law and insider trading jurisprudence is correct, then requiring evidence of personal benefit to prove that a selective disclosure is deceptive is a precedent that could be reevaluated in light of changed circumstances. And, as described above, circumstances with respect to what constitutes a legitimate selective disclosure and what kinds of deceptive practices might trigger insider trading liability have changed dramatically since 1983.[196]

2. Personal Benefit Test Is Dicta

Additionally, courts might not be bound by the personal benefit test enunciated in *Dirks* because the discussion of a personal benefit test in *Dirks* is almost certainly dicta. To understand why the *Dirks* personal benefit test is dicta, it is necessary to step back and review all the issues regarding selective disclosure liability addressed by the Court in *Dirks*. The *Dirks* opinion addresses three different questions that arise when considering whether a selective disclosure might lead to an insider trading violation. These are: (1) What makes the tipper's actions sufficiently wrongful to trigger insider trading liability? (2) Can the tippee face insider trading liability absent improper conduct by the tipper? and (3) How much tippee involvement in wrongdoing is necessary for her to face liability?[197]

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193. *Kimble*, 135 S. Ct. at 2412–13 (citation omitted). *But see* Barak Orbach, *Antitrust Stare Decisis*, ANTITRUST SOURCE (Oct. 2015) (arguing that the ways in which *stare decisis* is applied to antitrust law are more complex than suggested by the *Kimble* opinion).

194. *See supra* note 47 and accompanying text.

195. Nagy, *Beyond* Dirks, *supra* note 5, at 34.

196. *See supra* Part II.

197. *See* Dirks v. SEC, 463 U.S. 646, 665, 667 (1983).

An analysis of the answers the Court provides in *Dirks* to the second and third of these questions is presented below. This analysis shows that the answers to these two questions, given the facts in *Dirks,* provide more than sufficient grounds for the Court to conclude that there should not be insider trading liability imposed in the *Dirks* case. The Court did not need to resolve when a selective disclosure is a manipulative or deceptive practice to reverse the decision against Dirks. The entire discussion of a personal benefit test in *Dirks* is dicta.[198]

In deciding *Dirks,* the Supreme Court for the first time addressed how to determine insider trading liability when information is covertly passed from one person to another. In doing so, the Court needed to resolve a number of issues related to this type of wrongdoing. One question to be addressed was whether a tippee can face insider trading liability absent improper conduct by the tipper (the second question listed above). *Dirks* held that if there is no tipper wrongdoing then there will be no tippee liability.[199]

This holding, that tippee liability is exclusively derivative of tipper liability, appears at various points throughout the *Dirks* opinion. For example, Justice Powell writes in the majority opinion that "some tippees must assume an insider's duty to the shareholders not because they receive inside information, but rather because it has been made available to them improperly."[200] This is why the Court describes liability for trading based on nonpublic information as "derivative" of wrongdoing by the person providing the information.[201] The statement in *Dirks* that "the tippee's duty to disclose or abstain is derivative from that of the insider's duty"[202] summarizes the idea that the recipient of selectively disclosed material nonpublic information will not face insider trading liability absent improper conduct by the party that provided the information.

The conclusion that tippee liability is derivative of tipper liability would seem to follow logically from the Court's holding three years earlier in *Chiarella v. United States*.[203] In *Chiarella,* the majority wrote that "[w]hen an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak," and that no such duty arises "from

198. However, it is noteworthy that the *Salman* opinion does not treat the *Dirks* personal benefit test as dicta. Alito writes: "Salman points out that many insider trading cases—including several that *Dirks* cited—involved insiders who personally profited through the misuse of trading information. But this observation does not undermine *the test Dirks articulated and applied*." Salman v. United States, 137 S. Ct. 420, 428 (2016) (emphasis added).

199. *Dirks*, 463 U.S. at 667.

200. *Id.* at 660 (emphasis omitted).

201. *Id.* at 662.

202. *Id.* at 659.

