THE MISCONCEIVED PERSONAL-BENEFIT REQUIREMENT OF INSIDER TRADING LAW: ABOUT THE INSECURITIES MARKETS

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ABSTRACT

In *Dirks v. SEC* and *Salman v. United States*, the Supreme Court held that, under Section 10(b) of the Securities Exchange Act, tipper/tippee liability arises only if the tippee confers a benefit on the tipper. The ostensible justification for this rule arises from a mistaken premise. The error is rooted in the so-called classical theory of insider trading. When a corporate insider trades on material, nonpublic corporate information, the Supreme Court has held that the insider faces liability because that person profited from the trade. Building on this mistaken premise, the Court has held that when a tipper receives a personal benefit from the tippee, that benefit functions as a proxy for the profits the insider would have made had the insider, rather than the tippee, traded. This Article argues that the Court has misconceived the nature of insider trading liability. When an insider trades on confidential corporate information, the wrongful act is making an unauthorized trade. Whether a corporate insider profits from the trade is irrelevant. Even if the insider loses money, the insider has nevertheless committed the same wrongful act: the trade itself. Thus, in a tipper/tippee situation, the tippee's trade stands as a proxy for the trade the tipper might have made. That trade is a deceptive and manipulative device, which violates section 10(b).

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INTRODUCTION

The law of insider trading is confounding.[1] The Supreme Court has recognized three different theories, each with distinctive elements, and each beset with inconsistencies and contradictions.[2] The Court's fragmented approach has led to a conceptual muddle. The blueprint that the Court has used to fashion this disjoined framework is Section 10(b) of the Securities Exchange Act (Exchange Act)[3] and its Securities and Exchange Commission (SEC) complement, Rule 10b-5.[4] Section 10(b) makes it unlawful to use a deceptive or manipulative device in connection with the purchase or sale of a security.[5] Trading with the benefit of material, nonpublic information would seem to be a manipulative or deceptive device within the meaning of section 10(b) because such trading would unfairly disadvantage the counterparty.[6] Section 10(b), therefore, had promise as a starting point for developing a creditable insider trading regime. That promise, however, was never realized, because the Supreme Court, in its

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1. This Article refers to trading on inside information as "insider trading," even though misappropriation and tipper/tippee cases often involve outsiders rather than insiders. This Article's use of the general term "insider trading" when referring to outsider trading is merely a matter of convenience and common convention.

2. These three theories are the classical theory, the misappropriation theory, and tipper/tippee liability. Thaya Brook Knight, Salman v. U.S.*: Another Insider Trading Case, Another Round of Confusion*, 2016–2017 CATO SUP. CT. REV. 181, 182 (2017). Supplementing these three theories, Congress passed Rule 14e-3(a), a prohibition of trading on inside information relating to tender offers. Samuel N. Allen, *The Scope of the Disclosure Duty under SEC Rule 14e-3*, 38 WASH. & LEE L. REV. 1055, 1056 (1981). Rule 14e-3(a) provides in pertinent part:

> If any person has taken a substantial step or steps to commence, or has commenced, a tender offer . . . it shall constitute a fraudulent, deceptive or manipulative act or practice within the meaning of section 14(e) of the Act for any other person who is in possession of material information relating to such tender offer which information he knows or has reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from (1) [t]he offering person, (2) [t]he issuer . . . or (3) [a]ny officer, director, partner or employee or any other person acting on behalf of the offering person or such issuer, to purchase or sell or cause to be purchased or sold any of such securities . . . unless within a reasonable time prior to any purchase or sale such information and its source are publicly disclosed . . . .

17 C.F.R. § 240.14e–3(a) (2025).

3. *See* 15 U.S.C. § 78j(b) (providing that "[i]t shall be unlawful for any person, directly or indirectly, by 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 . . . any manipulative or deceptive device or contrivance").

4. Rule 10b-5 provides in pertinent part:

> It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce or 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 light of 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.

17 C.F.R. § 240.10b–5 (2025).

5. *Id.* Because section 10(b) and Rule 10b-5 are conceptually inseparable, when this Article refers to section 10(b), it is implicitly referring to Rule 10b-5.

6. *See, e.g.*, Chiarella v. United States, 445 U.S. 222, 246 (1980) (Blackmun, J., dissenting) (criticizing the Court's majority for limiting insider trading liability to situations in which there is a "'special relationship' akin to fiduciary duty").

tripartite formulation, adopted an overly permissive view of insider trading.

The Court's first insider trading case was *Chiarella v. United States*,[7] which announced the classical theory.[8] This approach predicates a violation of section 10(b) on the fiduciary duties that insiders owe shareholders.[9] Based on these duties, *Chiarella* adopted the disclose-or-abstain rule: An insider must disclose the relevant confidential corporate information to the shareholders or abstain from trading.[10] Regrettably, the theory establishes an overly narrow scope of accountability because it subjects only corporate insiders to civil liability and criminal prosecution.[11] *Chiarella* does not impose any limitations on non-insiders who acquire and trade on material, nonpublic information. This approach, therefore, prohibits only a fraction of nefarious trading activities. The classical theory is a single stitch in an open wound.

In *United States v. O'Hagan*,[12] the Supreme Court prohibited a wider swath of blameworthy trading activities when it recognized the misappropriation theory. *O'Hagan* holds that, if a recipient of inside information represents to the source, explicitly or implicitly, not to trade on the information, the recipient breaches a fiduciary duty to the source by trading.[13] The conceptual basis for the misappropriation theory is straightforward. The recipient's breach of trust to the source constitutes a deceptive and manipulative device within the meaning of section 10(b).[14] Although this theory is superior to the classical theory because it applies to any source and any counterparty, it is nevertheless problematic. One shortcoming arises from what courts and commentators call the "brazen fiduciary" problem:[15] If the recipient of the information disavows the fiduciary duty to the source, the recipient may trade with impunity.[16]

Although the misappropriation theory establishes a broader scope of liability than the classical theory, neither addresses the issue of tipper/tippee liability, a common scenario in which a person provides confidential corporate information to another and permits the recipient to trade on the information. *Dirks v. SEC*[17] provides a framework for tipper/tippee liability. Under this theory, a tippee inherits the liability of the tipper if the tipper receives a benefit from the tippee.[18] The benefit may be monetary,

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7. 445 U.S. 222 (1980).
8. *See id.* at 230.
9. *See id.*
10. *Id.* at 227.
11. *Id.* at 231.
12. 521 U.S. 642 (1997).
13. *Id.* at 652.
14. *Id.*
15. *See infra* notes 22–23 and accompanying text (analyzing and debunking the brazen fiduciary problem).
16. *O'Hagan*, 521 U.S. at 689 (Scalia, J., dissenting).
17. 463 U.S. 646 (1983).
18. *Id.* at 663.

reputational, or even the prospect of future gains.[19] Sharing inside information with a close friend or relative also meets the personal-benefit requirement.[20] If a tipper does not receive a benefit from the tippee in exchange for the information, the tippee is free to trade, and neither the tipper nor the tippee will face civil or criminal culpability. Because of the personal-benefit requirement, tipper/tippee liability permits trading on inside information in instances where one might deem it unfair to disadvantaged counterparties and harmful to the integrity of securities markets.

Part I of this Article discusses the classical theory. As noted, this theory holds that an insider with material, nonpublic information owes a duty to the company's shareholders to disclose the information or abstain from trading. Part I examines the reasoning of *Chiarella*, which established the classical theory, and the expansion of the theory to include not only corporate directors and management but also employees and temporary insiders such as attorneys, auditors, and other consultants.[21] The key to classical liability, Part I notes, should not be whether the insider profited from the trade, but should be the trade itself, regardless of the outcome. (As shown in Part IV of this Article, this observation leads to the reformulation of tipper/tippee liability.) Part I observes that the classical theory's narrow scope of liability impelled the Court to extract two additional theories of liability from the language of section 10(b): misappropriation and tipper/tippee liability.

Seventeen years after the *Chiarella* decision, the *O'Hagan* Court recognized the misappropriation theory.[22] Part II explores this theory, which premises liability on a breach of duty to the source of the information. After examining the brazen fiduciary problem, Part II debunks the premise that the recipient of the information may unilaterally disavow the duty of loyalty to the source. This Part also observes that classical cases involve breaches of trust to the source of the information, which is the corporation. Because breaching a duty of trust owed to the source of the information is the very definition of misappropriation, all classical violations are also misappropriations. The classical theory is, therefore, superfluous. Most important, Part II points out that the Supreme Court's explanation of the misappropriation theory stands on firmer conceptual ground than the classical theory: The Supreme Court's explanation of the misappropriation theory recognizes that a violation arises from the unauthorized use of entrusted information, rather than on profits derived from trading.[23] Grounding liability on the very act of trading is correct. The source of confidential information does not instruct the recipient not to profit; the source instructs

19. *Id.*
20. *Id.* at 664.
21. *See, e.g.*, United States v. Kosinski, 976 F.3d 135, 148 (2d Cir. 2020) (recognizing the Supreme Court's extension of classical liability to independent contractors such as lawyers, accountant, underwriters, and other consultants).
22. *O'Hagan*, 521 U.S. at 650.
23. *Id.* at 652.

the recipient not to trade. The outcome of the trade, whether a gain or a loss, is irrelevant to the breach of fiduciary duty. By disregarding the instructions of the source of the information and trading, the misappropriator has breached the duty of trust and confidence to the source and has, therefore, engaged in a manipulative and deceptive device in violation section 10(b).[24]

Part III examines the Supreme Court's *Dirks* decision, which, in classical tipper/tippee cases, limited liability to instances in which the tipper received a benefit from the tippee.[25] The benefit, held the *Dirks* Court, may be financial or reputational.[26] *Dirks* also held, and *Salman v. United States*[27] confirmed, that a tip to a close friend or relative also meets this requirement.[28] Part III then discusses a series of Second Circuit cases that struggled to interpret *Dirks* and *Salman*. In *United States v. Martoma* (*Martoma I*),[29] the Second Circuit, while professing to follow *Dirks*, seemed to defy it, holding that tipper/tippee liability is established if the tipper *expected* the tippee to trade on the inside information.[30] The Second Circuit then withdrew that opinion and replaced it with a second one (*Martoma II*),[31] which would impose liability if the tipper *intended* the tippee to trade.[32]

Building on Part III, Part IV contends that *Martoma I* reached the right conclusion but for the wrong reason. This Part argues that the personal-benefit requirement has no sound basis in tipper/tippee cases whether arising under the classical theory or the misappropriation theory. A personal benefit, *Salman* explained, is a proxy for the profits that the insider or misappropriator would have made if that person, rather than a tippee, had traded on the inside information.[33] But, as noted in Parts I and II, the key to classical and misappropriation liability is not profits from the trade. Using the personal-benefit requirement as a proxy for profits therefore misconstrues what should constitute a tipper–tippee violation. The key is the trade itself, irrespective of profits resulting from it. Thus, if the tipper discloses inside information to a tippee, and the tippee trades on the information, the tippee's trade functions as a proxy for a trade the tipper might have made. Liability under section 10(b) simply requires that the tippee traded on the inside information. Part IV also discusses the Supreme

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24. *Id.* at 653.
25. Dirks v. SEC, 463 U.S. 646, 663 (1983).
26. *Id.* at 663–64.
27. 580 U.S. 39 (2016).
28. *Id.* at 49; *Dirks*, 463 U.S. at 664.
29. 869 F.3d 58 (2d Cir. 2017) *modified*, United States v. Martoma, 894 F.3d 64 (2d Cir. 2017) [hereinafter *Martoma I*].
30. *Id.* at 71.
31. 894 F.3d 64 (2d Cir. 2017) [hereinafter *Martoma II*].
32. *Id.* at 76.
33. Salman v. United States, 580 U.S. 39, 48 (2016) (explaining that "a tippee is exposed to liability for trading on inside information only if the tippee participates in a breach of the tipper's fiduciary duty," and the test of such participation, stated the Court, is the personal-benefit requirement (citing *Dirks*, 463 U.S. at 662)).

Court's principal rationale to support the personal-benefit requirement: that healthy securities markets benefit from the free flow of information from insiders to market analysts. Part IV shows that the personal-benefit requirement often has harmful unintended consequences that hamper the efficient functioning of securities markets. In addition, the personal-benefit requirement condones trading practices that undermine investor confidence. Finally, Part IV discusses Regulation FD, which the SEC adopted after the *Dirks* decision. This regulation requires public disclosure of information shared with securities analysts and therefore nullifies the Supreme Court's healthy-markets rationale.

This Article concludes by arguing that the federal courts should reconceptualize tipper/tippee liability to conform to the requirements of section 10(b). This change would abandon the personal-benefit requirement. Not only would such a change align the scope of liability with the terms of section 10(b) but it would also cast a wider net to punish those who take unfair advantage of inside information.

I. THE CLASSICAL THEORY

Because a violation of section 10(b) requires a deceptive or manipulative device in connection with the purchase or sale of a security, the three theories of unlawful insider trading are grounded in fraud based on a breach of a fiduciary duty. Decades of case law have refined these theories. All this judicial attention would seem to imply an analytically sound approach to this area of law. Unfortunately, the opposite is true. These three approaches involve twists and turns that lead to dead ends. This Article argues that the salient flaw in the overall framework is the requirement that liability hinges on a personal benefit.

A. The Advent of the Classical Theory

The Supreme Court announced the classical theory in *Chiarella v. United States*.[34] The Court based liability on a breach of the fiduciary duties the insider owes to the shareholders of the company.[35] To avoid a violation, the insider must publicly disclose the material, nonpublic information or abstain from trading.[36]

1. *Chiarella v. United States*: A Limited Approach

Chiarella was a "markup man" working for Pandick Press, a company which printed financial documents.[37] In 1975 and 1976, Chiarella handled

34. Chiarella v. United States, 445 U.S. 222, 230 (1980).

35. *Id.* (holding that "liability is premised upon a duty to disclose arising from a relationship of trust and confidence between the parties to a transaction" and that "[a]pplication of a duty to disclose prior to trading guarantees that corporate insiders, who have an obligation to place the shareholder's welfare before their own, will not benefit personally through fraudulent use of material, nonpublic information").

36. *Id.* at 227.

37. *Id.* at 224.

documents for five proposed takeovers.[38] Although the identities of the acquiring and target companies were concealed from Chiarella, he deduced the names of the targets and traded their stock before public announcement of the tender offers.[39] This strategy resulted in profits of more than $30,000.[40] The SEC investigated Chiarella's suspicious trading activities,[41] and in 1978, the Justice Department indicted him on seventeen counts of securities fraud.[42]

The issue facing the Supreme Court was whether Chiarella had engaged in unlawful insider trading under section 10(b).[43] The Court began its analysis by noting that section 10(b) prohibits the use of "any manipulative or deceptive device . . . in connection with the purchase or sale of any security."[44] To determine the scope of insider trading liability under section 10(b), the Court looked to *Cady, Roberts & Co.*,[45] an SEC administrative decision in which the Commission adopted the rule that a corporate insider possessing material, nonpublic information must either publicly disclose the information or abstain from trading.[46] Quoting *Cady, Roberts & Co.*, the Court noted the unfairness of insiders trading on material, nonpublic information "not known to persons with whom they deal and which, if known, would affect their investment judgment."[47] This theory of liability, the *Chiarella* Court explained, "is premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction."[48] The Court stressed that the duty does not apply to all market participants.[49] The duty runs from the insider to shareholders: "Application of a duty to disclose prior to trading, guarantees that corporate insiders, who have an obligation to place the *shareholder's* welfare before

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38. *Id.*
39. *Id.*
40. Chiarella v. United States, 445 U.S. 222, 224 (1980).
41. *Id.* In May 1977, Chiarella entered into a consent decree with the SEC in which he agreed to return the profits he had made to the counterparties to the trades he had made based on the information he had deduced from the takeover materials he had read. Pandick Press fired him on the day he entered into the consent decree. *Id.*
42. *Id.* at 225.
43. *Id.* at 224.
44. *Id.* at 225 (quoting 15 U.S.C. § 78j(b)).
45. Exchange Act Release No. 6668, 40 SEC Docket 907, 1961 WL 60638, at *3 (Nov. 8, 1961).
46. *Chiarella*, 445 U.S. at 227 (citing *Cady, Roberts & Co.*, 40 SEC Docket 907, 1961 WL 60638, at *3).
47. *Id.* (quoting *Cady, Roberts & Co.*, 40 SEC Docket 907, 1961 WL 60638, at *3).
48. *Id.* at 230.
49. *Id.* at 232–33. The Court criticized the Second Circuit because, in assessing liability against Chiarella, it "failed to identify a relationship between petitioner and the sellers that could give rise to a duty." *Id.* at 232. The Court continued,

> No duty could arise from petitioner's relationship with the sellers of the target company's securities, for the petitioner had no prior dealings with them. He was not their agent, he was not a fiduciary, he was not a person in whom the sellers had placed their trust and confidence. He was, in fact, a complete stranger who dealt with the sellers only through impersonal market transactions.

