

Beyond *Dirks*: Gratuitous Tipping and Insider Trading

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*Did an investment banker who gratuitously shared material nonpublic information with his brother, with no expectation of receiving anything in return, commit securities fraud? And is the investment banker's brother-in-law jointly liable for trading securities on the basis of what he knew to be gratuitous tips? The Supreme Court is poised to answer those questions in *Salman v. United States*, after steering clear of insider trading law for nearly two decades. It has been even longer still since the Court last addressed securities fraud liability relating to stock trading tips—it articulated a “personal benefit” test for joint tipper-tippee liability in 1983 in *Dirks v. SEC*, a decision reaffirming the “classical” theory of insider trading. In 2015, a circuit split arose as to whether gratuitous tipping constitutes a violation of the antifraud provisions in the federal securities laws, and the Court has granted certiorari in *Salman* to resolve that issue. This Article disagrees with the Second Circuit's finding that gratuitous tips do not result in a personal benefit and supports the Ninth Circuit's conclusion that such tips are illegal. But in arguing that gratuitous tips satisfy the personal benefit test, this Article draws from a potent combination of four post-*Dirks* developments in federal securities law and state corporate law. These developments should prompt the Court not only to affirm the Ninth Circuit's decision but also to look beyond *Dirks* either to replace the personal benefit test with a breach of the duty of loyalty standard or, more boldly, to consolidate the Court's prior complementary theories of insider trading liability—the classical and misappropriation theories—into a unified and expanded framework that would regard insider trading as a “fraud on contemporaneous traders.”*

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I. INTRODUCTION

In the iconic 1983 film *The Big Chill*, Harold (played by Kevin Kline) provided a stock trading tip to his long-time friend Nick, a Vietnam War veteran and former radio psychologist turned drug dealer (William Hurt). During a morning jog, Harold told Nick that a very large corporation was planning to buy his running shoe company, “Running Dog,” and that the company’s stockholders would see their money tripled. Harold shared this information in the hope that Nick would trade on it and then use the profits to get into some other line of work. Harold bluntly acknowledged that his stock tip could get him into big trouble because he was violating a host of federal securities laws. Later that evening, Harold’s wife Sarah (Glenn Close) chastised him for risking so much on a futile desire to change people’s lives.¹

The three Second Circuit judges who overturned the defendants’ insider trading convictions in *United States v. Newman*² would likely disagree with Harold’s assessment of his wrongdoing. In the court’s view, even if evidence establishes that a corporate insider and his “tippee” are friends, disclosing inside information does not constitute securities fraud absent proof that they had a “meaningfully close personal relationship”³ and that the insider expected some type of tangible benefit in exchange for the information.⁴ The film leaves little doubt that Harold and Nick shared a “meaningfully close personal relationship.”⁵ Harold, however, neither sought nor received a tangible benefit. Instead, he engaged in what can be termed “gratuitous tipping”—Harold gifted the confidential corporate information so that Nick could benefit from using it in a securities transaction.

The common sense notion that gratuitous tipping violates insider trading law aligns squarely with the Supreme Court’s holding in *Dirks v. SEC*⁶ (which, as it happens, shares the date of the movie—1983). Building on the “classical” theory developed three years before in *Chiarella v. United States*,⁷ *Dirks* held that the disclosure of material nonpublic information constitutes fraudulent tipping under Section 10(b) of the Securities Exchange Act⁸ and Rule 10b-5⁹ thereunder when the tipper breaches a fiduciary duty of trust and confidence by personally benefitting (directly or indirectly) from the disclosure. *Dirks* held further that a tippee’s liability under Rule 10b-5 derives from the tipper’s liability, provided the tippee knew or should have known about the tipper’s breach.¹⁰ An insider’s “personal benefit” from a tip would include a quid pro quo producing “pecuniary gain or a reputational benefit that will translate into future earnings.”¹¹ But *Dirks* stated explicitly that “[t]he elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend.”¹²

1. THE BIG CHILL (Columbia Pictures Corp. 1983). We know from the film that the tipping resulted in a securities transaction: Harold also shared Running Dog’s confidential information with Alex, another close friend (whose tragic death reunited the seven college friends who gathered for his funeral). During their jog, Harold told Nick that Alex had purchased Running Dog stock on the basis of his tip.