203. 445 U.S. 222 (1980).

the mere possession of nonpublic market information."[204] In fact, a footnote in *Dirks* states that *Chiarella* compels the conclusion that tippee liability can only be derivative.[205]

But how *Chiarella* helps to address whether someone who trades using selectively disclosed information should face insider trading liability absent wrongdoing by the tipper is not as self-evident as the *Dirks* opinion implies.[206] Rather, other considerations provide more direct support for the holding that tippee liability is exclusively derivative

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204. *Id.* at 235.

205. The footnote in *Dirks* explains the relevance of *Chiarella* as follows:

> As we emphasized in *Chiarella*, mere possession of nonpublic information does not give rise to a duty to disclose or abstain; only a specific relationship does that. And we do not believe that the mere receipt of information from an insider creates such a special relationship between the tippee and the corporation's shareholders.

Dirks, 463 U.S. at 656 n.15.

206. The only discussion in *Chiarella* about the situation where someone trades using selectively disclosed material nonpublic information appears in the following footnote:

> "Tippees" of corporate insiders have been held liable under §10(b) because they have a duty not to profit from the use of inside information that they know is confidential and know or should know came from a corporate insider. The tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty.

Chiarella, 445 U.S. at 230 n.12 (citation omitted).

The first sentence in this footnote might reasonably be read to endorse the idea that it is the confidential nature of the information, and not the purpose for which it was disclosed, which makes trading based upon selective disclosed information a violation of § 10(b). This is opposite to the conclusion in *Dirks* that liability from trading on selectively disclosed information can only be derivative. *See Dirks*, 463 U.S. at 667. Moreover, the case *Chiarella* cited, *Shapiro v. Merrill Lynch*, holds that the confidential nature of the information provided in a selective disclosure can be sufficient to trigger tippee liability. Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 238 (2d Cir. 1974) ("Since upon the admitted facts before us the selling defendants knew or should have known of the confidential corporate source of the revised earnings information and they knew of its non-public nature, they were under a duty not to trade . . . ."). For an alternative reading of this sentence in the *Chiarella* footnote, see Coles, *supra* note 5, at 203–04.

It is intriguing that in initially communicating with his fellow Justices about the *Dirks* case, Justice Powell chose to exclude this first sentence of the *Chiarella* footnote from his review of the relevant discussion in *Chiarella*, perhaps because it might be read to endorse a broader test for tippee liability than he preferred. *See* Pritchard on *Dirks*, *supra* note 5, at 860.

On the other hand, the second sentence in the *Chiarella* footnote does suggest that liability based on selective disclosure can only result when the individual who selectively discloses the information does so in breach of a fiduciary duty. Overall, the discussion in the *Chiarella* footnote is equivocal as to whether trading based on selectively disclosed material nonpublic information can provide an independent basis for insider trading liability.

of wrongdoing by the tipper. For example, the majority in *Dirks* cites a statement directly on point in oral argument by SEC attorney Paul Gonson. Gonson stated that the liability of Dirks and others who traded "is derivative of Secrist's duty in this case."[207] The *Dirks* opinion also cites the concurring opinion of an SEC Commissioner in an enforcement case involving liability for trading based on information that was selectively disclosed to an outsider.[208] In that case, *Investors Management Co.*, the Commissioner wrote in a concurrence that the "[t]ippee responsibility must be related back to insider responsibility."[209]

The *Dirks* majority appears to be concerned that allowing a basis for tippee liability other than wrongdoing by the tipper would require accepting that insider trading liability can attach whenever someone comes "into possession of material 'corporate information that they know is confidential and know or should know came from a corporate insider.'"[210] The *Dirks* majority chooses to reject explicitly the purported view "the SEC maintains that anyone who knowingly receives nonpublic material information from an insider has a fiduciary duty to disclose before trading."[211]

Another question *Dirks* addresses about the link between selective disclosure and insider trading is: How much involvement in wrongdoing by the recipient of information (the tippee) is necessary for that person to face liability (the third question listed above)?[212] A court might provide a wide range of answers to this question. At one extreme, a court might apply a strict liability rule. Under such a rule, no involvement with or knowledge of the wrongfulness of the selective disclosure would be necessary to trigger liability, so long as the selective disclosure itself was wrongful.[213] At the other extreme, a court could apply something comparable to an aiding and abetting standard. Under such a rule, a court would only impose liability on a person who trades on selectively disclosed information if that individual was also involved as an accomplice in the act of wrongful selective disclosure.