Id. at 232–33.

their own, will not benefit personally through fraudulent use of material, nonpublic information."[50]

Although the rule adopted in *Cady, Roberts & Co.* and approved in *Chiarella* declares that an insider must publicly disclose the confidential information or abstain from trading, disclosure is rarely, if ever, a viable alternative.[51] The fiduciary duty of loyalty forbids the insider to publicly disclose material, nonpublic information before the company does so.[52] This duty of nondisclosure applies, for example, to a company's quarterly earnings report,[53] and to material changes, which trigger a company's obligation to file a Form 8-K with the SEC.[54] Thus, the disclose-or-abstain rule, in practical effect, requires insiders to abstain from trading.[55]

Applying the classical theory to Chiarella, the Court found no basis for a violation of section 10(b).[56] The Court reversed Chiarella's conviction because the Department of Justice (DOJ) had failed to prove that Chiarella was a corporate insider of the target companies—the companies whose stocks he had traded—and he, therefore, had no fiduciary duty to them.[57] In addition, he acquired no information from the target companies.[58] He gleaned the inside information from documents that the acquiring companies furnished to Pandick Press.[59] Thus, even if he had been a corporate insider of the targets, not having acquired any material,

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50. *Id.* at 230 (emphasis added).

51. *See, e.g.*, Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition*, 52 WASH. & LEE L. REV. 1189, 1203 (1995) (observing the duty to disclose or abstain reduces in most cases to a duty to abstain because the insider may not prematurely disclose information before the company has done so).

52. *See, e.g.*, Charles M. Nathan, *Maintaining Board Confidentiality*, HARV. L. SCH. F. CORP. GOVERNANCE (Jan. 23, 2010), https://corpgov.law.harvard.edu/2010/01/23/maintaining-board-confidentiality/ (noting that among the fiduciary duties that directors owe to shareholders, "[f]irst, and most obvious, is maintenance of confidentiality of material non-public information about the company and its performance").

53. *See* 17 C.F.R. § 240.13a–13(a) (2025) (allowing federal agencies to require companies to make financial reports on a quarterly basis but no more frequently unless supported by special circumstances).

54. Examples of material changes requiring the filing of a Form 8-K are changes in directors, changes in financial condition, changes in the certifying accountant, and changes in company policy or practices. *See* 17 C.F.R. § 249.308 (2025); SEC Form 8-K, Items 2.02, 4.01, 5.02, 5.03. Companies must ordinarily file the Form 8-K with the SEC within four days of the triggering event. SEC Form 8-K, Item B.1.

55. *See, e.g.*, Bainbridge, *supra* note 51, at 1203 (recognizing that insiders in most cases may not publicly disclose confidential information and therefore have a duty to abstain from trading).

56. Chiarella v. United States, 445 U.S. 222, 231 (1980). Chiarella would likely have been convicted under two theories that did not exist at the time of his trading activities. The first is Rule 14e–3, which prohibits insider trading on information relating to tender offers. *See* 17 C.F.R. § 240.14e–3(a) (2025) (providing that it is unlawful for a person to trade on information of a tender offer if the person knew the information was material and nonpublic and acquired the information from the offeror, the issuer, or an insider). The second is the misappropriation theory, which prohibits committing a fraud on the source of inside information by breaching a representation not to trade on the information. *See* United States v. O'Hagan, 521 U.S. 642, 652 (1997).

57. *See Chiarella*, 445 U.S. at 231 (holding that, absent a duty to disclose, trading on inside information is not securities fraud).

58. *Id.*

59. *Id.* at 224. The Court added that "the 'market information' upon which [Chiarella] relied did not concern the earning power or operations of the target company, but only the plans of the acquiring company." *Id.* at 231.

nonpublic information from them, he could not have breached a fiduciary duty to them.[60]

In a dissenting opinion, Chief Justice Burger argued that any misappropriation of material, nonpublic information, regardless of the identity of the source or the recipient, should support a section 10(b) violation.[61] The Supreme Court ultimately adopted the Chief Justice's view in *United States v. O'Hagan.*[62] Before discussing *O'Hagan*, this Article will discuss the expansion of the classical theory.

2. Expansion of the Classical Theory

Federal courts have broadened the classical theory in two ways. First, rather than limiting the definition of an insider to high-level managers, the courts now consider any company employee to be an insider for purposes of the classical theory.[63] This extension of the classical theory follows from the premise that the "fiduciary principle is applicable . . . to employees."[64] Thus, for example, if a salesperson working for a retail electronics company acquires material, nonpublic financial information about the company's burgeoning retail sales figures and trades on that information, the courts would deem that salesperson, despite that person's rank-and-file status, an insider for purposes of the classical theory.

A second judicial expansion of the classical theory is to characterize independent contractors such as non-employee attorneys, accountants, and other consultants, as temporary insiders and, therefore, to subject them to the possibility of a classical violation.[65] To facilitate a consultant's ability to perform that person's job responsibilities, a company may need to

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60. *Id.*

61. *Id.* at 240 (Burger, C.J., dissenting). Chief Justice Burger wrote: "I would read [section] 10(b) and Rule 10b–5 . . . to mean that a person who has misappropriated nonpublic information has an absolute duty to disclose that information or to refrain from trading." *Id.* Justice Blackmun, in a separate dissenting opinion, argued that a section 10(b) violation should not require a breach of fiduciary duty to shareholders. *Id.* at 247 (Blackmun, J., dissenting). In his view, trading on information acquired unlawfully—as Chiarella did—regardless of any fiduciary relationship to shareholders, supported a violation. *Id.* at 247, 251.

62. United States v. O'Hagan, 521 U.S. 642, 653 (1997).

63. *See, e.g.*, United States v. Whitman, 904 F. Supp. 2d 363, 366–67 (S.D.N.Y. 2012) (agreeing with circuit courts that have held low-level employees subject to the classical theory's insider trading prohibition); SEC v. McGee, 895 F. Supp. 2d 669, 675 (E.D. Pa. 2012) (noting that, under the classical theory, "[a]n insider is anyone connected to the corporation, including not only officers, directors and employees, but also those working in a fiduciary capacity for the corporation, such as attorneys and accountants").

64. RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. c (A.L.I. 2006).

65. *See* Dirks v. SEC, 463 U.S. 646, 655 n.14 (1983). The *Dirks* Court stated:

> Under certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, lawyer, or consultant working for the corporation, these outsiders may become fiduciaries of the shareholders. The basis for recognizing this fiduciary duty is not simply that such persons acquired nonpublic corporate information, but rather that they have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes.

Id.

provide that person with confidential corporate information.[66] Such an independent contractor therefore has a relationship of trust and confidence with that company.[67]

United States v. Kosinski[68] illustrates the broadening of the definition of insiders to include certain independent contractors.[69] In 2005, Regado Biosciences, Inc. (Regado), a pharmaceutical company, commenced clinical trials of its anticoagulant drug, REGI.[70] In January 2014, Regado and Dr. Edward Kosinski entered into an agreement by which Kosinski agreed to conduct stage-three clinical trials of REGI at one of Regado's designated sites.[71] To avoid conflicts of interest, the agreement required Kosinski to maintain in "strict confidence" the information he acquired from Regado and to disclose to Regado the value of his holdings of Regado stock if the value exceeded $50,000.[72]

Between October 2013 and May 2014, Kosinski continually purchased Regado shares until the value of his holdings was approximately $250,000.[73] Although the value of Kosinski's Regado stock far exceeded the $50,000 limit stipulated in the contract, Kosinski did not disclose this fact to Regado.[74] On June 29, 2014, the study's management team informed Kosinski that it had halted the enrollment of new subjects because several patients had experienced allergic reactions to REGI.[75] The next day, Kosinski sold all his Regado stock.[76] The following day, the management team informed Kosinski that a subject had died from an allergic reaction to REGI and that the study was on hold pending further assessment of the drug's dangers.[77] Two days later, Kosinski bought put options in Regado stock, a bet that the stock's value would fall.[78] One month after that, Regado publicly announced that it had permanently discontinued the study of REGI.[79] After Regado stock had fallen from $2.80 per share to $1.10, Kosinski bought Regado shares and sold his put options at $2.50 per share, making about $3,300 on these transactions.[80]

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66. *See id.* (recognizing that some consultants may need inside information to perform their responsibilities to a company).

67. *See id.* (noting that a consultant may owe a duty of confidentiality to a company).

68. 976 F.3d 135 (2d Cir. 2020).

69. *Id.* at 148.

70. *Id.* at 139–40.

71. *Id.* at 140. Stage-three trials are comprehensive, involving thousands of subjects at multiple sites. *Id.* Regado engaged Dr. Kosinski as the principal investigator at one of those sites. *Id.*

72. *Id.* at 140. Kosinski was the president of Connecticut Clinical Research, LLC and had experience conducting clinical trials for various drugs. *Id.* He was responsible for recruiting subjects, disclosing the risks and the reasons for the study to the subjects, acquiring the subject's informed consent to participate in the study, ensuring that the patient's received the appropriate level of medical care, and reporting the result of the study. *Id.* at 139.

73. *Id.* at 141.

74. United States v. Kosinski, 976 F.3d 135, 141 (2d Cir. 2020).

75. *Id.*

76. *Id.*

77. *Id.* at 141–42.

78. *Id.* at 142.

79. *Id.*

80. United States v. Kosinski, 976 F.3d 135, 142 (2d Cir. 2020).

Although Kosinski was convicted of unlawful insider trading under the misappropriation theory, the Second Circuit pointed out that, as a temporary insider, he could have been convicted under the classical theory.[81] Kosinski argued that, as an independent contractor, he did not owe fiduciary duties to Regado or its shareholders.[82] Rejecting this argument, the court recognized that if, for business purposes, a corporation provides inside information to an independent contractor, that person owes the shareholders a duty of trust and confidence.[83] The court then held that Kosinski was a temporary insider of Regado.[84] To support this conclusion, the court noted that Regado engaged Kosinski in a highly responsible position.[85] Because of Kosinski's duties to Regado, he needed access to sensitive, confidential information.[86] Absent Kosinski's express agreement to preserve the confidentiality of that information, Regado would not have provided the information to him.[87] To ensure that Kosinski's financial interest remained independent of Regado's interests, the company insisted on the disclosure agreement.[88] All these facts supported Kosinski's status as a "temporary insider" and his fiduciary duty to Regado and its shareholders.[89]

Kosinski argued that his agreement with Regado did not restrict him from trading Regado stock but merely required him to disclose the value of Regado stock if the value exceeded $50,000.[90] Thus, he contended that his trading activities did not breach the duty specified in their contract.[91] The court disagreed, holding that the absence of an express prohibition to trade was irrelevant.[92] The requirement that Kosinski disclose his Regado holdings implied a prohibition to trade.[93]

Although the courts have expanded the reach of the classical theory to include rank-and-file employees and temporary insiders, the theory remains limited in its scope of liability. As shown below, the inadequacies

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81. *Id.* at 144–45.
82. *Id.* at 148.
83. *Id.* at 144 ("Under certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, lawyer, or consultant working for the corporation, these outsiders may become fiduciaries of the shareholders. The basis for recognizing this fiduciary duty is not simply that such persons acquired nonpublic corporate information, but rather that they have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes." (quoting Dirks v. SEC, 463 U.S. 646, 655 n.14 (1983))).
84. *Id.* at 145.
85. *See id.* at 146 (noting that, because of Kosinski's experience, Regado entrusted him to run clinical trials for the drug, REGI).
86. United States v. Kosinski, 976 F.3d 135, 145–46 (2d Cir. 2020).
87. *Id.* at 145.
88. *Id.* at 146–47.
89. *Id.* at 143–47.
90. *Id.* at 140.
91. *Id.* at 142–43.
92. United States v. Kosinski, 976 F.3d 135, 147 (2d Cir. 2020).
93. *Id.*

of the classical theory derive from its focus on a breach of fiduciary duty to shareholders.

B. Criticisms of the Classical Theory

Although the *Chiarella* Court left the scope of a prohibited breach of fiduciary duty murky,[94] some commentators assert that the classical theory prohibits insider trading only when the counterparty is a shareholder.[95] If the fiduciary duty runs exclusively to shareholders, insider trading with any other counterparty would not establish liability.[96] Tying the fiduciary duty of the insider to trading with a shareholder seems an unduly restrictive interpretation of Rule 10b-5 and of the manipulative and deceptive devices it forbids. A broader and more sensible view is that the fiduciary duty runs to any counterparty. Such an approach fits easily within the prohibitory language of section 10(b).[97] As Justice Blackmun argued in his dissenting opinion in *Chiarella*, if insiders trade on material, nonpublic information, they have, because of their informational advantage, engaged in a manipulative device within the meaning of section 10(b).[98]

If insiders owe the duty to disclose or abstain only to existing shareholders, a vexing corollary follows: Liability attaches only if the insider purchases, rather than sells, securities.[99] Under this dubious proposition,

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94. *See* Chiarella v. United States, 445 U.S. 222, 231 (1980). Although the Court emphasized that insiders owe a fiduciary duty to shareholders, it suggested in a footnote that the duty to disclose or abstain also runs to non-shareholders who buyer the security in question. *See id.* at 227 n.8 (stating SEC's position that "it would be a sorry distinction to allow [an insider] to use the advantage of his position to induce the buyer into the position of a beneficiary although he was forbidden to do so once the buyer had become one" (quoting Cady, Roberts & Co., Exchange Act Release No. 6668, 40 SEC Docket 907, 1961 WL 60638, at *5 n.23 (Nov. 8, 1961))).

95. *See, e.g.*, Zachary J. Gubler, *A Unified Theory of Insider Trading Law*, 105 GEO. L.J. 1225, 1228–29 (2017) (concluding that "because corporate insiders owe a duty of disclosure, at most, only to current shareholders, the classical theory implies that the insider trading ban extends only to sellers, and not purchasers, of the corporation's stock"); A.C. Pritchard, United States v. O'Hagan*: Agency Law and Justice Powell's Legacy for the Law of Insider Trading*, 78 B.U. L. REV. 13, 26 (1998) (asserting that "the fiduciary obligation of corporate officers and directors generally extends only to current shareholders" and that the "obligation does not extend to prospective shareholders who may purchase their shares for the first time when an insider sells"). *But see* David Cowan Bayne, *The Insider's Natural-Law Duty:* Chiarella *and the 'Fiduciary' Fallacy*, 19 J. CORP. L. 681, 706 (1994) (questioning whether *Chiarella* limits insider trading liability to shareholder-sellers); Edward Douma, Comment, *The Misappropriation Theory: Too Much of a Good Thing?*, 17 PAC. L.J. 111, 120–21 (1985) (implying that the classical theory prohibits insider trading on material, nonpublic information only when the insider purchases securities); *contra* Donald C. Langevoort, *Insider Trading and the Fiduciary Principle: A Post*-Chiarella *Restatement*, 70 CAL. L. REV. 1, 13 (1982) (interpreting *Chiarella* to impose an insider's disclose-or-abstain obligation to "persons who bought into the corporation, even though there was no pre-existing duty of disclosure, because that very transaction brought them into such a relationship"). *Cf.* Windon Third Oil & Gas Drilling P'ship v. FDIC, 805 F.2d 342, 347 (10th Cir. 1986), *cert. denied*, 107 S. Ct. 1605 (1987) (requiring a fiduciary relationship as a precondition to establish a duty to disclose).