2. *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014).

3. *Id.* at 452.

4. *Id.*

5. *Id.*

6. *Dirks v. SEC*, 463 U.S. 646 (1983).

7. *Chiarella v. United States*, 445 U.S. 222 (1980).

8. 15 U.S.C. § 78j(b) (1934).

9. 17 C.F.R. § 240.10b-5 (1951).

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

11. *Id.* at 663.

12. *Id.* at 664.

Surreptitious gifts of confidential information can likewise originate from an “outsider” to the corporation that issued the securities subject to a tip, as opposed to a classical insider such as Harold. An unethical lawyer or accountant, for instance, could breach a client’s confidence to enable a friend or relative to profit mightily in the stock market.¹³ Gratuitous trading tips can also come from rogue employees who are privy to market-sensitive developments that have yet to be announced publicly¹⁴ or from persons who secretly relay business-related confidences that have been entrusted to them by a family member or friend.¹⁵ Because such outsider scenarios involve a breach of the duty of trust and confidence owed to the source of the entrusted information rather than to a trading party, they are analyzed under the “complementary” misappropriation theory endorsed by the Court in *United States v. O’Hagan*.¹⁶

The court in *Newman* evaded *Dirks*’s reference to informational gifts because it refused to view as a personal benefit the “ephemeral benefit of the ‘value of [a tippee’s] friendship.’”¹⁷ Specifically, *Newman*’s two-fold requirement of a “meaningfully close personal relationship”¹⁸ and “a personal benefit of . . . some consequence”¹⁹ prompted the court to reject the jury’s finding that an investor relations official had personally benefitted when he disclosed, on multiple occasions, his company’s confidential earnings information to a securities analyst, who had been his classmate in business school and a former colleague.²⁰ *Newman* likewise rejected the jury’s finding regarding the personal benefit received by a second tipper, an insider at a different corporation who repeatedly shared that company’s confidential earnings information with a family friend.²¹

Since the Second Circuit decided *Newman*, its heightened standard for proving a personal benefit has been impeding Department of Justice (DOJ) and Securities and Exchange Commission (SEC) efforts to prosecute tipping and trading in both classical-insider and misappropriation-outsider contexts. One highly publicized instance occurred a month after *Newman*, when a federal district court vacated the guilty pleas of several

13. See, e.g., *United States v. Gansman*, 657 F.3d 85, 90–97 (2d Cir. 2011) (affirming conviction under Rule 10b-5 where defendant-attorney illegally tipped his girlfriend about information pertaining to clients at Ernst & Young); *United States v. Grossman*, 843 F.2d 78, 84–87 (2d Cir. 1988) (affirming conviction under Rule 10b-5 where defendant-law firm associate both traded on the basis of confidential client information and tipped relatives who subsequently traded).

14. See, e.g., *SEC v. Materia*, 745 F.2d 197, 199–204 (2d Cir. 1984) (affirming tipper-defendant’s liability under Rule 10b-5 for his disclosure of information misappropriated from his printer-employer, even though there was insufficient proof that tippee-wife was aware that she had traded on misappropriated information).

15. See, e.g., *United States v. McGee*, 763 F.3d 304, 308–22 (3d Cir. 2014) (affirming judgment upholding conviction of defendant who traded and tipped a friend based on material nonpublic information that was entrusted to him by the corporate executive whom he had sponsored at Alcoholics Anonymous meetings); *SEC v. Rocklage*, 470 F.3d 1, 14 n.4 (1st Cir. 2006) (allegations in complaint stated a claim under Rule 10b-5 that the wife of a corporate executive misappropriated information from her husband in order to give her brother a “gift of information”).

16. *United States v. O’Hagan*, 521 U.S. 642, 652 (1997) (emphasizing that the classical and misappropriation theories of insider trading are “complementary” because they each address “efforts to capitalize on nonpublic information through the purchase or sale of securities”).

17. *United States v. Newman*, 773 F.3d 438, 452 (2d Cir. 2014) (quoting *United States v. Jiau*, 734 F.3d 147, 153 (2d Cir. 2013)).