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207. Transcript of Oral Argument at 38, *Dirks*, 463 U.S. 646 (1983) (No. 82-276); *see Dirks*, 463 U.S. at 659 ("[T]he tippee's duty to disclose or abstain is derivative from that of the insider's duty.").

208. *Dirks*, 463 U.S. at 660 n.19 (citing Inv'rs Mgmt. Co., 44 S.E.C. 633, 651 (1971) (Smith, Comm'r, concurring)).

209. Inv'rs Mgmt. Co., 44 S.E.C. at 651 (Smith, Comm'r, concurring).

210. *Dirks*, 463 U.S. at 651.

211. *Id.* at 656.

212. *See supra* text accompanying note 190.

213. Such a rule is sometimes applied to the possession of stolen goods. *See, e.g.*, Stuart P. Green, *Thieving and Receiving: Overcriminalizing the Possession of Stolen Property*, 14 NEW CRIM. L. REV. 35, 35–36 (2011).

The Supreme Court in *Dirks* provides something of a middle-ground answer to this question of how much "involvement" by the tippee is required to trigger tippee insider trading liability, stating:

> Thus, a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and *the tippee knows or should know* that there has been a breach.[214]

The *Dirks* Court settles here on a negligence-like standard to resolve the question of what level of involvement will trigger tippee liability.[215]

The most surprising aspect of this particular aspect of the holding in *Dirks* is how little attention it receives, despite the relatively novel nature of the question. The "knows or should know" standard appears only once in the *Dirks* opinion.[216] Moreover, the footnotes supporting this conclusion cite cases that offer a variety of standards for determining the level of tippee involvement necessary to trigger insider trading liability. While some of the cases *Dirks* cites to support this holding do apply a "knows or should have known" standard to determine the extent of tippee involvement necessary to trigger tippee insider trading liability, others do not.[217]

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214. *Dirks*, 463 U.S. at 660 (emphasis added). Surprisingly, the *Salman* opinion misstates the test as requiring actual knowledge of the tipper wrongdoing. Alito writes: "The tippee acquires the tipper's duty to disclose or abstain from trading if *the tippee knows* the information was disclosed in breach of the tipper's duty, and the tippee may commit securities fraud by trading in disregard of *that knowledge*." Salman v. United States, 137 S. Ct. 420, 423 (2016) (emphasis added). This may reflect an effort to shift away from the "knows or should know" standard in *Dirks*, or could simply reflects the fact that in *Salman* the tipper did have actual knowledge of the tippee wrongdoing.

215. Langevoort, at points in his treatise, seems to suggest that the personal benefit test in *Dirks* is a means to evaluate the tippee's level of "involvement" in the selective disclosure. In Section 6:13, Langevoort writes:

> The only way to taint a tippee with responsibility for such a [misappropriation] breach is to find a co-venture with the actual fiduciary, and for better or worse, the Supreme Court has indicated that such coventures exist only where there is something like a quid pro quo involved in the tip.

18 LANGEVOORT, *supra* note 5, § 6:13. This is not how this author understands the role the personal benefit test plays in the opinion. Rather, the personal benefit test appears solely relevant to determining the wrongfulness of the tipper's selective disclosure.

216. *Dirks*, 463 U.S. at 660.