96. *See, e.g.*, Pritchard, *supra* note 95, at 26.

97. *See generally* Kenneth R. Davis, *The Equality Principle: How Title VII Can Save Insider Trading Law*, 39 CARDOZO L. REV. 199, 209 (2017) (arguing that the Title VII model of equality of opportunity be applied to insider trading law, a change which would result in equal access to information for all investors).

98. *Chiarella*, 445 U.S. at 246, 251 (Blackmun, J., dissenting).

99. *See supra* text accompanying note 95 (discussing the scope of an insider's fiduciary duty to buyers of securities).

an insider with adverse information about a company who sells that company's security would escape liability because the counterparty-purchaser is probably not an existing shareholder. Anyone, regardless of shareholder status, may purchase a security. Giving a free pass to insiders who sell rather than buy would surely be a welcome loophole for unscrupulous corporate bigwigs who wish to cash in on inside information.

Limiting liability to purchases of securities confounds common sense. None of the policy reasons for restricting insider trading apply more persuasively to buying stock than to selling it. Insider selling inflicts as much harm on a counterparty as does insider buying. In both cases, a counterparty is at an informational disadvantage compared to the insider. Similarly, insider buying and selling cause the same harm to the confidence of market participants and market integrity.

It would seem, thankfully, that this restrictive interpretation of *Chiarella* is not the law. In *United States v. Chestman*,[100] the Second Circuit, although in a footnote, rejected this narrow view.[101] The Second Circuit noted that *Cady, Roberts & Co*., the SEC case establishing the disclose-or-abstain rule, applied the rule to an insider who sold, rather than bought, corporate stock.[102] Observing that the *Chiarella* Court, also in a footnote, approved the reasoning of *Cady, Roberts & Co.*, the Second Circuit concluded that insiders owe a duty of disclosure to all counterparties, regardless of whether they are preexisting shareholders.[103]

The *Chestman* decision is intuitively sensible. As the court explained, "[I]t would be a sorry distinction to allow [an insider] to use the advantage of his position to induce the buyer into the position of a beneficiary although he was forbidden to do so once the buyer had become one."[104] The decision, however, is hard to defend doctrinally. *Chiarella* was based expressly on the fiduciary duty that insiders owe to shareholders rather than to the investing public.[105] One may, therefore, question why this duty extends to a non-shareholder purchaser.

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100. 947 F.2d 551 (2d Cir. 1991).

101. *Id.* at 565 n.2 (quoting *Chiarella*, 445 U.S. at 227 n.8) (relying on a footnote in *Chiarella*, which criticized limiting an insider's duty to existing shareholders); *see also* Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 165 n.14 (1980) (acknowledging that the *Chiarella* disclose-or-abstain rule applies when the insider sells a security); Steve Thel, *Statutory Findings and Insider Trading Regulation*, 50 VAND. L. REV. 1091, 1119 n.113 (recognizing that insider selling may violate the prohibition established in *Chiarella*, even though the insider owes no fiduciary duty to a non-shareholder counterparty).

102. *Chestman*, 947 F.2d at 565 n.2 (quoting *Chiarella*, 445 U.S. at 227 n.8 (1980)).

103. *Id.* (quoting *Chiarella*, 445 U.S. at 227 n.8 (1980)) (relying on the footnote in *Chiarella*, which criticized limiting an insider's duty to existing shareholders and stating "[t]he insider's fiduciary duties, it should be noted, run to a buyer (a shareholder-to-be) and to a seller (a pre-existing shareholder) of securities, even though the buyer technically does not have a fiduciary relationship with the insider prior to the trade").

104. *Id.* (quoting *Chiarella*, 445 U.S. at 227 n.8).

105. *Chiarella*, 445 U.S. at 230 (emphasizing that "[a]pplication of a duty to disclose prior to trading guarantees that corporate insiders, who have an obligation to place the shareholder's welfare

These shortcomings of the classical theory, however, are not the theory's most glaring flaw. As discussed below, a misconception undermines the efficacy of the theory. This misconception wrongly conditions a violation on whether the insider profited from the improper trade.

C. The Mistaken Focus on Profits

When discussing the classical theory, the Supreme Court asserted: "Application of a duty to disclose prior to trading guarantees that corporate insiders . . . will not *benefit personally* through fraudulent use of material, nonpublic information."[106] The Court's focus on a benefit, meaning profits from the trade, was mistaken. This mistake not only injects confusion into the classical theory, but as shown in Part IV, also distorts the theory of tipper/tippee liability, which, as a derivative of the classical theory, requires that the tipper receive a personal benefit from the tippee.[107] The personal-benefit requirement in tipper/tippee theory functions as a proxy for the profits the tipper–insider might have made had that person traded.[108] Part IV demonstrates that this proxy is unnecessary because profiting from the trade should be irrelevant to classical liability.

To determine whether section 10(b) requires the insider to derive a benefit from the trade, one might revisit *Chiarella*'s basis for classical liability: either disclose the information or abstain from trading.[109] As noted, this rule ordinarily requires abstention from trading because the insider may not disclose the information, which is the property of the corporation.[110] Note, however, that the rule mandates abstention from trading, not abstention from making profits.[111] The rule does not speak to the insider gaining a benefit. This distinction may seem facile, for surely trading on inside information and profiting from the trade go hand in hand. An insider trades to make money, not to lose it.

Trading and profiting from a trade, however, do not necessarily coincide. They are independent events. Consider the insider with material, nonpublic information, who trades on that information but loses money. Such a situation is altogether possible. For example, shortly preceding the execution of the trade, the stock markets may swoon. The reason might be

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before their own, will not benefit personally through fraudulent use of material, nonpublic information"). Furthermore, the *Chiarella* Court rejected the SEC's position that an insider owes a general duty to the public to disclose or abstain from trading. *Id.* at 232 (explaining that "[n]o duty could arise from petitioner's relationship with the sellers of the target company's securities, for petitioner had no prior dealings with them").

106. *Id.* at 230 (emphasis added).

107. *See* Dirks v. SEC, 463 U.S. 646, 663 (1983).

108. *Id.* at 659 (explaining that "the tippee's duty to disclose or abstain is derivative from that of the insider's duty").

109. *See Chiarella*, 445 U.S. at 226–27 (citing Cady, Roberts & Co., Exchange Act Release No. 6668, 40 SEC Docket 907, 1961 WL 60638, at *3 (Nov. 8, 1961) for the principle that the insider must disclose the information or abstain from trading).

110. *See, e.g.*, Bainbridge, *supra* note 51, at 1202–03, 1252 (characterizing a corporation's interest in its confidential information as a property right).

111. *See Chiarella*, 445 U.S. at 230 (requiring disclosure "prior to trading," but not referring to profits made from trading).

the escalation of a simmering war, the sudden imposition of outsized tariffs on international trade, or a statement of a member of the Federal Reserve Board foretelling a rise in interest rates. The insider may have learned of any of these risks before trading but gambled that the favorable inside information, when disclosed, would outweigh the effect of the adverse information. The vagaries of the securities markets should not determine liability. By trading on confidential corporate information, the insider has breached the fiduciary duty to the shareholders by the very act of trading, regardless of the outcome.

Section 10(b) forbids deceptive and manipulative devices in connection with the purchase or sale of securities.[112] Classical liability is based on an insider's fiduciary duty of loyalty to the company's shareholders.[113] When an insider engages in self-dealing, the insider has breached that duty.[114] Trading on confidential corporate information is an act of prohibited self-dealing.[115] More specifically, the forbidden act is an insider's unauthorized use of corporate information.[116] Such breaches of fiduciary duty are deceptive or manipulative devices in connection with the purchase or sale of securities and therefore violate section 10(b).[117] Whether the insider profited from the unauthorized use of the information is irrelevant to the breach of fiduciary duty to the corporation's shareholders and is therefore irrelevant to a violation of section 10(b). The rationale that a necessary element of a breach of fiduciary duty is profit on the trade is a judicial construct, a contrivance that misconstrues the very nature of the fiduciary duty owed to shareholders and the meaning of section 10(b).

D. The Need for a Broader Theory of Liability

As shown above, *Chestman* adopted the broadest possible view of classical-theory liability. Even under *Chestman*'s view, the scope of classical liability is inadequate because it applies only to corporate insiders. An insider might confide confidential corporate information in outside attorneys, auditors, printers of legal documents, or anyone else. The classical theory does not address the possible liability of any of these parties.

112. 15 U.S.C. § 78j(b).

113. *See Chiarella*, 445 U.S. at 228–30.

114. *See* White v. White, 704 S.W.3d 250, 269–70 (Tex. Ct. App. 2024) (stating that "self-dealing is essentially a subset of a claim for breach of fiduciary duty, but with the additional requirement that the fiduciary used the advantage of his position to gain a benefit or profit at the expense of those to whom he owes a fiduciary duty"); *In re* Primedia, Inc., 67 A.3d 455, 479–80, 488–89 (Del. Ch. 2013) (asserting that a corporate insider breaches the duty of loyalty by "misusing material, nonpublic information"); Asaf Eckstein & Gideon Parchomovsky, *Toward a Horizontal Fiduciary Duty in Corporate Law*, 104 CORNELL L. REV. 803, 813 (2019) (noting that the duty of loyalty prohibits self-dealing); Victor Brudney, *Revisiting the Import of Shareholder Consent for Corporate Fiduciary Loyalty Obligations*, 25 J. CORP. L. 209, 211 (2000) (discussing the boundaries that delineate when an agent's self-dealing violates a breach of fiduciary duty to the principal).

115. *See, e.g.*, *Chiarella*, 445 U.S. at 230–31 (holding insider trading on material, nonpublic information is a prohibited act of self-dealing).

116. *See, e.g.*, RESTATEMENT (THIRD) OF AGENCY § 8.05 (A.L.I. 2006) (asserting that "[a]n agent has a duty . . . not to use or communicate confidential information of the principal for the agent's own purposes or those of a third party") (emphasis removed).

117. 15 U.S.C. § 78j(b).

Recognition of the narrow scope of classical-theory liability led the Supreme Court to adopt the misappropriation theory, which casts a wider net to snare anyone who breaches a duty of trust and confidence to the source.

II. THE MISAPPROPRIATION THEORY

In *United States v. O'Hagan*, the Supreme Court established the misappropriation theory.[118] Like the *Chiarella* Court, the *O'Hagan* Court derived liability from section 10(b).[119] After analyzing the *O'Hagan* decision, this Part debunks the so-called brazen fiduciary problem. Then this Part shows that the misappropriation theory differs from the classical theory in that it imposes a duty only to abstain from trading, not a duty to disclose. In addition, Part II argues that, although intended to prohibit outsider trading, the misappropriation theory applies equally to insider trading classical cases. Most important, Part II demonstrates that a misappropriation arises, not from profiting from a trade but rather from the very act of trading.

A. United States v. O'Hagan*: A Broader and Better Approach*

1. O'Hagan's Misappropriation

James O'Hagan was a partner in the Minneapolis law firm, Dorsey & Whitney.[120] In July 1988, Grand Metropolitan PLC (Grand Met) retained Dorsey & Whitney to represent it in a tender offer for Pillsbury Company.[121] Both Grand Met and Pillsbury took measures to ensure that, until Grand Met made the tender offer, the offer would remain confidential.[122] Although O'Hagan did not work on the tender offer, as a Dorsey & Whitney partner, he learned that it was imminent.[123] Armed with this knowledge, he purchased Pillsbury call options and common stock for $39 per share.[124] When Grand Met publicly announced its tender offer for Pillsbury, the value of Pillsbury stock jumped to nearly $60 per share.[125] O'Hagan sold his securities in Pillsbury, making a profit of $4.3 million.[126] After an SEC investigation, the DOJ filed a fifty-seven-count indictment against

118. *See* United States v. O'Hagan, 521 U.S. 642, 649–50 (1997). Ten years before *O'Hagan*, the Supreme Court affirmed criminal convictions for wire fraud and mail fraud based on the misappropriation of information scheduled for publication in the *Heard on the Street* column of the *Wall Street Journal*. Carpenter v. United States, 484 U.S. 19, 21–22, 24 (1987). Although *Carpenter* involved insider trading on the misappropriated information, it was not until the *O'Hagan* decision that the Supreme Court applied the misappropriation theory to section 10(b). *O'Hagan*, 521 U.S. at 649–50.

119. *See O'Hagan*, 521 U.S. at 649–52.

120. *Id.* at 647.

121. *Id.*

122. *Id.*

123. *Id.*

124. *Id.* at 647–48. In September 1988, Dorsey &Whitney ceased representing Grand Met, but by that time O'Hagan had already acquired information of the coming tender offer. *Id.* at 647.

125. United States v. O'Hagan, 521 U.S. 642, 648 (1997).

126. *Id.*

O'Hagan.[127] The indictment accused O'Hagan of violating section 10(b) by misappropriating the information of the tender offer that Grand Met and Dorsey & Whitney had entrusted to Dorsey & Whitney's lawyers.[128]

2. Recognition of the Misappropriation Theory

The primary issue in *O'Hagan* was whether the misappropriation of confidential corporate information violates section 10(b).[129] Distinguishing the misappropriation theory from the classical theory, which applies to corporate insiders, the Court explained that the misappropriation theory applies to corporate "outsiders."[130] To support the misappropriation theory, the Court invoked common law agency principles.[131] If the source of confidential information forbids the recipient to trade, the recipient of the information breaches a fiduciary duty by trading on the entrusted information.[132] The Court expressed this principal as follows: "[A] fiduciary's undisclosed, self-serving *use* of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information."[133] The Court correctly emphasized that the breach of fiduciary duty arises from the unauthorized use of the information rather than from profits derived from the trade.

In the final step of its analysis, the Court held that such a breach violates section 10(b) because the breach constitutes a "'deceptive device or contrivance' used 'in connection with' the purchase or sale of securities."[134] In other words, such a breach of trust works a fraud on the source of the information.[135] By trading on information of Grand Met's planned

127. *Id.* The indictment alleged that O'Hagan used his trading profits on the tender offer to conceal his previous embezzlement of the trust funds of a different client. *Id.*

128. *Id.* The district court sentenced O'Hagan to a forty-one-month prison term. *Id.* at 649.

129. *Id.* at 647.

130. *Id.* at 652–53.

131. United States v. O'Hagan, 521 U.S. 642, 654–55 (noting the government's reference to agency principles); *see also e.g.*, Ryan Fane, *Agency Problems and the Misappropriation Theory of Insider Trading in* SEC v. Panuwat, U. CHI. L. REV. ONLINE (May 13, 2022), https://lawreview.uchicago.edu/online-archive/agency-problems-and-misappropriation-theory-insider-trading-sec-v-panuwat (observing that "the misappropriation theory is rooted in the law of agency"); Pritchard, *supra* note 95, at 17 (asserting that "the misappropriation theory draws primarily on the common law of agency").

132. *O'Hagan*, 521 U.S. at 651–52, 654.

133. *Id.* at 652 (emphasis added).

134. *Id.* at 653. The Court reemphasized that the trade, not profits derived from it, constitutes the breach of fiduciary duty under the misappropriation theory, writing: "A misappropriator who *trades on the basis of material, nonpublic information*, in short, gains his advantageous market position through deception; he deceives the source of the information and simultaneously harms members of the investing public." *Id.* at 656 (emphasis added).