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.*

defendants who had traded on a tip, allegedly passed from one friend to another, about an imminent acquisition.²² That court read *Newman* to demand evidence that the initial tipper expected a monetary or other quantifiable benefit from his friend—not merely the warm feelings of satisfaction that occur when one pal does a favor for another.²³ A host of other defendants, both within and outside the Second Circuit, have since sought to have their indictments or complaints dismissed, criminal convictions or civil liability determinations overturned, and guilty pleas or settlements vacated.²⁴ The growing list includes former Goldman Sachs director Rajat Gupta, who recently convinced the Second Circuit to reconsider his motion to vacate his conviction for fraudulent tipping.²⁵

However, in jurisdictions that continue to adhere to *Dirks*'s pronouncement that a personal benefit derives from gifting information to a friend or family member, the SEC and DOJ have garnered several post-*Newman* successes. The government's most salient victory occurred in the Ninth Circuit, with the decision in *United States v. Salman*.²⁶ The tipper was an investment banker who shared confidential merger and acquisition (M&A) information with his brother, who traded securities on the basis of that information.²⁷ The brother also passed the tips on to the defendant, Bassam Salman (a close friend who later became a family in-law), who traded as well.²⁸ The Ninth Circuit affirmed the defendant's conviction based on *Dirks*'s "gift" language²⁹ and held that "[p]roof that the insider disclosed material nonpublic information with the intent to benefit a trading relative or friend is sufficient to establish the breach of fiduciary duty element of insider trading."³⁰ The First Circuit has likewise declined to follow *Newman*'s heightened standard for personal benefit.³¹

22. *United States v. Conratt*, No. 12 Cr. 887, 2015 WL 480419 (S.D.N.Y. Jan. 22, 2015). *But see* SEC v. Payton, 97 F. Supp. 3d 558, 563–65 (S.D.N.Y. 2015) (holding that the SEC stated a valid claim for securities fraud under Rule 10b-5 in a civil enforcement action related to the same tipping at issue in *Conratt*).

23. See Phyllis Diamond, *Newman Topples Insider Charges Against Defendants in IBM Merger Case*, 47 SEC. REG. & L. REP. 202 (Jan. 29, 2015) (quoting a letter by the U.S. Attorney for the Southern District of New York requesting the court to dismiss the indictments because *Newman* "'creates a novel evidentiary bar for tipper benefit and tippee knowledge of such a benefit, that the Government cannot now meet'").

24. See Greg Stohr & Patricia Hurtado, *Insider Cases Imperiled as High Court Spurns Appeal*, 47 SEC. REG. & L. REP. 1929 (Oct. 12, 2015) (reporting that *Newman*'s ruling "threatens at least 10 convictions" and has "raised the bar for prosecutions stemming from information passed by a corporate insider to a friend, relative or business associate"); Patricia Hurtado, *Insider Traders Who May Find Hope in Supreme Court Move: List*, 47 SEC. REG. & L. REP. 1930 (Oct. 12, 2015) (identifying prosecutions impacted by the *Newman* ruling).

25. Chris Dolmetsch, *Rajat Gupta's Conviction to Get New Review*, 48 SEC. REG. & L. REP. 307 (Feb. 15, 2016). Gupta, who is now out of prison after having served a term of 19 months, *id.*, asserts that he was found guilty without a finding by the jury that his tips to billionaire hedge fund manager Raj Rajaratnam were part of "'an agreed-upon exchange of tips for consequential benefits.'" Patricia Hurtado, *Ex-Goldman Director Gupta Says Insider Conviction Should Be Tossed*, 47 SEC. REG. & L. REP. 540 (Mar. 16, 2015) (quoting Gupta's attorney Gary Naftalis).

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

27. *Id.* at 1089–90.

28. *Id.*

29. *Id.* at 1092 (quoting *Dirks v. SEC*, 463 U.S. 646, 664 (1983)).

30. *Id.*

31. See, e.g., *United States v. Parigian*, 824 F.3d 5, 15–16 (1st Cir. 2016) (finding that the tipper and tippee were "reasonably good friends" and that the tipper requested and received a golfing outing and other luxury entertainment in "return for the tips"); *United States v. McPhail*, 831 F.3d 1, 11 (1st Cir. 2016) (finding that the tipper received "concrete benefits" including "a free dinner, wine, and a massage parlor visit" as well as subtle benefits such as "the group's general gratitude for his largesse").