217. On the one hand, the *Dirks* Court correctly notes that in *In re Investors Management Co.*, the "SEC itself has recognized that tippee liability properly is imposed only in circumstances where the tippee knows, or has reason to know, that" the selective disclosure of information was wrongful. *Dirks*, 463 U.S. at 660 n.19. The "knows or should know" standard also appears in the

Similarly, the *Dirks* majority opinion favorably cites *Mosser v. Darrow*[218] as support for the proposition that those who trade on selectively disclosed information may have liability, but in doing so the *Dirks* majority notes that "the transactions of those *who knowingly participate* with the fiduciary in such a breach are 'as forbidden' as transactions 'on behalf of the trustee himself.'"[219] Observe that here again the *Dirks* Court relies on a precedent without mentioning that the precedent does not apply the "knows or should know" standard for triggering tippee liability.[220]

In any case, the combination of these two holdings, first, that tippee liability is derivative, and second, that such liability is only imposed when the tippee "knows or should know" of the breach, makes clear why the discussion in *Dirks* about the personal benefit test is actually just dicta.[221]

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footnote in *Chiarella* that discusses liability for those who trade based on selectively disclosed information. Chiarella v. United States, 445 U.S. 222, 230 n.12 (1980). For a more detailed discussion of this footnote, see *supra* note 199.

On the other hand, *Dirks* cites two Restatement provisions relating to when liability passes to someone who receives information in violation of a duty owed to the source of the information that both require actual knowledge. *Dirks*, 463 U.S. at 660 n.20. The Restatement of Agency provision requires actual knowledge (RESTATEMENT (SECOND) OF AGENCY § 312 cmt. c ("A person who, with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be [deemed] . . . a constructive trustee.")), as does the Restatement of Restitution(RESTATEMENT (FIRST) OF RESTITUTION § 201(2) (AM. LAW INST. 1937) ("Where a fiduciary in violation of his duty to the beneficiary communicates confidential information to a third person, the third person, if he had notice of the violation of duty, holds upon a constructive trust for the beneficiary any profit which he makes through the use of such information.")).

218. 341 U.S. 267 (1951).

219. *Dirks*, 463 U.S. at 659 (emphasis added) (quoting Mosser v. Darrow, 341 U.S. 267, 272 (1951)).

220. In fact, Pritchard found that earlier drafts of the *Dirks* opinion included an actual knowledge standard, that only the final draft contained the "knows or should know" standard, and that there is no written record as to why the "knows or should know" standard was included in the final versions of the opinion. Pritchard on *Dirks*, *supra* note 5, at 864.

Pritchard contacted the clerk who assisted in preparing the *Dirks* opinion to ask why the "knows or should know" standard was adopted. *Id.* at 865 & n.43. The clerk's recollection was that this standard was incorporated "to make the opinion more consistent with those authorities as well as the concurring opinion of Commissioner Smith in *In re Investors Management Co*." Pritchard on *Dirks*, *supra* note 5, at 865. The "knows or should know" language would also make the standard consistent with footnote 12 of the *Chiarella* decision. *See supra* note 199.

221. The Black's Law Dictionary definition of judicial dictum is an "opinion by a court on a question that is directly involved . . . , but that is not essential to the decision and therefore not binding even if it may later be accorded some weight." *Dictum*, BLACK'S LAW DICTIONARY (10th ed. 2014). *But see* Michael Abramowicz & Maxwell Stearns, *Defining Dicta*, 57 STAN. L. REV. 953, 1065 (2005) (offering the following alternative definition: "A holding consists of those propositions along the chosen decisional path or paths of reasoning that (1) are actually decided,

Based on these two holdings for Dirks to face insider trading liability, it must be true that there was wrongdoing on the part of the original tipper, Ronald Secrist, and that Dirks either knew or should have known about this wrongdoing. However, no claim was ever made that Secrist's original disclosure constituted deceptive conduct or wrongdoing. A footnote in the *Dirks* opinion observes that "we do not understand the SEC to have relied on any theory of a breach of duty by Secrist in finding that Dirks breached his duty to Equity Funding's shareholders."[222] Therefore, the case against Dirks can be fully resolved without delving into what type of behavior would have constituted wrongdoing by Secrist if the facts had been different than those in the present case.[223]

Justice Powell recognized early on that the discussion of what constitutes tipper wrongdoing in *Dirks* would be dicta when he wrote to his clerk: "*Dirks* is easy, but is there a general principle?"[224] Similarly, the first memorandum from Justice Powell on the case to his fellow Justices observed that the "SEC . . . recognized that 'Dirks' informants were entitled to disclose the [Equity Funding] fraud.'"[225] The personal benefit test discussion involved a counter-factual situation.