135. *Id.* at 652–54. Justice Scalia argued that section 10(b) requires that a prohibited deception be visited on the trading counterparty, rather than the source who was not involved in the trade. *Id.* at 679 (Scalia., J., concurring in part and dissenting in part). Justice Thomas seized upon the government's concession—adopted by the Court's majority—that trading on embezzled funds would not be "in connection with" the purchase or sale of a security. *See id.* at 683–85 (Thomas, J., dissenting). The government made this concession because, it contended, the wrong would have been completed when the funds were embezzled, not when the trade was made. *Id.* at 683. Because embezzled funds may be

tender offer for Pillsbury, O'Hagan had breached a duty of trust and confidence to Grand Met and Dorsey & Whitney.[136]

3. Policy Considerations

The Court invoked policy considerations to justify the misappropriation theory. The theory, the Court observed, enhances investor confidence in the securities markets because investors not privy to such inside information are at an informational disadvantage.[137] The Court found the informational advantage of a misappropriator unfair to uninformed investors, who cannot overcome this disadvantage with research or skill.[138] Allowing such misuse of inside information would undermine investor confidence in the securities markets and discourage disgruntled parties from investing.[139]

4. The "Brazen Fiduciary" Problem

Because deception is an element of a section 10(b) violation, the Supreme Court explained that if a recipient of inside information discloses to the source the intention to trade on the information, the recipient has not committed an insider trading violation.[140] Such a disclosure, reasoned the Court, negates the element of deception.[141] This evasion of a misappropriator's duty is called the "brazen fiduciary" problem.[142] Following this line

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used for many purposes having nothing to do with trading securities, the use of embezzled funds is incidental to the wrongful trade, not a necessary part of it. *Id.* at 683–84. Justice Thomas argued that the majority made a false distinction between trading on misappropriated information and trading with embezzled funds. *Id.* at 684–85. Just as the embezzler may use the stolen funds for a multitude of purposes, information may be used for purposes other than trading. *See id.* at 685 (explaining that the information could have been used for personal amusement). For example, he noted that information may be sold. *Id.* Despite its inventiveness, Justice Thomas's argument misconstrues the "in connection with" element of section 10(b), because the "in connection with" element requires a nexus between the fraud and the trade. *See, e.g.*, SEC v. Zandford, 535 U.S. 813, 824–25 (2002) (holding that a broker's scheme to sell client-owned securities and steal the proceeds was "in connection with" the purchase or sale of a security, because the sale and theft were two parts of a unitary scheme). Inside information provides a trading advantage to those fortunate enough to have it. The nexus between the information and the trade is obvious. In the embezzled-funds hypothetical posed in the *O'Hagan* case, the embezzled funds do not provide the thief with any trading advantage.

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

137. *Id.* at 658.

138. *Id.* at 658–59.

139. *See id.* at 659 (citing Victor Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322, 356 (1979) (arguing that those at an informational disadvantage may view the market as a rigged enterprise and refrain from trading securities)).

140. *Id.* at 655. The Court explained that "full disclosure forecloses liability under the misappropriation theory: Because the deception essential to the misappropriation theory involves feigning fidelity to the source of information, if the fiduciary discloses to the source that he plans to trade on the nonpublic information, there is no 'deceptive device' and thus no [section] 10(b) violation—although the fiduciary-turned-trader may remain liable under state law for breach of a duty of loyalty." *Id.* The Government conceded this point at oral argument. *See id.* (quoting Transcript of Oral Argument at 12, United States v. O'Hagan, 521 U.S. 642 (1997) (No. 96-842).

141. *Id.* at 655.

142. *See, e.g.*, Gubler, *supra* note 95, at 1263 (explaining that the brazen fiduciary "can unilaterally contract around [a duty of trust] by providing the information source with notice of an intent to trade on the source's information"); Roberta S. Karmel, *Outsider Trading on Confidential Information—A Breach in Search of a Duty*, 20 CARDOZO L. REV. 83, 95 (1998) (acknowledging the tactic

of reasoning, the Court noted that O'Hagan's failure to disclose his intention to trade Pillsbury stock to the sources of the information of the impending tender offer—Grand Met and Dorsey & Whitney—established a violation of section 10(b).[143] If, however, O'Hagan had made such a disclosure, he would have evaded liability.[144] To support this perplexing proposition, the Supreme Court cited *Restatement (Second) of Agency* Sections 390 and 395.[145] However, neither section supports the Court's view. Section 390 permits agents to act on their own behalf only with the consent of their principal.[146] Section 395 prohibits an agent from using confidential information against the principal's instructions.[147]

The following hypothetical illustrates why "brazen fiduciaries" may not unilaterally disclaim their fiduciary duties. Suppose that Dee Seaver is negotiating the sale of a ring to Vic Tim. The stone in the ring is a cubic zirconium, which to the untrained eye might appear to be a diamond. Using false documentation to establish that the stone is a diamond, Dee sells the ring to Vic for $15,000, the fair market value if the stone were a diamond. Dee has committed fraud.[148] Now suppose that Dee discloses her lie to Vic before the sale is consummated. Vic will not purchase the ring,

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of informing the source of one's intention to trade as a means of avoiding liability); Richard W. Painter, Kimberly D. Krawiec, & Cynthia A. Williams, *Don't Ask, Just Tell: Insider Trading After* United States v. O'Hagan, 84 VA. L. REV. 153, 180 (1998) (noting that under *O'Hagan* "a fiduciary is permitted to trade even without the principal's consent so long as disclosure is made to the principal first").

143. *O'Hagan*, 521 U.S.at 660.

144. *See id.* (explaining that by not disclosing to Grand Met or Dorsey and Whitney O'Hagan committed misappropriation).

145. *Id.* at 654.

146. *See* RESTATEMENT (SECOND) OF AGENCY § 390 (A.L.I. 1958). Section 390 does not support the Supreme Court's position. That section provides:

> An agent who, to the knowledge of the principal, acts on his own account in a transaction in which he is employed has a duty to deal fairly with the principal and to disclose to him all facts which the agent knows or should know would reasonably affect the principal's judgment, unless the principal has manifested that he knows such facts or that he does not care to know them.

Id. The section makes clear that an agent may not take such actions on his own behalf absent the principal's consent. *Id.* cmt. a.

147. *See* RESTATEMENT (SECOND) OF AGENCY § 395 (A.L.I. 1958). Section § 395 provides:

> Unless otherwise agreed, an agent is subject to a duty to the principal not to use or to communicate information confidentially given him by the principal or acquired by him during the course of or on account of his agency or in violation of his duties as agent, in competition with or to the injury of the principal, on his own account or on behalf of another, although such information does not relate to the transaction in which he is then employed, unless the information is a matter of general knowledge.

Id.

148. *See, e.g.*, Robinson Helicopter Co. v. Dana Corp., 102 P.3d 268, 274 (Cal. 2004) (noting that "[t]he elements of fraud are: (1) a misrepresentation (false representation, concealment, or nondisclosure); (2) knowledge of falsity (or scienter); (3) intent to defraud, i.e., to induce reliance; (4) justifiable reliance; and (5) resulting damage"); Gennari v. Weichert Co. Realtors, 691 A.2d 350, 367 (N.J. 1997) (stating that "[t]he five elements of common-law fraud are: (1) a material misrepresentation of a presently existing or past fact; (2) knowledge or belief by the defendant of its falsity; (3) an intention that the other person rely on it; (4) reasonable reliance thereon by the other person; and (5) resulting damages"); Jo Ann Homes at Bellmore, Inc. v. Dworetz, 250 N.E.2d 214, 217 (N.Y. 1969) (noting that the elements of fraud are "a representation of fact, which is either untrue and known to be untrue or recklessly made, and which is offered to deceive the other party and to induce them to act upon it, causing injury").

and absent a purchase, Dee has not committed an actionable fraud because Vic did not rely on Dee's misrepresentation or suffer an injury.[149] The circumstances of a misappropriation case are dramatically different from this illustration. Whereas Vic may decline to purchase the ring, the source of misappropriated information does not have the ability to prevent the misappropriator from trading. The misappropriator may trade against the wishes of the source. In other words, the misappropriator achieves the objective of the fraud, regardless of disclosing the intent to trade.

To allow the brazen fiduciary to trade on the information provided by the source undermines the misappropriation theory.[150] There is a plausible explanation for the lapse of judicial analysis that led the Supreme Court to exonerate a brazen fiduciary. This wrongful exoneration conflates the classical theory with the misappropriation theory. The classical theory recognizes that the counterparty is at an informational disadvantage compared to the insider. It follows that if the insider eliminates the informational advantage by disclosure, the trade does not violate a fiduciary duty to the counterparty. This reasoning does not apply to the misappropriation theory because the recipient of the information owes no duty to the counterparty. The recipient owes a duty to the source, and that duty is simply not to trade.[151] The duty has nothing to do with an informational advantage and, therefore, is not vitiated by disclosure—either to the counterparty or to the source.[152] Declaring to the source, "I am going to trade on the information you confided in me," does not abrogate the deception.[153] If such a duty were so easily discarded, a promise to the source would devolve into a meaningless ritual, the promisor withdrawing the duty on a whim and then trading with impunity. On the other hand, if the source permits the recipient to trade, the case no longer involves misappropriation. Rather, the case

149. *See, e.g.*, *Robinson Helicopter Co.*, 102 P.3d at 274; *Gennari*, 691 A.2d at 367; *Jo Ann Homes at Bellmore, Inc.*, 250 N.E.2d at 217.

150. *See* Donna M. Nagy, *Reframing the Misappropriation Theory of Insider Trading Liability: A Post*-O'Hagan *Suggestion*, 59 OHIO ST. L.J. 1223, 1257 (1998) (suggesting that the brazen fiduciary problem may prove rare when employers entrust confidential information to employees because an employees would fear reprisals, but cautioning that in other contexts such as the sharing of information between family members or the sharing of information between businesspersons, the fiduciary may become brazen); Randall W. Quinn, Comment, *The Misappropriation Theory of Insider Trading in the Supreme Court: A (Brief) Response to the (Many) Critics of* United States v. O'Hagan*,* 8 FORDHAM J. CORP. & FIN. L. 865, 894 (2003) (minimizing the brazen fiduciary problem because an employer of a brazen fiduciary will fire the person and seek an injunction to prevent anyone from trading on the confidential information).

151. *See* United States v. O'Hagan, 521 U.S. 642, 652 (1997) (holding that misappropriating confidential information is a breach of a duty owed to the source).

152. *Compare* Chiarella v. United States, 445 U.S. 222, 230 (1980) (holding under the classical theory that "liability is premised upon a duty to disclose" the inside information to shareholders), *with O'Hagan*, 521 U.S. at 652–53 (holding that the misappropriation theory applies because the recipient of information owes a fiduciary duty to the source of the information).

153. *See* Zachary J. Gubler, *Insider Trading as Fraud*, 98 N.C. L. REV. 533, 536 (2020) (asserting that "it is not clear why disclosing such breaches, either by the brazen or halfhearted fiduciary, would have any effect on liability under traditional views of fraud").

involves a tipper and tippee. A tip given with permission to trade is the very definition of the tipper/tippee scenario.[154]

B. The Scope of the Misappropriation Theory

1. The Inclusiveness of the Misappropriation Theory

The *Kosinski* court observed that Kosinski, in addition to violating the misappropriation theory, violated the classical theory.[155] The court's observation was correct. When an insider trades on inside information, that person is liable under both theories.[156] The classical theory applies because, as *Kosinski* recognizes, a temporary insider—or any insider—is obligated under the classical theory to disclose or abstain from trading.[157]

The misappropriation theory also applies. The following explanation shows why: Because the corporation is the source of the information, the information belongs to it.[158] Put another way, the corporation has a property right to its material, nonpublic information.[159] An insider is an agent of the corporation[160] and, therefore, owes the corporation the fiduciary duty of trust and confidence.[161] One aspect of that duty is not to use corporate information for self-interest.[162] An insider who makes an authorized trade on corporate material, nonpublic information has engaged in forbidden self-dealing and has consequently breached the duty of trust and

154. *See infra* Part III; Dirks v. SEC, 463 U.S. 646, 660–61 (1983).

155. United States v. Kosinski, 976 F.3d 135, 144–45 (2020) (stating that "[t]his court has recognized that the classical and misappropriation theories are 'overlapping,' sometimes proscribing the same or similar conduct") (quoting United States v. Newman, 773 F.3d 438, 445 (2d Cir. 2014)).

156. *See, e.g.*, Gubler, *supra* note 95, at 1239 (observing that the misappropriation theory applies to insider trading cases to which courts have traditionally applied the classical theory).

157. *See* Bainbridge, *supra* note 51, at 1203 (explaining that disclosure is rarely permissible, and, therefore, the *Cady, Roberts & Co.* rule to disclose or abstain almost always requires abstention from trading).

158. *See, e.g.*, Carpenter v. United States, 484 U.S. 19, 26 (1987) (holding that "[c]onfidential information acquired or compiled by a corporation in the course and conduct of its business is a species of property to which the corporation has the exclusive right and benefit, and which a court of equity will protect through the injunctive process or other appropriate remedy"); *Martoma II*, 894 F.3d 64, 73 (2d Cir. 2017) (pointing out that "[a] firm's confidential information belongs to the firm itself, and an insider entrusted with it has a fiduciary duty to use it only for firm purposes").

159. *See, e.g.*, Bainbridge, *supra* note 51, at 1202 (arguing that the classical theory's prohibition against insider trading is based on corporate property rights to confidential information).

160. *See* Deborah A. DeMott, *Corporate Officers as Agents*, 74 WASH. & LEE. L. REV. 847, 848 (2017) (acknowledging that officers and directors are agents of their corporation and arguing that their fiduciary duties should be viewed as distinct).

161. *See, e.g.*, Eckstein & Parchomovsky, *supra* note 114, at 813 (noting that corporate insiders owe a fiduciary duty of loyalty to their corporation).

162. *See* RESTATEMENT (THIRD) OF AGENCY § 8.02 cmt. d (A.L.I. 2006) (noting that an agent may not use for his or her personal benefit the principal's confidential information).

confidence owed to the corporation.[163] Such a breach of fiduciary duty constitutes misappropriation.[164]

The classical theory, however, does not have the breadth of the misappropriation theory. One may misappropriate information, as did O'Hagan, without being an insider subject to liability under the classical theory. Because all cases falling under the classical theory are a subset of cases under the misappropriation theory, the classical theory is superfluous.

Applying the misappropriation theory to cases formerly analyzed under the classical theory would be a salutary development because the misappropriation theory would dispense with the analytic inconsistency of basing liability on the failure to disclose to shareholders, rather than all counterparties.[165] In addition, the rule of parsimony prefers the use of one unifying theory rather than two, especially when the unifying theory is simpler than the one it replaces.[166] The misappropriation theory is simpler than the classical theory because the misappropriation theory does not require disclosure. Most importantly, the misappropriation theory is conceptually sounder than the classical theory. Part I showed that the classical theory erroneously prohibits profiting from trading on inside information, rather than prohibiting the very act of such trading.[167] The misappropriation theory does not make this mistake; it prohibits the trade itself, not the gain that may result from it. As shown below, agency law supports the view that profiting from the trade is irrelevant to establishing both a breach of fiduciary duty and a deceptive or manipulative device under section 10(b).

2. The Irrelevance of Personal Gain to Misappropriation

As the Supreme Court recognized in *O'Hagan*, it is irrelevant to the misappropriation theory whether the insider profits from the transaction.[168] Self-dealing, not profit, is the forbidden act.[169] More specifically, an

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163. *See, e.g.*, White v. White, 704 S.W.3d 250, 269 (Tex. Ct. App. 2024) (stating that "self-dealing is essentially a subset of a claim for breach of fiduciary duty, but with the additional requirement that the fiduciary used the advantage of his position to gain a benefit or profit at the expense of those to whom he owes a fiduciary duty"); *In re* Primedia, Inc., 67 A.3d 455, 479–80 (Del. Ch. 2013) (asserting that a corporate insider breaches the duty of loyalty by "misusing material, nonpublic information"); Eckstein & Parchomovksy, *supra* note 114, at 813 (noting that the duty of loyalty prohibits self-dealing).

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

165. *See, e.g.*, *supra* notes 94–95 and accompanying text (discussing whether transactions with non-shareholders may violate the classical theory).

166. The rule of parsimony holds that when a problem has two or more solutions, the simplest solution is best. *See, e.g.*, R.H. Helmholz, *Ockham's Razor in American Law*, 21 TUL. EUR. & CIV. L.F. 109, 110–11 (2006). This rule is often referred to as "Ockham's razor." *Id.* at 109. Known to Aristotle, the preference for the simple over the complex did not originate with the thirteenth-century English philosopher William Ockham, nor did he even coin the term with the metaphorical razor, but he did advocate the preference for simplicity over complexity. *Id.* at 111.