Securities law scholars have mirrored the divergent views of the federal circuits. Scholars who have sided with *Newman* include Professors Stephen Bainbridge, Jonathan Macey, and Todd Henderson. They view *Newman* as “an important corrective to the government’s drive to expand the limits of insider trading liability,”³² and they regard communications between corporate executives and securities analysts as “industry activity that the Supreme Court correctly understands to be normal, socially beneficial, and important to the integrity of capital markets, and that it explicitly seeks to protect.”³³ Professor Adam Pritchard likewise references *Dirks*’s policy objectives and observes that Justice Lewis Powell’s majority opinion sought “to leave space for securities professionals to uncover nonpublic information, even if it came from corporate insiders.”³⁴ He therefore concludes that “*Newman*’s interpretation of personal benefit is consistent with, if not compelled by, Powell’s purpose in *Dirks*.”³⁵

My own views coincide with those of scholars including Professors Michael Perino,³⁶ Jay Brown,³⁷ and James Cox,³⁸ who each regard *Newman* as a blatant misapplication of *Dirks* and a troubling impediment to effective insider trading enforcement. For as long as *Newman* remains the controlling precedent in the “Mother Court” of securities law,³⁹ unscrupulous tippers—whether corporate insiders or fiduciary outsiders—will be even more emboldened to leak confidential information, which would undermine investor confidence by fostering the perception that securities markets are “rigged” against honest traders.⁴⁰ *Newman*’s consequences are particularly troubling because they resulted from catapulting the policy objectives that motivated *Dirks* above the Court’s actual holding (as well as the complementary holding in *O’Hagan*). Although *Dirks*’s doctrine remains a fundamental component of the federal prohibitions of insider trading and tipping, the policy goals that *Dirks* sought to achieve fail to align with those currently of Congress and the SEC—the expert agency that Congress created to administer and enforce the federal securities laws.

32. Brief of Amicus Curiae Law Professors Stephen Bainbridge, M. Todd Henderson, and Jonathan Macey in Opposition to the United States of America’s Petition for Rehearing or Rehearing En Banc at *1, *United States v. Newman* (2014), (No. 13–1837-cr(L)), 2015 WL 1064409.

33. *Id.* at *9.

34. A.C. Pritchard, *Dirks and the Genesis of Personal Benefit*, 68 SMU L. REV. 857, 861 (2015).

35. *Id.* at 874.

36. Michael Perino, *The Gift of Inside Information*, N.Y. TIMES: DEALBOOK (Dec. 12, 2014), http://dealbook.nytimes.com/2014/12/12/the-gift-of-inside-information/?_r=0 (pointing out that “[t]he essence of a ‘gift’ is that it is gratuitous—a true gift is made with no expectation of anything in return”).

37. J. Robert Brown Jr., *US v. Newman and the Rewriting of the Law of Insider Trading (Part I)*, RACETO THEBOTTOM.ORG (Mar. 2, 2015, 6:00 AM), <http://www.theracetothetopbottom.org/home/us-v-newman-and-the-rewriting-of-the-law-of-insider-trading.html> (observing that most tips to friends and relatives “will not be motivated by the potential for pecuniary gain,” and criticizing *Newman* for essentially eliminating “from the prohibition on insider trading the exchange of information by family members”).

38. James D. Cox, *Giving Tippers a Pass: US v. Newman*, CLS BLUE SKY BLOG (Jan. 27, 2015), <http://clsbluesky.law.columbia.edu/2015/01/27/giving-tippers-a-pass-u-s-v-newman-3/> (lamenting that *Newman* “pours gas onto [a] raging fire” because “corporate insiders are not very good about keeping secrets [and] their tippees are delighted that they do not”).

39. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting).

40. See *infra* text accompanying note 235 (quoting congressional concerns about the harms from insider trading); *infra* text accompanying note 145 (referencing *O’Hagan*’s observation that promoting investor confidence and market integrity are “animating” purposes of the Exchange Act).