If the personal benefit test is dicta, the Court is not bound to follow it as precedent. Similarly, the doctrine of *stare decisis* does not provide a compelling reason to ignore changes in securities markets practices and regulations, most importantly the enactment of Regulation FD and the *O'Hagan* decision, when considering whether or how to update the *Dirks* test for determining when a selective disclosure is sufficiently deceptive to trigger insider trading liability. It is not just appropriate but increasingly necessary to consider anew how to determine when a selective disclosure is sufficiently wrongful to trigger insider trading liability.

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(2) are based upon the facts of the case, and (3) lead to the judgment. If not a holding, a proposition stated in a case counts as dicta").

222. *Dirks*, 463 U.S. at 666 n.27. The Court also concludes in reversing Dirks' conviction with a restatement of the tippee derivative liability footnote from *Chiarella*. "In the absence of a breach of duty to shareholders by the insiders, there was no derivative breach by Dirks. Dirks therefore could not have been 'a participant after the fact in [an] insider's breach of a fiduciary duty.'" *Id.* at 667 (alteration in original) (citation omitted) (quoting Chiarella v. United States, 445 U.S. 222, 230 n.12 (1980)).

223. Langevoort reaches the same conclusion about whether the discussion of the personal benefit test was necessary given the other two holdings in the opinion, and writes that the "Court could have stopped its analysis here and still reversed the Commission, for it was clear, to the majority at least, that there had been no breach of fiduciary duty by the former Equity Funding employees . . . ." 18 LANGEVOORT, *supra* note 5, § 4:3.

224. Pritchard on *Dirks*, *supra* note 5, at 862.

225. Bobtail Bench Memorandum at 3, *Dirks*, 463 U.S. 646 (No. 82-276) (alteration in original).

IV. A MULTIPLE TRIGGER TEST FOR TIPPER WRONGDOING

To update the test for when a selective disclosure is sufficiently wrongful to trigger insider trading liability, the appropriate starting point is the underlying statutory prohibition against deceptive conduct.[226] This statutory prohibition against any manipulative or deceptive device or contrivance no longer justifies making evidence of a personal benefit a necessary condition for determining whether a selective disclosure should trigger insider trading liability. A better test would recognize that a personal benefit provides evidence that is likely sufficient, but by no means necessary, to determine when a selective disclosure is deceptive. The better approach, which this Article calls the multiple trigger approach, would recognize that there are several ways to find that a selective disclosure is sufficiently deceptive to trigger insider trading liability.

This Section details this multiple trigger approach, considering in detail two scenarios in which the multiple trigger approach would correctly conclude that a selective disclosure is sufficiently wrongful to trigger insider trading liability, but in which neither a personal benefit test nor a breach of a fiduciary duty test would reach the correct result.

A. *Deception Without Personal Benefit or Fiduciary Breach*

The basic problem with exclusive reliance on the personal benefit test (or on a test requiring evidence of a fiduciary duty breach) to determine when a selective disclosure triggers insider trading liability is that such a test is unjustifiably underinclusive. There are many situations in which a selective disclosure unequivocally constitutes a deceptive practice, but in which there might be neither a personal benefit nor a fiduciary duty breach. In such situations, there is no good reason to hold as a matter of law that the selective disclosure cannot trigger insider trading liability.[227]

This Section describes two scenarios where there is a selective disclosure involving deceptive conduct, but where there is neither a personal benefit nor a fiduciary duty breach. In the first scenario, a computer hacker deceives employees at a public company to gain access to material nonpublic information and then selectively discloses that information to a distant friend as a gesture of friendship. That friend, who is fully cognizant of the deception used to gather the information, trades for a profit using the information. The second scenario involves the

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226. More specifically, Section 10(b) of the Securities Exchange Act refers to "any manipulative or deceptive device or contrivance," and Rule 10(b)(5) promulgated thereunder refers to "any device, scheme, or artifice to defraud." *See supra* note 8.