167. *See supra* Section I.C.

168. *See O'Hagan*, 521 U.S. at 676 (suggesting that the trade itself, rather than profits on the trade, is the basis of a misappropriation violation).

169. *See id.* at 652 (noting that the self-serving use of inside information violates the duty of confidentiality to a corporation).

unauthorized trade is an act of self-dealing that constitutes the breach of fiduciary duty.[170] The view that the unauthorized trade, rather than any profits derived from the trade, constitutes the breach finds support in agency law. As stated in the *Restatement (Third) of Agency*, "An agent's *attempted* acquisition of a material benefit may breach the agent's duty to the principal."[171] The agent's success in securing the benefit is, therefore, irrelevant to the breach.[172] The *Restatement (Third) of Agency* provides an instructive example: P, who owns a used-car lot, employs A as its general manager. A's duties include contracting with suppliers to replenish P's inventory. A tells S, a supplier of used cars, that A will not consider purchasing cars from S unless S pays A $1,000 kickback in advance of any transaction. S refuses to pay A. A is subject to liability to P.[173]

Although A's attempt to benefit from the transaction with S failed, A breached the fiduciary duty of loyalty to P. Similarly, if an insider in a classical case or a misappropriator makes an unauthorized trade but fails to profit from that trade, the insider or misappropriator has breached the fiduciary duty of loyalty.[174] Under the classical theory, the insider has breached the duty of loyalty to the shareholders.[175] Under the misappropriation theory, the trader has breached the duty of loyalty to the source of the information.[176] In both cases, the breach of fiduciary duty is a deceptive or manipulative device under section 10(b).

3. The Irrelevance of Board Approval

Even if the board of directors purportedly authorized the insider to trade on material, nonpublic information, the insider would still commit a breach of the fiduciary duty of loyalty to the corporation and its shareholders because the board's permission would itself be improper.[177] A corporation sets dates for the release of quarterly earnings, and it must file a Form 8-K not later than four days after material corporate developments.[178] Agency law "disallows the pursuit of self-interest as a motivating

170. *See id.* (asserting that "a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information").

171. RESTATEMENT (THIRD) OF AGENCY § 8.02 cmt. c (A.L.I. 2006) (emphasis added).

172. *See id.* (stating that an attempt at gaining a personal benefit, regardless of success, may breach an agent's duty).

173. *Id.* cmt. b (explaining such an example in Illustrations 3, 5, and 6).

174. One might quibble that an insider might trade without seeking a profit. In such a case, the RESTATEMENT example, which is based on an attempted profit, would not apply. However, the possibility of anyone trading with the intention of losing money is so remote that one may dismiss it as a near impossibility.

175. Chiarella v. United States, 445 U.S. 222, 230 (1980).

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

177. *See* Mangesh Patwardhan, *To Legislate or Not to Legislate: Judging the Judge-Made Insider Trading Prohibition Theories in the United States*, 45 DEL. J. CORP. L. 323, 339 (2021) (noting that, to drive up a stock's price, it might be advantageous to a company to allow insiders to trade on undisclosed knowledge of an impending takeover bid and that such insider trading would be a violation of the insider's fiduciary duty).

178. *See, e.g.*, 17 C.F.R. § 249.308 (2025).

force in actions the agent determines to take on the principal's behalf."[179] An insider who, even with board approval, gun-jumps an earnings report or 8-K filing would violate this rule of agency law by failing to follow the abstain or disclose rule of *Chiarella*.[180] The insider would simultaneously have engaged in misappropriation.[181] In either case, such a trade would constitute a deceptive or manipulative device under section 10(b).[182] Board collusion in allowing an insider to gun-jump would compound the violation, not eliminate it.

4. Remedies

The principal's potential remedies are manifold, including recovery of damages for any harm caused by the breach.[183] When an insider trades on confidential corporate information, the corporation may incur financial harm. SEC and DOJ investigators and *Wall Street Journal* and *Barons* reporters may discover the malefaction. Public disclosure of the news may cause the company reputational harm and a consequent drop in revenues, profits, and the stock price.[184]

5. Limitation: Tipper/Tippee Liability

The misappropriation theory does not address the problems arising when a party with inside information provides the information to another but does not prohibit that party from trading. A third theory of insider trading, called tipper/tippee liability, addresses this situation. Part III examines the framework for tipper/tippee liability and focuses on one element of such a violation: the personal-benefit requirement. Part IV argues that the Supreme Court has misconceived the personal-benefit requirement and that the law should abandon it.

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179. RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. b (A.L.I. 2006).

180. *See Chiarella*, 445 U.S. at 230 (holding that insider trading liability "is premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction," and "[a]pplication of a duty to disclose prior to trading guarantees that corporate insiders, who have an obligation to place the shareholder's welfare before their own, will not benefit personally through fraudulent use of material, nonpublic information").

181. *See O'Hagan*, 521 U.S. at 652 (holding that the deceptive use of confidential corporate information constitutes misappropriation. Despite the board's collusion, one might argue, however unpersuasively, that the insider who trades with board approval is a brazen fiduciary and therefore free of liability. This Article, however, has debunked the brazen fiduciary doctrine. *See* Part II.A.4 (showing the flaws in the doctrine).

182. *See id.* at 649 (noting that section 10(b) prohibits the use of manipulative or deceptive devices in connection with the purchase or sale of securities); *Chiarella*, 445 U.S. at 230 (discussing what constitutes a violation of section 10(b)).

183. *See* RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. d (A.L.I. 2006) (describing several bases upon which the principal may recover).

184. Trading by insiders on corporate material, nonpublic information may result in reputational damage to the corporation, but such injury is not certain to occur. *See, e.g.*, Charles C. Cox & Kevin S. Fogarty, *Bases of Insider Trading Law*, 49 OHIO ST. L.J. 353, 356 (1988) (arguing that insider trading on corporate information may harm a corporation by damaging public confidence in the company and by increasing the perception of risk, which may result in a fall in the stock price).

III. TIPPER/TIPPEE LIABILITY

Decided fourteen years before *O'Hagan*, *Dirks v. SEC*[185] established the framework for tipper/tippee liability.[186] This framework conditions liability on whether the tipper received a benefit from the tippee.[187] As shown below, the personal-benefit requirement has spawned controversy, involving the Second Circuit in a tug-of-war not only with the Supreme Court, but also with itself.

A. Dirks v. SEC*: The Personal-Benefit Requirement*

As a principal for a broker-dealer, Raymond Dirks analyzed insurance companies for institutional clients.[188] Ronald Secrist was a former officer of Equity Funding of America, a company engaged in selling insurance and mutual funds.[189] On March 6, 1973, Secrist informed Dirks that Equity Funding had fraudulently overstated its assets.[190] Dirks then visited Equity Funding's headquarters where certain of its employees confirmed Secrist's charges of fraud.[191] Dirks shared this information with many of his clients, some liquidating their positions in Equity Funding.[192] He also disclosed this information to William Blundell, a *Wall Street Journal* bureau chief, urging Blundell to publish an article exposing the fraud.[193] Blundell, however, refused because he feared that if the charges proved false, Equity Funding might commence a libel suit against the *Wall Street Journal.*[194] During this period, Equity Funding's share price fell from $26 to $15.[195] As a result of this precipitous decline, the New York Stock Exchange halted trading in the stock.[196] California authorities soon uncovered the fraud, and the SEC filed a complaint against Equity Funding.[197]

In an administrative proceeding, the SEC found that Dirks had aided and abetted a violation of Section 17(a) of the Securities Act of 1933,[198]

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185. Dirks v. SEC, 463 U.S. 646 (1983).
186. *Id.* at 660.
187. *Id.* at 663.
188. *Id.* at 648.
189. *Id.* at 649.
190. *Id.*
191. Dirks v. SEC, 463 U.S. 646, 649 (1983). Senior management denied any wrongdoing. *Id.*
192. *Id.* Dirks's clients sold more than $16 million of Equity Funding securities. *Id.*
193. *Id.*
194. *Id.* at 649–50.
195. *Id.* at 650.
196. *Id.*
197. Dirks v. SEC, 463 U.S. 646, 650 (1983). After the commencement of the SEC action, the *Wall Street Journal* published a front-page story detailing the fraud. *Id.* Equity Funding then went into receivership. *Id.*
198. *Id.* Section 17(a)(3), applies only to sales and not purchases of securities and is narrower than section 10(b) which applies to both purchases or sales. 15 U.S.C. § 77q(a)(3) (2025); 15 U.S.C. § 78j(b) (2025). On the other hand, section 17(a)(3) is broader than section 10(b) in that it proscribes negligence, rather than scienter, in the sale of securities. § 77q(a)(3). The SEC brought a section 17(a)(3) claim against Dirks because Dirks's clients sold Equity Funding stock. *Dirks*, 463 U.S. at 650–51. It is noteworthy that most insider trading cases involve fraudulent purchases, rather than

Section 10(b) of the Exchange Act, and Rule 10b-5.[199] The SEC reasoned that any person acquiring material, nonpublic information from a corporate insider must publicly disclose that information or abstain from trading.[200] The D.C. Circuit confirmed the SEC's ruling.[201] The Supreme Court granted a writ of certiorari and reversed the judgment of the D.C. Circuit.[202]

Because Secrist was an insider of Equity Funding, the Supreme Court analyzed this case under the classical theory.[203] The Court began its analysis by invoking *Cady, Roberts & Co.*, the SEC administrative decision that required corporate insiders with material, nonpublic information either to disclose that information publicly or to abstain from trading.[204] Citing *Chiarella*, the Court went on to explain that section 10(b) imposes liability in a classical case only on those who engage in manipulation or deception.[205] A prohibited manipulation or deception, the Court held, occurs when an insider trades on the information and profits from the trade.[206]

The Court then turned to the liability of a tipper and tippee.[207] A tippee, the Court held, will "inherit[]" the tipper's duty to disclose or abstain if the tipper benefits, directly or indirectly, from the disclosure to the tippee.[208] The *Dirks* Court stated, "[I]nsiders [are] forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, [and] they may not give such information to an outsider for the same improper purpose."[209] The Court summed up its view of what constitutes a breach of fiduciary duty in violation of section 10(b) as follows: "Absent some personal gain, there has been no breach of duty to stockholders," and "absent a breach by the insider," the tippee may lawfully trade on the information.[210] In reaching this decision, the Court

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fraudulent sales. Two scholars have proposed that Congress amend section 17(a)(3) to proscribe purchases of securities. Marc I. Steinberg & Abel Ramirez, *The SEC's Neglected Weapon: A Proposed Amendment to Section 17(A)(3) and the Application of Negligent Insider Trading*, 19 U. PA. J. BUS. L. 239, 264 (2017). The benefit of such an amendment would be to expand the scope of insider trading liability to a negligence standard, regardless of whether the trade was a purchase or sale. *Id.* The authors recognize that such an amendment would benefit only the SEC because section 17(a) does not confer a private right of action. *Id.* at 265.

199. *Dirks*, 463 U.S. at 650–51.

200. *Id.* at 651 (quoting *In re* Dirks, Exchange Act Release No. 17480**,** 21 SEC Docket 1401, 1981 WL 36329, at *6 (Jan. 22, 1981)).

201. *Id.* at 652.

202. *Id.*

203. *Id.* at 654 (discussing insider liability under the classical theory).

204. *Id.* at 653 (quoting Cady, Roberts & Co., Exchange Act Release No. 6668, 40 SEC Docket 907, 1961 WL 60638, at *3 (Nov. 8, 1961).

205. Dirks v. SEC, 463 U.S. 646, 653–54 (1983) (quoting Chiarella v. United States, 445 U.S. 222, 227 (1980)).

206. *Id.* at 654 (quoting *Cady, Roberts & Co.*, 40 SEC Docket 907, 1961 WL 60638, at *6 n.31).

207. *Id.* at 655.

208. *Id.* at 664.

209. *Id.* at 659.

210. *Id.* at 662.

expressly rejected the SEC's persuasive argument that trading on any tip, even absent a profit, should trigger tipper/tippee liability.[211]

The Court's focus on profits was misguided. It is the use of the information—the self-dealing in derogation of the corporation's exclusive right to its nonpublic information—that constitutes the breach.[212] After reaching this erroneous position, the Court sought to justify the personal-benefit requirement. The Court explained, "Imposing 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 influence on the role of market analysts."[213] The Court observed that market analysts often acquire information from corporate insiders.[214] Market analysts evaluate securities based on this information and share their judgements with clients.[215] "It is the nature of this type of information," reasoned the Court, "and indeed the markets themselves, that such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally."[216]

The Court then elaborated on what constitutes a personal benefit. It noted that "pecuniary gain" or "reputational benefit that will translate into future earnings" satisfies the personal-benefit requirement.[217] The Court also stated that the relationship between the tipper and the tippee may suggest a quid pro quo for the information.[218] Although the Court did not specify any examples of such a relationship, one might surmise that a tipper providing inside information to a prospective customer might suggest such a quid pro quo. Similarly, if a stockbroker were to provide inside information to an existing client, the stockbroker might well benefit because such a "gift" of information might induce the client to do more business with the stockbroker. The Court provided a final pathway to establish a personal benefit: when the tipper provides inside information to a "trading

211. Dirks v. SEC, 463 U.S. 646, 655–58 (1983). Critical of the SEC's stance on insider trading, the Court noted, "[t]he SEC's position, as stated in its opinion in this case, is that a tippee 'inherits' the *Cady, Roberts* obligation to shareholders whenever he receives inside information from an insider." *Id.* at 655. The Court was similarly critical of the SEC's position on Dirks's culpability. *Id.* at 657–59. Referring to Dirks, the SEC argued that "a tippee breaches the fiduciary duty which he assumes from the insider when the tippee knowingly transmits the information to someone who will probably trade on the basis thereof." *Id.* at 656 (quoting *In re* Dirks, Exchange Act Release No. 17480**,** 21 SEC Docket 1401, 1981 WL 36329, at *7 n.42 (Jan. 22, 1981)). The Court also pointed out that it rejected the SEC's similar argument to the Second Circuit in *Chiarella. Id.* The SEC argued in *Chiarella* that anyone, even if not an insider, "who regularly receives material nonpublic information may not use that information to trade in securities without incurring an affirmative duty to disclose." *Id.* (quoting United States v. Chiarella, 588 F.2d 1358, 1365 (2d Cir. 1978)). The Court criticized the SEC's positions because they would "require equal information among all traders," a principle which the Court repudiated. *Id.* at 657.

212. *See supra* text accompanying note 114 (establishing that self-dealing, rather than personal gain, constitutes a corporate insider's breach of fiduciary duty).

213. *Dirks*, 463 U.S. at 658.

214. *Id.*

215. *Id.* at 658–59.

216. *Id.* at 659.

217. *Id.* at 663.

218. *Id.* at 664.

relative or friend."[219] The Court likened this situation to a trade made by the insider followed by a gift of the profits to someone with whom the tipper has a close personal relationship.[220] It is noteworthy that the Court again emphasized profits derived from a trade. The Court could hardly have condoned spouses tipping each other or parents tipping their children. The Court, however, might have focused on a tipper's condonation of a close friend or relative's unauthorized use of confidential corporate information, which would constitute a clear breach of fiduciary duty by the insider. Instead, the Court labored to adhere to its profits-on-the trade rationale, resorting to a fictional trade and a hypothetical gift of the profits.

Applying these principles to Dirks, the Court found no violation of section 10(b).[221] Dirks had no relationship with Equity Funding and, therefore, owed no fiduciary duty to it.[222] Although Secrist and other Equity Funding employees who revealed inside information to Dirks did owe a fiduciary duty to Equity Funding, they received no benefit in exchange for the information.[223] Rather, the tippers' motivation was to reveal Equity Funding's fraud.[224]

The majority's condonation of insider trading not involving a personal benefit to the tipper sparked a three-Justice dissent.[225] Justice Blackmun criticized the majority because "[t]his innovation [the majority decision] excuses a knowing and intentional violation of an insider's duty to shareholders if the insider does not act from a motive of personal gain."[226] Justice Blackmun's criticism was trenchant. The *Dirks* majority not only excused but also encouraged trading that one could persuasively argue violates Rule 10b-5. The broad language of section 10(b), which prohibits any deceptive or manipulative device in connection with the purchase or sale of a security, does not lead to the majority's strained personal-benefit requirement.