227. In many ways the argument here parallels the analysis in *Dorozhko* except that the question here involves whether a selective disclosure rather than the garnering of material nonpublic information involves deceptive conduct.

doctrinally more complex situation in which an insider at a public company selectively discloses material nonpublic information about the firm in violation of Regulation FD, but the insider's supervisor sanctions this disclosure.

1. Computer Hacking

The first scenario involves a computer hacker who passes material nonpublic information on to a distant friend. This scenario is a modified version of the situation analyzed by the Second Circuit panel in the *Dorozhko* case.[228]

Suppose that a computer hacker gains access to a company's material nonpublic information that she intends to use for securities trading purposes by misrepresenting herself as an employee who misplaced her user information. Then she passes this material nonpublic information on to a distant friend as a gesture of friendship. The friend knows how the information was generated, and still trades on the information for a profit in the stock market.

The question in this first scenario is whether the distant friend's trade violates Section 10(b) of the Securities Exchange Act and Rule 10b-5. Under the *Dirks* rule that tippee liability can only be derivative of tipper wrongdoing[229] the crucial issue is whether the computer hacker's purloining of material nonpublic information was sufficiently wrongful to trigger insider trading liability.

The evaluation of tipper wrongdoing in this scenario—if based on the underlying statutory prohibition—would involve two questions. First, was there deceptive conduct? Here the answer is obviously yes, as the hacker gained access to the information through an act of deception. There is no need in this scenario, other than to follow the *Dirks* precedent, to consider whether the tipper's personal benefit was sufficient to make the act by which the tipper gained access to the information deceptive. The deceptive nature of the act is self-evident.[230]

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228. *See supra* notes 146–53 and accompanying text. The risks that this type of computer hacking might pose to securities markets are significant, as suggested by charges brought in 2015 against hackers who were accused of gaining access to over 150,000 unreleased news stories related to both public and private companies. *See* Matthew Goldstein & Alexandra Stevenson, *Nine Charged in Insider Trading Case Tied to Hackers*, N.Y. TIMES (Aug. 11, 2015), http://www.nytimes.com/2015/08/12/business/dealbook/insider-trading-sec-hacking-case.html?_r=0l. *See generally* Robert T. Denny, *Beyond Mere Theft: Why Computer Hackers Trading on Wrongfully Acquired Information Should Be Held Accountable Under the Securities Exchange Act*, 2010 UTAH L. REV. 963 (highlighting confusion about whether computer hackers can be liable under the Securities Exchange Act).

229. *See supra* notes 193–204 and accompanying text.

230. This conclusion is, among other things, supported by SEC v. Dorozhko, 574 F.3d 42 (2d Cir. 2009).

The second question in evaluating whether there is tippee liability in this scenario—if based on the underlying statutory prohibition—would be whether the tipper's deception is sufficiently "in connection with" a securities transaction to violate Section 10(b) and Rule 10b-5.[231] In *O'Hagan*, the Court held that if someone "misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information,"[232] his action is sufficiently in connection with such a securities transaction to trigger insider trading liability. That case did not, however, involve passing along information between tippers and tippees, which further extenuates the connection between the deceptive conduct and securities market trading. The anti-circumvention rationale for adopting a rule creating tipper and tippee liability in *Dirks* should resolve the issue of whether to extend tipper/tippee liability to this situation.[233] Allowing tippers to achieve by indirection what is otherwise illegal would make little sense.

To summarize, the correct holding in this first scenario would be to find the tippee liable for an insider trading violation if the analysis is based on the underlying statute and the facts presented. The tipper's behavior involved deception in connection with the purchase or sale of securities and the tippee knew this. Reaching this conclusion did not require investigating either the depth of the personal relationship between the tipper and the tippee or the nature of the fiduciary duty breach by the tipper. In fact, in this first scenario, it is unlikely that either a personal benefit test (because they were distant friends) or a breach of a fiduciary duty test (because the hacker did not have a fiduciary relationship with the company) would lead to the correct conclusion that the tipper wrongdoing should trigger insider trading liability.

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231. *See supra* note 8.

232. United States v. O'Hagan, 521 U.S. 642, 652 (1997).

233. In fact, the Solicitor General's brief in the *Salman* case assumed that the *Dirks* opinion had already addressed the issue of what would be required for a tipper's actions to be sufficiently in connection with a purchase or sale to trigger insider trading liability, stating that one of the elements of the tipper's wrongdoing in *Dirks* is that the tipper provides the tip "knowing or expecting that the information will be used for securities trading. . . . The insider's knowledge that a tippee will 'exploit[]' the confidential information in trading is thus critical to finding securities fraud." Brief for the United States, *supra* note 178, at 23 (alteration in original). The heading of this section of the brief states: "Dirks makes clear that the tipper's understanding that the information will be used for trading by a tippee is critical to liability." *Id.* There is, however, no explicit statement in either the *Dirks* or *O'Hagan* regarding the extent to which tippers beliefs about whether the selectively disclosed information would be used for securities trading is relevant to a finding of tipper wrongdoing.

2. Company-Sanctioned Selective Disclosure

A second, more analytically challenging scenario involves an insider at a public company making a selective disclosure of material nonpublic information to a distant friend in violation of Regulation FD, but also assuming the insider's supervisor at the company sanctions the selective disclosure. This scenario, as with the first scenario discussed above, explores the tradeoffs between a multiple trigger approach, a personal benefit test, and a fiduciary duty breach test for tipper wrongdoing.

In this scenario, let us assume the tipper is covered by the provisions of Regulation FD. For example, the tipper might be an individual who works at a public company in a position where she regularly communicates with investors.[234] Further, let us assume, as noted above, this tipper's supervisor instructed her to make this selective disclosure. Finally, assume this tipper is fully aware that such selective disclosure violates both Regulation FD and the firm's stated policy against selective disclosure of such information. This scenario is similar in some respects to the facts in the *Newman* case, at least as understood by the Second Circuit panel that decided the case.[235]

The question now becomes how to determine whether this tipper's sanctioned disclosure in violation of Regulation FD is sufficiently wrongful to trigger insider trading liability. Under the personal benefit test, a court would look to the nature of the relationship between the tipper and the tippee, much as the panel in *Newman* did, even though the relationship between the tipper and tippee in this scenario has little to do with whether the tipper's behavior was deceptive. For example, if the tipper's selective disclosure were to a close friend there might be clear evidence of a personal benefit based on the *Dirks* standard, but whether the conduct was deceptive would still remain an open question, because the disclosure was sanctioned. Using a fiduciary duty test to determine tipper wrongdoing in this scenario would require answering complicated questions about how fiduciary duty law deals with situations in which a principal's instructions contradict either federal rules or guidance from that principal's ultimate principal.

The multiple trigger approach works much better, because it simply requires making a determination of whether her behavior involved deceptive conduct. This is the central issue that the personal benefit test

234. *See supra* text accompanying note 123. For a discussion of what makes a company public, see Michael D. Guttentag, *Patching a Hole in the JOBS Act: How and Why to Rewrite the Rules that Require Firms to Make Periodic Disclosures*, 88 IND. L.J. 151, 152–53 (2013).