B. Judicial Reactions to Dirks*'s Personal-Benefit Requirement*

1. *United States v. Newman*: Misreading *Dirks*

Although *Dirks* clearly held that a tip to a trading friend or relative equates to personal gain to the tipper, the Second Circuit in *United States v. Newman*[227] interpreted *Dirks* differently.[228] The Second Circuit read *Dirks* to permit the inference of a personal gain when an insider tips a

219. Dirks v. SEC, 463 U.S. 646, 664 (1983).
220. *Id.*
221. *Id.* at 665 (explaining that Dirks did not breach a duty of confidentiality to Equity Funding or its shareholders).
222. *Id.*
223. *Id.* at 666–67.
224. *Id.* at 667.
225. Dirks v. SEC, 463 U.S. 646, 668 (1983) (Blackmun, J., dissenting). Justices Brennan and Marshall joined in the dissent. *Id.* at 667.
226. *Id.* at 668.
227. 773 F.3d 438 (2d Cir. 2014), *abrogated by*, Salman v. United States, 580 U.S. 39 (2016).
228. *Id.* at 452.

trading friend or relative only if the relationship "generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature."[229] *Newman*'s misreading of *Dirks* rendered a personal relationship between the tipper and tippee irrelevant. Resolving any confusion that *Newman* might have caused, the Supreme Court decided *Salman v. United States.*[230]

2. *United States v. Salman*: Confirming *Dirks*

In *Salman*, Maher Kara, a worker in Citigroup's healthcare investment banking group, received confidential information about corporate mergers and acquisitions.[231] Maher shared this information with his brother, Michael, who traded on it with Maher's knowledge.[232] Michael, in turn, conveyed this information to his friend and Maher's brother-in-law, Bassam Salman, who traded on the information and profited over $1.5 million.[233] The DOJ indicted Salman on multiple counts of securities fraud.[234]

Following *Newman*'s dubious reading of *Dirks*, Salman argued that a personal relationship between the tipper and trading tippee does not alone meet the personal-benefit requirement.[235] Salman urged that, even when tipping a friend or relative, a tipper will be liable only if that person obtained "money, property, or something of tangible value."[236] The DOJ took the opposite view, arguing "that a gift of confidential information to anyone . . . is enough to prove securities fraud."[237] Adhering to *Dirks*, the Supreme Court rejected both positions.[238] The Court held that "by disclosing confidential information as a gift to his brother with the expectation that he would trade on it, Maher breached his duty of trust and confidence to Citigroup and its clients—a duty Salman acquired, and breached himself, by trading on the information with full knowledge that it had been improperly disclosed."[239] Thus, the Court ruled that tipper/tippee liability requires (1) a benefit to the tipper, an element which may be met by a close relationship, (2) the tipper's expectation that the tippee will trade on the

229. *Id.*
230. Salman v. United States, 580 U.S. 39 (2016).
231. *Id.* at 43.
232. *Id.*
233. *Id.* Salman used the account of another relative to execute the trades. *Id.* The two split the profits. *Id.*
234. *Id.* Both Maher and Michael were also indicted. *Id.* They pleaded guilty and testified at Salman's trial. *Id.*
235. *Id.* at 46.
236. Salman v. United States, 580 U.S. 39, 46 (2016).
237. *Id.* at 47.
238. *Id.* at 51.
239. *Id.* at 50. Ninth Circuit correctly analyzed *Salman* as a misappropriation case. *Id.*at 46 n.2. As an employee of Citigroup's healthcare investment group, Maher had access to inside information about mergers and acquisitions of companies in the healthcare industry but was not an insider of any of those companies. *Id.* at 42. His duty was to Citigroup because he implicitly promised not to disclose the inside information he acquired as its employee. Because Maher breached a duty of confidentiality to Citigroup, the source of the information, the case falls under the misappropriation theory. *See* United States v. O'Hagan, 521 U.S. 642, 651–52 (1997).

information, and (3) the tippee's knowledge that the information is material and nonpublic.[240]

After *Dirks* and *Salman*, the personal-benefit issue may have appeared settled. But in the two *Martoma* decisions[241] the Second Circuit did not see it that way.[242]

3. *United States v. Martoma*: A Valiant Attempt to Expand *Dirks*

Mathew Martoma was a portfolio manager for Capital Advisors, a hedge fund owned by Steven A. Cohen.[243] Elan Corporation and Wyeth Pharmaceuticals, Inc. were jointly developing a drug to treat Alzheimer's disease.[244] Martoma paid two medical doctors, Joel Ross and Sidney Gilman, consulting fees for inside information about the results of the drug's clinical trials.[245] As a quid pro quo for the fees he received, Gilman informed Martoma that data from the clinical trials cast doubt on the efficacy of the drug.[246] Martoma conveyed this information to Cohen, who reduced his firm's position in Elan and Wyeth.[247] To reward Martoma for his "loyal" service to the company, Cohen lavished a $9 million bonus on him.[248]

The *Martoma* case resulted in two decisions, the Second Circuit withdrawing the first and replacing it with the second. In *Martoma I*, the Second Circuit overruled its decision in *Newman*, which held that a meaningful relationship alone is not enough to meet *Dirk*'s personal-benefit requirement.[249] As noted above, *Newman* interpreted *Dirks* to require a tangible or reputational benefit in addition to a personal relationship.[250] *Martoma I* also stated in dicta that the personal-benefit requirement is met when the tipper *expects* the tippee, that is *any* tippee, to trade on inside information.[251] In reaching this breathtakingly expansive view of *Dirks* and *Salman*, the Second Circuit ignored the Supreme Court's unambiguous holding that providing inside information to "a trading relative or friend" meets the personal-benefit requirement.[252]

The Second Circuit may have been more interested in expanding the scope of tipper/tippee liability than in faithfully applying *Salman*. The

240. *Salman*, 580 U.S. at 49–50.
241. *Martoma I,* 869 F.3d 58 (2d Cir. 2017), *amended by Martoma II*, 894 F.3d 64 (2d Cir. 2017).
242. *See id.* at 79.
243. *Id.* at 68–69.
244. *Id.* at 68.
245. *Id.* at 69.
246. *Id.* at 69–70.
247. *Martoma II*, 894 F.3d 64, 70 (2d Cir. 2017).
248. *Id.*
249. *Martoma I*, 869 U.S. 58, 69 (2d Cir. 2017).
250. *Id.* at 68 (quoting United States v. Newman, 773 F.3d 438, 452 (2d Cir. 2014)).
251. *Id.* at 69. Because Dr. Gilman received financial compensation from Martoma, the personal-benefit element was met without resort to the majority's position that any tip to anyone would meet this element if the tipper intended the tippee to benefit. *Id.* at 67.
252. *See, e.g.*, Dirks v. SEC, 463 U.S. 646, 664 (1983) (holding that providing inside information to "a trading relative or friend" meets the personal-benefit requirement).

Second Circuit's goal was praiseworthy. *Martoma I* interpreted the personal-benefit requirement out of existence because nearly all tippers expect their tippees to trade on valuable inside information. If the tipper wanted the tippee to refrain from trading, the tipper would say so, and if the tippee disregarded the tipper's admonition, the case would become one of misappropriation. *Martoma I* launched a stealth attack on the personal-benefit requirement.

The Second Circuit in *Martoma II* retracted its overruling of *Newman*, pointing out that *Newman*'s gloss on *Dirks*—that a personal relationship without a pecuniary or reputational benefit does not meet the *Dirks* personal-benefit requirement—merely acknowledged one way to meet that test.[253] Resorting to verbal gymnastics, *Martoma II* read *Newman* to allow the possibility that a close personal relationship alone might be enough.[254] Apparently realizing that *Newman* contradicted *Dirks*, *Martoma II* engaged in damage control, laboring to obscure *Newman*'s holding.

In addition, Chief Judge Katzmann, joined by Judge Chin, tempered the dicta in *Martoma I*, stating that the personal-benefit requirement is met if the tipper *intends* rather than *expects* a tippee—meaning any tippee—to trade on inside information.[255] The key word is *intends* as opposed to *Martoma I*'s dicta, which required that the tipper *expects* the tippee to trade. By requiring an intention rather than an expectation, the Second Circuit narrowed the scope of liability. To reach this conclusion, Chief Judge Katzmann misinterpreted the personal-benefit requirement by distorting the meaning of a quote from *Dirks*.[256] In its discussion of what constitutes a benefit to the tipper, the *Dirks* Court stated, "[T]here may be a relationship between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the particular recipient."[257] It seems clear that "the particular recipient" in the second part of the sentence refers to the "recipient"—one having a relationship with the tipper—in the first part of the sentence.

Chief Judge Katzmann thought otherwise. He construed the Supreme Court's pronouncement to mean that the personal-benefit requirement is met anytime a tipper intends for any tippee, even absent a relationship between them, to trade on the information.[258] The Chief Judge reached this questionable interpretation by focusing on the comma in the sentence he

253. *Martoma II*, 894 F.3d 64, 76–78 (2d Cir. 2017). The court noted that "because there are many ways to establish a personal benefit, we conclude that we need not decide whether *Newman*'s gloss on the gift theory is inconsistent with *Salman*." *Id.* at 71.

254. *Id.* at 76.

255. *Id.*; *see also, e.g.*, Gupta v. United States, 913 F.3d 81, 86 (2d Cir. 2019) (following *Martoma* and affirming conviction for tipper/tippee unlawful trading on the grounds that the personal-benefit requirement is met if the tipper intends the tippee to trade).

256. *See Martoma II*, 894 F.3d at 84 (Pooler, J., dissenting) (noting that the Chief Judge's balkanized reading of this key sentence in *Dirks* strains credulity).

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

258. *Martoma II*, 894 F.3d at 70–71.

quoted from *Dirks*. He argued that the comma severed the sentence into two distinct parts. By splitting the sentence in two, he concluded that "the particular recipient" in the second part of the sentence could be any recipient, even if that person had no relationship with the tipper.[259] To illustrate his view of tipper/tippee liability, the Chief Judge imagined a situation in which a tipper provides inside information to a stranger (say, a cab driver) and tells the cabbie that he can make a killing by trading on this information. The cabbie then trades. According to Chief Judge, this trade constitutes unlawful trading on inside information, although the tipper and the cabbie had no preexisting personal relationship.[260]

Chief Judge Katzmann's argument clashes with the plain meaning of *Dirks*.[261] As Judge Pooler recognized in his dissent, if *Dirks* prohibits tippers from intending that any recipient profit from a tip, one must ask why the Court established the rather involved personal-benefit requirement with all its permutations.[262] It would have been simpler for the Supreme Court to dispense with its discussion of financial gain, reputational benefit, and personal relationships if none of those things mattered.[263] Furthermore, *Dirks*'s explicit prohibition against tipping a friend or relative would become superfluous if *Dirks* forbids tipping anyone who ultimately trades.[264] Finally, one may wonder how a tip to a stranger, in contrast to a tip to a friend or relative, results in a personal benefit to the tipper.[265]

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259. *Id.* at 74. Chief Judge Katzmann came up with a new version of the sentence, which, he claimed, clarified its meaning: "[T]here may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or *there may be* an intention to benefit the particular recipient." *Id.* (emphasis added). Thus, according to Chief Judge Katzmann, the second half of the sentence does not refer to a relationship between the tipper and the tippee. *See id.* at 74–75 (interpreting the second half of the sentence differently from the dissent's more sensible interpretation).

260. *See id.* at 75 (arguing that a personal benefit to any tippee constitutes a violation, regardless of the relationship between the tipper and the tippee).

261. *See Dirks*, 463 U.S. at 655–57 (rejecting the SEC's position that "a tippee 'inherits' the *Cady, Roberts* obligation to shareholders whenever he receives information from an insider").

262. *See Martoma II*, 894 F.3d at 85 (Pooler, J., dissenting). Judge Pooler observed that the majority's "theory makes it difficult to understand why the *Dirks* court would have adopted the personal benefit test in the first place. If a jury can conclude that a tipper breached his duty so long as it concludes that she intended to benefit the tippee, why should it go through the tortuous process of concluding that the tipper received a personal benefit based on its conclusion that the tipper intended to benefit the tippee? Why should we care about the tipper's benefit at all?" *Id.*

263. *See id.*

264. *See id.* at 85–86.

265. *Id.* at 86 (lampooning the idea that "the warmth that comes with knowing that somebody else might have made some money because of his action" would meet the personal-benefit requirement). Despite Judge Pooler's correct reading of *Dirks* and *Salman*, *Martoma II*'s expansion of the personal-benefit requirement is viable Second Circuit law. *See, e.g.*, Marshall v. United States, 807 F. App'x. 56, 59 (2d Cir. 2020) (relying on *Martoma* to affirm a guilty plea in an insider trading case, because "a jury can often infer that a corporate insider receives a personal benefit . . . from [a tipper's disclosure of] confidential information without a corporate purpose and with the expectation that the tippee will trade on it"); Gupta v. United States, 913 F.3d 81, 86 (2d Cir. 2019) (citing *Martoma* for the proposition that the personal-benefit test of *Dirks* is met when a tipper intends for the tippee to benefit from the inside information); United States v. Klein, 913 F.3d 73, 78 (2d Cir. 2019) (reading *Martoma* to stand for the proposition that a tipper is liable for unlawful insider trading if the tipper shared inside information with a tippee with the expectation that the tippee will trade on the information). The reach of *Martoma* has occasionally extended beyond the Second Circuit. *See, e.g.*, United States v. Beshey, No. 17 CR 643, 2019 WL 277730, at *2 (N.D. Ill. Jan. 22, 2019).

Chief Judge Katzmann's verbal sleight of hand, although commendable, contradicted *Dirks* and *Salman.* His misinterpretation of these cases may have been a self-conscious attempt to shore up the flimsy curbs that *Dirks* and *Salman* placed on insider trading. As shown in Part IV of this Article, although his view conflicts with *Dirks* and *Salman*, his view aligns with the requirements of section 10(b). To establish tipper/tippee liability, *Dirks* and *Salman* wrongly require that the tipper receive a personal benefit from the tippee. Part IV shows that, rather than a personal benefit to the tipper, section 10(b) merely requires that the tippee trade on the inside information.

IV. A CRITIQUE OF THE PERSONAL-BENEFIT REQUIREMENT IN TIPPER/TIPPEE CASES

This Part argues that the Supreme Court's framework for tipper/tippee liability is fundamentally flawed. The deficiency in the Court's analysis stems from its view that a tipper has breached a fiduciary duty to the source of the information only if the tipper received a personal benefit.[266]

A. The Irrelevance of Personal Benefits to Section 10(b)

Part I showed that profits from insider trading should be irrelevant to a classical violation. It is the very act of trading, rather than any profits derived from trading, that constitutes an actionable breach of fiduciary duty to the shareholders and the corporation.[267] The personal-benefit requirement in a classical tipper/tippee case is a proxy for the profits that the insider would have made had that person traded.[268] As *Dirks* explained, "[T]he tippee's duty to disclose or abstain is derivative . . . of the insider's duty."[269] Because profits should be irrelevant to classical violations, profits should also be irrelevant to classical tipper/tippee liability. The courts should therefore abandon the personal-benefit requirement.

B. The Proper Basis for Tipper–Tippee Liability Under Section 10(b) in a Classical Case

What then in a classical tipper–tippee case constitutes a breach of fiduciary duty that violates section 10(b)? If the personal-benefit requirement is not a necessary element of tipper/tippee liability, how would a tipper and tippee violate the section? The answer to these questions begins with *Dirks. Dirks* held that tipper/tippee liability arises when a tippee acts as a proxy for the tipper.[270] To determine when a tippee acts as a proxy for a tipper, one must review the elements of a classical violation. As discussed in Part I, section 10(b) forbids an insider from the very act of

266. Dirks, 463 U.S. at 662 (holding that "the test [for classical insider trading liability] is whether the insider personally will benefit, directly or indirectly, from his disclosure" and that "[a]bsent some personal gain, there has been no breach of duty to stockholders").