235. United States v. Newman, 733 F.3d 438, 455 (2d Cir. 2014) ("That is especially true here, where the evidence showed that corporate insiders at Dell and NVIDIA regularly engaged with analysts and routinely selectively disclosed the same type of information."). The *Newman* panel did not address the question of whether or to what extent this practice would violate Regulation FD.

or a fiduciary duty approach only addresses indirectly. So, is the tipper's behavior in this scenario deceptive? Clearly, yes. While the tipper may not have deceived her immediate principal, the tipper deceived both the ultimate principal, the firm, which has adopted a policy prohibiting such behavior, and the federal government by violating a rule prohibiting this type of selective disclosure. At least some degree of deception on her part was necessary to carry out this selective disclosure.

These two scenarios, one involving a computer hacker and one involving a sanctioned violation of Regulation FD, illustrate that neither a personal benefit test nor a fiduciary duty test does a good job of identifying situations in which a selective disclosure constitutes a deceptive practice.[236] After the enactment of Regulation FD and the decision in *O'Hagan*, there is little justification for continuing to cabin the analysis of the potential wrongfulness of a selective disclosure into either a personal benefit test or a breach of fiduciary duty test.

Unfortunately, the *Salman*[237] decision did not help advance the analysis of when the selective disclosure of material nonpublic information should trigger insider trading liability. In *Salman*, the tipper wrongdoing involved all three of the wrongs that could plausibly be relied upon as providing a sufficient basis for triggering insider trading liability. There was deceptive conduct, a violation of company policy, and receipt of the type of personal benefit specifically described in *Dirks*. The facts of *Salman* allowed the Court to avoid addressing important questions about when a selective disclosure should trigger insider trading liability after the enactment of Regulation FD and the *O'Hagan* decision.[238]

CONCLUSION

This Article explains why the Court first introduced the rule in *Dirks* that the selective disclosure of material nonpublic information can only trigger insider trading liability if "the insider personally will benefit, directly or indirectly, from his disclosure,"[239] and shows that the various rationales for adopting this rule no longer justify making evidence of a personal benefit a necessary condition for identifying when a selective

236. The fiduciary duty aspects of insider trading jurisprudence have always had an uneasy relationship with the statutory language that prohibits manipulative or deceptive practices. Nagy uses the apt term of fiduciary "fictions" to describe the Supreme Court's logic in certain insider trading cases. Nagy, *supra* note 10, at 1337. One response on the part of lower courts and the SEC to this mismatch is that as a descriptive matter, according to Nagy's analysis, "a host of lower courts and the SEC have in effect concluded that the offense of insider trading focuses on a person's wrongful use of confidential information, regardless of whether a fiduciary-like duty is breached." *Id.* at 1337.

237. Salman v. United States, 137 S. Ct. 420 (2016).

238. *See* Guttentag, *supra* note 9.

239. Dirks v. SEC, 463 U.S. 646, 662 (1983).

disclosure involves deceptive conduct and triggers insider trading liability.

In particular, the personal benefit test in *Dirks*: (1) no longer establishes reliable objective criteria for determining when a selective disclosure is wrongful, (2) can no longer be justified as necessary to allow corporate communications which in 2017 would violate Regulation FD, (3) does a poor job of preventing the circumvention of the insider trading prohibition, and (4) does not reliably indicate the presence or absence of deceptive conduct.[240] There is little reason to continue to force federal courts to try and resolve nettlesome questions about personal benefit and fiduciary duty breach when the legal issues can be more easily and directly resolved by looking directly to the relevant statutory language.

The personal benefit test as a necessary condition for finding tipper wrongdoing should be acknowledged for what it is: a spandrel that might be sufficient but is certainly no longer a necessary element for identifying when a selective disclosure is sufficiently wrongful to violate the Securities Exchange Act.[241]

240. *See supra* Section III.A.

241. For a more general discussion of spandrels, see S.J. Gould & R.C. Lewontin, *The Spandrels of San Marco and the Panglossian Paradigm: A Critique of the Adaptationist Programme*, 205 PROC. ROYAL SOC'Y B. 581, 581–82 (1979).