267. *See supra* Section I.C.

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

269. *Id.*

270. *Id.* at 659–60.

trading on material, nonpublic information, regardless of whether the tippee profits from the trade. Thus, if an insider simply provides the information to a tippee and the tippee trades on that information, the tippee has engaged in the very act forbidden to the insider. Put another way, the tippee has acted as the tipper's proxy. If a tipper trades on the information, the trade is a breach of fiduciary duty owed to the shareholders. A tippee's trade, as a proxy for the tipper's trade, would likewise constitute such a breach of fiduciary duty. The tippee's trade is, therefore, a deceptive and manipulative device in connection with the purchase or sale of a security and a violation of section 10(b).

Martoma I reached this conclusion but for the wrong reason, twisting *Dirks*'s and *Salman*'s meaning of the personal-benefit requirement beyond recognition.[271] The Second Circuit's analytic contortions were unnecessary. The correct reasoning has nothing to do with whether the tippee provided a personal benefit to the tipper. The unauthorized trade constitutes a violation of section 10(b).

C. The Irrelevance of the Healthy-Market Rationale

The Court's primary justification for the personal-benefit requirement was that disclosure of confidential corporate information to securities analysts "is necessary to the preservation of a healthy market."[272] A blanket rule prohibiting the communication of confidential corporate information to securities analysts would, therefore, hinder the sound functioning of securities markets. This rationale was not and could not have been the basis of the Court's adoption of the personal-benefit requirement. Whether the flow of information from insiders to market analysts enhances the vitality of securities markets is irrelevant to whether such disclosures constitute securities fraud under section 10(b). The key to a section 10(b) violation is the use of a manipulative or deceptive device in connection with the purchase or sale of a security.[273] Market considerations cannot change the elements of a section 10(b) violation. Nevertheless, it is important to analyze the Supreme Court's healthy-market argument because the Court relied heavily on it in deciding *Dirks.* As shown below, the healthy-market argument does not withstand scrutiny.

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271. *See Martoma I*, 869 F.3d 58, 70 (2d Cir. 2017) (holding that a tipper personally benefits from a disclosure of inside information whenever the information is disclosed with the expectation that the tippee will trade on it).

272. *Dirks*, 463 U.S. at 658. Another rationale for the Court's personal-benefit rule is its belief that simultaneous disclosure to all shareholders and the market in general is impracticable. *Id.* at 659. When the Court decided *Dirks* in 1983 that rationale may have been sound, but in the information age where the internet facilitates the instantaneous dissemination of information, that rationale appears dubious.

273. 15 U.S.C. § 78b(3).

D. Arguments for and Against the Healthy-Market Rationale

1. The Analysis of Commentators

Some commentators laud the personal-benefit requirement because they believe it enhances the functioning of securities markets.[274] They point out that when insiders disclose company wrongdoing to market professionals, those professionals may further disclose the information, which may bring the corporate wrongdoers to civil and criminal accountability.[275] If such disclosures were unlawful, tippers, fearful of prosecution, might refrain from revealing corporate wrongdoing. *Dirks* provides an example of how the personal-benefit requirement may result in positive outcomes. In *Dirks*, Secrist's disclosure to Dirks of Equity Funding's improprieties led to an SEC investigation, the ultimate demise of the corrupt company, and numerous indictments and guilty pleas.[276]

Proponents of the personal-benefit requirement also argue that disclosure of inside information to market professionals benefits companies, their shareholders, and the securities markets because a backchannel dissemination of otherwise undisclosed corporate information results in more accurate stock prices.[277] If market professionals are subject to the risk of liability for acquiring and disclosing inside information, they will be reluctant to seek out and report it.[278] Depriving the markets of information relevant to the pricing of a company's securities drives up the cost of capital, particularly for small companies, which receive less analyst coverage than larger ones.[279]

Other commentators see harmful economic consequences resulting from insiders feeding confidential information to market analysts. Unconstrained leaks of corporate information to a select few, they argue, may

274. *See, e.g.*, Jonathan R. Macey, *The Genius of the Personal Benefit Test*, 69 STAN. L. REV. ONLINE 64, 70 (2016) (arguing that "[t]he personal benefit test is an expression of the view that the receipt by a tippee of a personal benefit in exchange for her tip obviates the defense that the tip was for a valid corporate purpose," and that "the personal benefit test is also an expression of the view that if a tipper did not receive a personal benefit in exchange for the information, one should infer that the tip was provided for a valid corporate purpose").

275. *Id.*

276. *See Dirks*, 463 U.S. at 649–52 (discussing the investigation and case outcome); Robert A. Wright, *5 Indicted in Equity Funding Collapse Change Pleas to Guilty Before Trial*, N.Y. TIMES (Feb. 4, 1974), https://www.nytimes.com/1974/02/04/archives/5-indicted-in-equity-funding-collapse-change-pleas-to-guilty-before.html (reporting that five of twenty-two people indicted for the Equity Funding fraud pleaded guilty to criminal charges).

277. *See, e.g.*, Jonathan R. Macey, *Beyond the Personal Benefit Test: The Economics of Tipping by Insiders*, 2 U. PA. J.L. & PUB. AFF. 25, 39 (2017) (arguing that tipping may result in public awareness of information that will correct inaccurate pricing).

278. *Id.* at 43; *see, e.g.*, Cox & Fogarty, *supra* note 184, at 355 (discussing the validity of numerous arguments for and against insider trading restrictions); Kayla Quigley, *The Insider Trading Prohibition Act: A Small Step Towards a Codified Insider Trading Law*, 26 FORDHAM J. CORP. & FIN. L. 183, 197–99 (2021) (arguing that increasing the scope of insider trading liability would have a chilling effect on legitimate research efforts).

279. *See, e.g.*, Macey, *supra* note 274, at 69.

impair investor confidence.[280] If the system seems unfair, investors may be reluctant to participate in the securities markets.[281] A lack of investor participation may drive up the cost of capital.[282] Similarly, a decline in investor participation may suppress stock prices.[283] Many argue that a system with built-in favoritism is fundamentally unfair.[284]

2. Fallacies of the Healthy-Market Rationale

The economic arguments that support insiders sharing information with market analysts are overblown.[285] Absent a compelling argument that the welfare of the markets depends on insiders tipping market professionals, the law should not perpetuate institutionalized unfairness. Eliminating the personal-benefit requirement would reduce the perception, if not the reality, of a rigged system. Although legitimate research efforts deserve protection, the Supreme Court went too far in its effort to ensure open discourse between insiders and market analysts.

a. Asymmetries in Market Information

The Court's healthy-market argument rings true only to a limited point. It is proper and even laudable for a diligent analyst to visit a corporation's plant to determine, for example, the efficiencies in the corporation's manufacturing processes or its prospects for product innovation. It is also proper for an analyst to gain insight into a corporation's competitive position by asking questions of employees, officers, and directors. However, one may question the propriety of a CEO sharing with an analyst otherwise undisclosed financial or operational corporate information. First, ordinary investors, regardless of their efforts, would find it nearly impossible to acquire critical inside information that insiders may feed gratuitously to market professionals. Non-professionals are, therefore, at a trading disadvantage compared to market analysts and their tippees.[286] Second, the premature disclosure of confidential information may

280. *See, e.g.*, Kenneth R. Davis, *Insider Trading Flaw: Toward a Fraud-on-the-Market Theory and Beyond*, 66 AM. U.L. REV. 51, 73 (2016) (arguing that "[t]raders who see their investments dwindle feel cheated when beset with an informational disadvantage spawned by unequal access").

281. *See, e.g.*, Steven R. Salbu, *The Misappropriation Theory of Insider Trading: A Legal, Economic, and Ethical Analysis*, 15 HARV. J.L. & PUB. POL'Y 223, 235 (1992) (contending that unchecked trading based on insider tips "almost inevitably causes market failure," and that "information asymmetry is likely to squeeze smaller shareholders from stock market participation").

282. *See, e.g.*, Cox & Fogarty, *supra* note 184, at 356.

283. *Id.*

284. *See, e.g.*, Davis, *supra* note 280, at 73 (arguing that corporate insiders have an unfair trading advantage compared to other investors and that the law should not countenance that disparity).

285. *See, e.g.*, Cox & Fogarty, *supra* note 184, at 357 (noting that "[a]rguments on both sides make plausible points as to how rational investors or markets might react to the pressure or possibility of insider trading, but it is more difficult to establish how in fact they do react and whether, balanced against countervailing reactions, it really makes much difference").

286. *See, e.g.*, Chiarella v. United States, 445 U.S. 222, 241 (1980) (Burger, C.J., dissenting) (arguing that any trading on material, nonpublic corporate information violates section 10(b) because of "the unfairness inherent in trading on such information when it is inaccessible to those with whom one is dealing").

compromise a company's competitive advantage. A company often keeps information confidential to deprive rival companies of the information.[287]

b. The Disincentive of the Personal-Benefit Requirement

It is questionable whether the personal-benefit requirement achieves its intended purpose of facilitating the flow of information to market analysts and enhancing the efficiency of securities markets.[288] A personal benefit provides an incentive to the tipper to disclose inside information. Tipping is, therefore, more likely when market analysts provide insiders with personal benefits than when they do not. But *Dirks* makes it unlawful for tipper's to derive a personal benefit in exchange for information. The *Dirks* personal-benefit requirement therefore creates a disincentive for the flow of information from insiders to market analysts. This is not to suggest that the Supreme Court should condone the bribery of corporate insiders. The point is simply that the personal-benefit requirement is counterproductive. Rather than maximizing the achievement of the Supreme Court's policy of facilitating the role of market analysts, the personal-benefit requirement inhibits it.

c. Mixed Motives

The flaw in *Dirks* and *Salman* runs deeper. An insider may have mixed motives for disclosing confidential information to a market analyst: One motive may be beneficial to the securities markets while the other may be self-interested. Suppose that Secrist had refused to disclose Equity Funding's fraud to Dirks unless Dirks paid him for the information. In such a case, Secrist's disclosure to Dirks would have alerted the securities markets and enforcement authorities to Equity Funding's fraud, while Dirks's payoff would have provided Secrist with a personal gain. Because of Dirks's payoff to Secrist, both would have been civilly and criminally responsible despite the benefit of exposing Equity Funding's wrongdoing. The prospect of legal responsibility would impose a powerful disincentive to disclose.

d. Self-Interests Other Than a Court-Defined Personal Benefit

An insider who receives no personal benefit may have other self-interested motives for disclosing information. For example, a CEO might prematurely disclose to a market analyst an unexpected increase in corporate earnings to drive up the price of the company's common stock and thereby increase the value of stock options that are part of the CEO's

287. *See, e.g.*, *id.* (noting that confidential "information [is] intended to be available only for a corporate purpose").

288. *See* Michael D. Guttentag, *Selective Disclosure and Insider Trading*, 69 FLA. L. REV. 519, 555 (2017) (arguing that the personal-benefit requirement does not advance the goal of preventing selective disclosure of confidential corporate information and that any selective disclosure, regardless of personal benefit, should be unlawful).

compensation package. The law should not allow the CEO to evade liability because the market analyst did not induce the disclosure with a bribe.

e. Inconsequential Personal Benefits

Yet another flaw in the personal-benefit requirement is that the benefit may be so inconsequential that it should not be the lynchpin for determining civil liability and criminal prosecution. Suppose a CEO of a public company telephones a reporter from the *Wall Street Journal* and gratuitously reveals confidential information that the company has lost market share. The reporter trades on the information and discloses the information to friends who also trade. Neither the CEO, the reporter, nor the friends have violated insider trading law, because none of them has gained a personal benefit. On the other hand, assume that in exchange for disclosing the information, the *Wall Street Journal* reporter promises to praise the CEO in a feature article. By lionizing the CEO, the article may induce the board of directors of the CEO's company to increase the CEO's compensation package. The boost to the CEO's reputation may meet *Dirks*'s personal-benefit requirement.[289] All parties in the tipping chain might well be civilly and criminally culpable. The difference between lawful and unlawful conduct stands on a razor's edge. That razor's edge is not policy driven. Regardless of the promise to publish an article in the *Wall Street Journal*, the effect on counterparties to the trades is the same, and the potential loss of investor confidence in the securities markets is also the same. It makes no sense to base civil and criminal responsibility on a flattering article in the *Wall Street Journal.*

f. The Hazy Line Between the Close and the Casual

The line between a close personal relationship and a not-too-close one is often obscure. In *SEC v. Warde*,[290] the Second Circuit held that a "close friendship" meets the *Dirks* personal-benefit requirement.[291] In *SEC v. Spivak*,[292] the Federal District Court for the District of Massachusetts noted that a "casual . . . friendship" does not.[293] A factfinder must puzzle over the distinction between the close and the casual.[294] What of an analyst who, following a company, repeatedly interacts with a corporate insider? Their relationship may cross the perilous line into the zone of culpability. Discerning the obscure distinction between a close and casual relationship

289. *See* Dirks v. SEC, 463 U.S. 646, 663 (1983) (holding that an indirect benefit such as a boost to one's reputation may meet the personal-benefit requirement).

290. 151 F.3d 42 (2d Cir. 1998).

291. *Id.* at 48–49.

292. 194 F. Supp. 3d 145 (D. Mass. 2016).

293. *Id.* at 155.

294. *See* Michael T. Byrne, United States v. Blaszczak *Brings Insider Trading Law to a Tipping Point*, 66 VILL. L. REV. 187, 198 (2021) (pointing out that courts have struggled to distinguish between relationships close enough to meet the personal-benefit requirement and those that fail to meet the test).

is a daunting exercise.[295] An insider and market professional may have eaten dinner together once, three times, or five times. They may have gone together to a hockey game. One too many appetizers or shots on goal may subject them to civil liability and criminal prosecution. This Kafkaesque approach is as relevant to culpability as an astrological chart or the turn of a tarot card.

What of relationships between family and friends such as those involved in the *Salman* case?[296] Suppose the tipper and tippee knew each other in college. If the tipper admits, "We were college buddies," he and the tippee may be convicted of unlawful trading.[297] If the cagy tipper demurs, "We were just friendly acquaintances in our college years," the parties may escape retribution. The thinnest factual distinction leads to a chasm in legal consequences. Although objective circumstances such as time spent together and experiences shared may suggest the closeness of a relationship,[298] when interpersonal feelings are central to the outcome of an issue, the nature of a relationship may prove hazy if not impenetrable.

g. The Condonation of Tipping Absent a Personal Benefit

Assume that the CEO of a publicly traded corporation knows that a forthcoming quarterly earnings report will show enormous profitability. The CEO discloses this nonpublic information to an acquaintance at a cocktail party, or to the affable cabbie driving the CEO to the airport. The cocktail party acquaintance and cab driver may trade on the information and even share the information with others—remote tippees—who may trade. No liability attaches to anyone trading in this tipping chain. *Dirks* provides no satisfactory rationale for exonerating the CEO, the cocktail party acquaintance, or the affable cabbie.[299]

3. Regulation FD: Evisceration of the Personal-Benefit Requirement

If all this were not enough to reject the Court's healthy-market argument, the SEC's adoption of Regulation FD substantially eviscerates it.[300]

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295. *See* SEC v. Obus, 693 F.3d 276, 291 (2d Cir. 2012) (holding that, for pleading purposes, a college friendship is sufficient to create a jury question as to whether that relationship meets the *Dirks* personal-benefit requirement).

296. Salman v. United States, 580 U.S. 39, 43 (2016) (noting that the evidence at trial established a close and loving relationship between Maher and Michael).

297. *See Obus*, 693 F.3d at 291.

298. *See* Dirks v. SEC, 463 U.S. 646, 663 (1983) (urging courts to focus on "objective criteria" when determining whether the circumstances of a tip meet the personal-benefit requirement).

299. *See, e.g.*, Chiarella v. United States, 445 U.S. 222, 246 (1980) (Blackmun, J., dissenting) (lamenting that the Supreme Court "continues to pursue a course, charted in certain recent decisions, designed to transform [section] 10(b) from an intentionally elastic 'catchall' provision to one that catches relatively little of the misbehavior that all too often makes investment in securities a needlessly risky business for the uninitiated investor").

300. Regulation FD provides, in relevant part:

> Whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer or its securities to any person described in paragraph

Regulation FD makes it unlawful for an insider to disclose material, nonpublic information to market professionals, including analysts.[301] The impetus for this rule surely began with *Chiarella* and *Dirks* and the Supreme Court's rebuff of the SEC's position to ban all trading on inside information.[302] To achieve its objective of banning disclosures to market professionals, the SEC promulgated Regulation FD.[303] Contrary to the Supreme Court's support for the disclosure of inside information to market professionals, the SEC explained that selective disclosure of inside information to market professionals "bears a close resemblance . . . to ordinary 'tipping' and insider trading" by enabling "a privileged few [to] gain an informational edge—and the ability to use that edge to profit—from their superior access to corporate insiders, rather than from their skill, acumen, or diligence."[304] Again contradicting the Supreme Court's position to protect the flow of information from insiders to market analysts, the SEC emphasized that it intended Regulation FD to prevent securities issuers from using "material information as a commodity to be used to gain or maintain favor with particular analysts or investors."[305] The SEC has sought enforcement of Regulation FD in numerous civil actions, flouting the Supreme Court's call in *Dirks* to protect the selective disclosure of inside information to market analysts.[306] By prohibiting insiders from selectively disclosing material, nonpublic information to market professionals,

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> (b)(1) of this section, the issuer shall make public disclosure of that information . . . (1) Simultaneously, in the case of an intentional disclosure; and (2) Promptly, in the case of a non-intentional disclosure.

17 C.F.R. § 243.100(a) (2025). Regulation FD applies "to a disclosure made to any person outside the issuer," including "a broker or dealer," "an investment adviser," "an investment company," an "institutional investment manager," and anyone who "is a holder of the issuer's securities, under circumstances in which it is reasonably foreseeable that the person will purchase or sell the issuer's securities on the basis of the information." 17 C.F.R. § 243.100(b)(1) (2025).

301. 17 C.F.R. § 243.100(b)(1) (2025). Violators of Regulation FD are subject to cease-and-desist orders, fines, and imprisonment. 41 C.F.R. § 102–74.450 (2025).

302. *See Chiarella*, 445 U.S. at 234 (seeing no basis for the SEC's theory on insider trading); *see also Dirks*, 463 U.S. at 655–56 (rejecting the SEC's position "that a tippee 'inherits' the *Cady, Roberts* obligation to shareholders whenever he receives inside information from an insider").

303. *See, e.g.*, 17 C.F.R. §§ 243.100–243.103 (2025).

304. Selective Disclosure and Insider Trading, Exchange Act Release No. 7881, 73 S.E.C. Docket 3, 2000 WL 1201556, at *2 (Aug. 15, 2000).

305. *Id.*

306. *See* SEC v. AT&T, Inc., 626 F. Supp. 3d 703, 712–13 (S.D.N.Y. 2022) (citing cases in which the SEC pursued claims against alleged violators of Regulation FD and achieved the imposition of civil penalties and monetary settlements). One highly publicized incident that may have violated Regulation FD involved Jim Cramer, the host of the popular TV program, *Mad Money*, and Tim Cook, the CEO of Apple. *See, e.g.*, Jennifer Booton, *Apple CEO Tim Cook May Have Violated SEC Rules with Jim Cramer Email*, MARKETWATCH (Aug. 24, 2015, at 4:46 PM), https://www.marketwatch.com/story/apple-ceo-tim-cook-may-have-violated-sec-rules-with-jim-cramer-email-2015-08-24. Prior to releasing Apple's quarterly earnings report, Cook emailed Cramer informing him that iPhone activations had risen and sales in China were at year highs. *Id.* On the evening of the day Cramer received the email, he read it aloud on his program. *See Regulation FD and Mad Money: Tim Cook's E-mail to Jim Cramer*, PRAC. L. CORP. & SEC., Sept. 3, 2015, Res. ID W-000-5514. Cramer's prompt public disclosure may explain why there are no reports of an SEC investigation into the incident.

Regulation FD undercuts the efficacy of the Supreme Court's healthy-market rationale.[307]

To this point, this Article has argued against applying the personal-benefit requirement to classical-theory tipper/tippee cases. As shown below, the same objections apply with even more force to tipper/tippee cases based on the misappropriation theory.

E. The Personal-Benefit Requirement's Inapplicability to Tipper/Tippee Misappropriation Cases

Courts are divided on whether the personal-benefit requirement should apply to tipper/tippee misappropriation.[308] It is unfortunate that some courts have not recognized that the personal-benefit requirement has no place in any tipper/tippee case, especially one based on misappropriation. The analysis against applying the personal-benefit requirement to classical tipper/tippee cases applies with greater force to tipper/tippee misappropriation cases. The Supreme Court recognized in *O'Hagan* that a misappropriation is based on the unauthorized use of the entrusted information, not on trading profits.[309] The source of the information in a misappropriation case does not forbid the recipient from profiting from the

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307. *See, e.g.*, Andrea J. Sessa, *The Negative Consequences of Regulation FD on the Capital Markets*, 45 N.Y.L. SCH. L. REV. 733, 756 (2002) (acknowledging that the regulation clashes with *Dirks* rationale of noninterference with the communication of material, nonpublic information between insiders and market professionals); *see also id.* at 740–41 (arguing that by restraining the flow of information the regulation is harmful to the investors and securities markets that it seeks to protect); *id.* at 747–50 (arguing that restraining the flow of information increases market volatility and ignores the inability of ordinary investors to timely assimilate information); Donna M. Nagy, *Beyond* Dirks: *Gratuitous Tipping and Insider Trading*, 42 J. CORP. L. 1, 40–41 (2016) (arguing that "Regulation FD has sucked out most of the air from the very space that *Dirks* created for insider-analyst communications").

308. The *Salman* Court did not discuss or decide whether the personal-benefit requirement applies in misappropriation tipper/tippee cases. Salman v. United States, 580 U.S. 39, 46 n.2 (2016) (noting that "[t]he parties do not dispute that *Dirks*'s personal-benefit analysis applies in both classical and misappropriation cases, so we will proceed on the assumption that it does"). Most federal courts that have addressed the issue have engrafted the personal-benefit requirement into misappropriation tipper/tippee cases. *See, e.g.*, United States v. Bray, 853 F.3d 18, 25 (1st Cir. 2017) (applying the personal-benefit requirement to a tipper/tippee misappropriation case but not providing a rationale for doing so); SEC v. Yun, 327 F.3d 1263, 1275 (11th Cir. 2003) (explaining that failing to apply the personal-benefit requirement to misappropriation cases would "construct[] an arbitrary fence" between misappropriation and classical cases); SEC v. Sabrdaran, 252 F. Supp. 3d 866, 880 (N.D. Cal. 2017) (setting forth in the jury instructions of a misappropriation tipper/tippee case that, to establish liability, the tipper must have received a personal benefit from the tippee); Veleron Holding v. Morgan Stanley, 117 F. Supp. 3d 404, 456 (S.D.N.Y. 2015) (explaining the tipper–tippee liability theory). Some district courts in the Second Circuit have declined to do so. *See, e.g.*, Tan v. Goldman Sachs Grp., Inc., No. 21-CV-8413, 2023 WL 2753238, at *4 (S.D.N.Y. Mar. 31, 2023). The split in district courts in the Second Circuit is not surprising given that the Second Circuit has reached contradictory viewpoints on the issue. *Compare* United States v. Libera, 989 F.2d 596, 600 (2d Cir. 1993) (relying on *United States v. Chestman*, 947 F.2d 551, 566 (2d Cir. 1991) for the proposition that the personal-benefit requirement does not apply to misappropriation tipper/tippee cases), *with* United States v. Newman, 773 F.3d 438, 446 (2d Cir. 2014) (stating in dictum that "[t]he elements of tipping liability are the same, regardless of whether the tipper's duty arises under the 'classical' or the 'misappropriation' theory"), *and* SEC v. Obus, 693 F.3d 276, 285–86 (2d Cir. 2012) (holding that "[t]he Supreme Court's tipping liability doctrine was developed in a classical case" although "the same analysis governs in a misappropriation case").

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

information. The source forbids the recipient to use the information in an unauthorized way.[310] No one conveying inside information to another would say, "I don't want you to make money on this stock." The source would more likely warn, "I don't want you trading this stock." The trade is the forbidden act, which constitutes a breach of fiduciary duty and a violation of section 10(b).[311] The breach of duty in a misappropriation tipper/tippee case is derived from the duty in the basic misappropriation case. Because it is irrelevant whether the source of the information received a benefit in a basic misappropriation case, it is likewise irrelevant whether the source received a benefit in a tipper/tippee case based on misappropriation.

The healthy-market rationale for tipper/tippee liability has even less relevance to misappropriation cases than it has to classical cases.[312] Corporate executives and directors occupy positions exposing them to valuable, confidential information that attracts the interest of market analysts. When trying to ferret out such information, market analysts therefore ordinarily approach insiders, not outsiders, be they lawyers such as O'Hagan, auditors, or printers such as Chiarella. Conversely, because corporate outsiders tend not to have relationships with market professionals, outsiders with inside information are not positioned to contact such professionals to share information. It is more likely that such misappropriators would tip a relative, a friend, or even a stranger. In *Salman,* for example, Maher Kara tipped his brother, Michael, not a market professional.[313]

F. Misappropriation: The Only Theory of Tipper/Tippee Liability

Part II of this Article showed that all classical-theory cases may be analyzed under the misappropriation theory.[314] Similarly, the misappropriation theory accounts for all tipper/tippee cases. Regardless of whether the initial source of the information is a corporate insider or an outsider, the initial tipper violates a duty of loyalty to the source by disclosing information to a third party. All tipper/tippee cases, therefore, fit into the misappropriation mold. Any misappropriator who trades on material, nonpublic information, regardless of whether the person is an insider, an outsider, or a tippee, violates section 10(b).

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310. *Id.*

311. *See id.* at 651–52.

312. *See* Merritt B. Fox & George N. Tepe, *Personal Benefit Has No Place in Misappropriation Tipping Cases*, 71 SMU L. REV. 767, 771–72 (2018) (arguing that "entities such as financial printers, law firms, and investment banking firms do not give socially valuable interviews to market analysts about the future prospects of companies about which they have confidential knowledge").

313. *Salman*, 580 U.S. at 43 (explaining that Maher Kara, an employee at Citigroup's healthcare investment banking group, shared confidential information with his brother, Michael, who then conveyed it to his friend, Bassam Salman).

314. *See supra* Part II.

CONCLUSION

The Supreme Court has plotted a peripatetic course in its quest to find a sensible regime for insider trading law. It is no wonder that this approach has gone astray. Defaulting to section 10(b) as the solution to a serious problem has led to blind alleys and impassable roadblocks. As read by the Supreme Court, section 10(b) is the wrong roadmap. The Court's most conspicuous misstep comes with tipper/tippee liability. The personal-benefit requirement encourages both insiders and outsiders who possess confidential corporate information to trade without fear of legal consequences. Tippees, like Dirks's clients, score outsized gains while others who rely on the integrity of the secondary market play blindfolded. The SEC and DOJ are powerless to correct these inequities. The Supreme Court has set the rules.

By interpreting section 10(b)'s prohibition of "deceptive and manipulative devices" too narrowly, the Court allows many who trade on inside information to escape accountability.[315] Insider trading law tips the scales in favor of those lucky enough to have connections with a tipped-off broker or a chatty CEO. Although close friends and relatives may not share in the bounty, others may stoke their money market accounts with their stock-market winnings. Trading securities is a card game with a marked deck.

Congress could revamp insider trading law. It seems, however, that Congress will not act.[316] Representative Jim Himes of Connecticut introduced a bill that would make unlawful a broad range of insider trading

315. *See* Dirks v. SEC, 463 U.S. 646, 662 (1983) (establishing the personal-benefit requirement for tipper/tippee liability); *Salman v. United States*, 580 U.S. 39, 48 (2016) (adhering to the *Dirks* personal-benefit requirement).

316. *See* United States v. Shvartsman, 722 F. Supp. 3d 276, 296 (2024) (observing that Congress has failed to pass insider trading reform bills proposed in 2015, 2019, and 2021).

activities that current law condones.[317] The House passed this bill on May 18, 2021, but the Senate has declined to bring the proposal to a vote.[318]

As a result of congressional inaction, the task to repair a broken insider trading regime falls to the federal courts. The Second Circuit has taken the lead. In the guise of following *Dirks* and *Salman*, the Second Circuit in the *Martoma* decisions effectively rejected the personal-benefit requirement. The court held in *Martoma I* that if a tipper expects the tippee to trade, and the tippee does so, they have violated section 10(b).[319] This holding would render unlawful nearly all tipper/tippee trading on inside information because a tipper generally expects the tippee to trade. Despite the intellectual exertions of the Second Circuit in *Martoma I*, basing liability on a tipper's expectation that a tippee will trade departs from *Dirks*'s personal-benefit test. Perhaps recognizing how far this holding strayed from *Dirks*, the Second Circuit withdrew *Martoma I* and replaced it with *Martoma II*, imposing liability if the tipper intends rather than expects the tippee to trade.[320] Intent is harder to prove than an expectation. The tipper's intent that the tippee will trade, however, is much easier to prove than an outright gift or even a reputational benefit. Although professing to follow *Dirks* and *Salman*, *Martoma I* and *II* rationalized a departure from the personal-benefit requirement. These were brave attempts at reform, but more work remains. The federal district and circuit courts should reconceptualize tipper/tippee liability and reject the personal-benefit requirement. Bold judicial action may nudge the Supreme Court into following a path that

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317. Section 16A(a) of the bill provides in pertinent part:

> It shall be unlawful for any person, directly or indirectly, to purchase, sell, or enter into, or cause the purchase or sale of or entry into, any security . . . while aware of material, nonpublic information relating to such security . . . or any nonpublic information, from whatever source, that has, or would reasonably be expected to have, a material effect on the market price of any such security . . . if such person knows, or recklessly disregards, that such information has been obtained wrongfully, or that such purchase or sale would constitute a wrongful use of such information.

H.R. 2655, 117th Cong. § 16A(a) (2021). Section 16A(b) mirrors the Second Circuit's approach in *Martoma I* to tipper–tippee liability. The section provides in pertinent part:

> It shall be unlawful for any person whose own purchase or sale of a security . . . would violate subsection (a), wrongfully to communicate material, nonpublic information relating to such security…or any nonpublic information, from whatever source, that has, or would reasonably be expected to have, a material effect on the market price of any such security . . . to any other person if (1) the other person (A) purchases, sells…any security . . . to which such communication relates . . . or communicates the information to another person who makes . . . such a purchase [or] sale . . . and (2) such a purchase [or] sale . . . is reasonably foreseeable.

Id. § 16A(b). *See* Stephen M. Bainbridge, *A Critique of the Insider Trading Prohibition Act of 2021,* 2021 U. ILL. L. REV. ONLINE 231, 241–43 (2021) (criticizing the proposed legislation because it would eliminate the access of market professions to inside information and consequently erode market efficiency).

318. *See Insider Trading Prohibition Act*, GOVTRACK, Govtrack.us/congress/bills/117/s3990 (last visited Nov. 4, 2025) (reporting the Senate's inaction).

319. *Martoma I*, 869 F.3d 58, 71 (2d Cir. 2017) *(second emphasis added)* (emphasizing that its "holding reaches only the insider who discloses inside information to someone *he expects will trade on the information").*

320. *Martoma II*, 894 F.3d 64, 74 (2d Cir. 2017) (interpreting *Dirks* to ascribe liability if a tipper intended the tippee to trade on the confidential information).

will lead to the perception, if not the reality, of a more equitable securities market.