With its grant of certiorari in *Salman v. United States*,⁴¹ the Court will revisit the legality of gratuitous tipping. The question presented quotes from *Newman*'s holding and expressly asks the Court to determine which circuit interpreted *Dirks* correctly.⁴² After being left to the devices of lower courts for the nearly two decades since *O'Hagan* and the 33 years since *Dirks*, the fictionalized fate of *The Big Chill*'s Harold—and the very real fate of *Salman* and dozens of other defendants in pending cases—now lies with the Supreme Court.

The Court's 2016-17 term will therefore be extraordinarily important for the law of insider trading, no matter how the Court ultimately rules on the legality of gratuitous tipping. While the Court in *Salman* could affirm the Ninth Circuit simply by invoking *Dirks*'s explicit statement that informational gifts to relatives or friends fall within the personal-benefit test, this Article sets out two alternate paths that the Court could take in resolving this crucial controversy.

If the Court chooses to adhere to its “deceptive silence by a fiduciary” paradigm, the first alternative involves looking beyond *Dirks* to consider a potent combination of four developments in corporate and securities law: 1) the “fraud on the source” misappropriation theory, which the *O'Hagan* Court endorsed in a 6–3 opinion authored by Justice Ruth Bader Ginsburg;⁴³ 2) federal securities legislation in 1984, 1988, and 2012 that clearly ratifies, and builds on, the Court's holdings that Section 10(b) and Rule 10b-5 prohibit insider trading and tipping;⁴⁴ 3) the SEC's decision in 2000 effectively to ban the practice of selective disclosure through its adoption of Regulation FD (Fair Disclosure);⁴⁵ and 4) state court decisions that construe breaches of the duty of loyalty to encompass other deliberate conduct evidencing a lack of good faith, in addition to actions involving self-dealing.⁴⁶ These developments not only bolster the Ninth Circuit's interpretation of *Dirks*, they also pave the way for a clearer doctrine of joint tipper-tippee liability that explicitly turns on a tipper's breach of the duty of loyalty, whether or not that breach resulted in a personal benefit to the tipper.

The alternative approach, which I term the “fraud on contemporaneous traders” path, is one I have advocated in previous articles,⁴⁷ but never at such a crucial doctrinal juncture

41. *Salman v. United States*, 792 F.3d 1087 (9th Cir. 2015), *cert. granted*, 84 U.S.L.W. 3405 (U.S. Jan. 19, 2016) (No. 15-628).

42. *See infra* note 134 (quoting the first question presented in Petition for a Writ of Certiorari at *i, *Salman v. United States*, 792 F.3d 1087 (9th Cir. 2015) (No. 15-628), 2015 WL 7180648, (filed Nov. 10, 2015)).

43. *United States v. O'Hagan*, 521 U.S. 642, 652, 682 (1997).

44. Insider Trading Sanctions Act of 1984 (ITSA), Pub. L. No. 98-376, 98 Stat. 1264 (1984); Insider Trading and Securities Fraud Enforcement Act of 1988 (ITSFEA), Pub. L. No. 100-704, 120 Stat. 4677 (1988); Stop Trading on Congressional Knowledge (STOCK) Act of 2012, Pub. L. No. 112-105, 176 Stat. 291 (2012).

45. 17 C.F.R. § 243.100 (2011).

46. *In re Walt Disney Co. Derivatives Litig.*, 906 A.2d 27 (Del. 2006); *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362 (Del. 2006). In addition, although it can hardly be categorized as a development in its own right, the Court's decision in *Bateman Eichler, Hill Richards, Inc. v. Berner*, 474 U.S. 299 (1985), provides valuable contemporaneous insight into how the Court construed the then-recent test for joint tipper-tippee liability in the course of deciding whether to recognize an *in pari delicto* (unclean hands) defense, which would have barred plaintiff investors from recovering under Rule 10b-5 the damages they incurred from purchasing securities on the basis of what amounted to “false tips” by the defendants. *See infra* text accompanying notes 89–94 (discussing *Bateman Eichler*).

47. *See generally* Donna M. Nagy, *Insider Trading and the Gradual Demise of Fiduciary Principles*, 94 IOWA L. REV. 1315, 1369–78 (2009) [hereinafter Nagy, *Fiduciary Principles*]; Donna M. Nagy, *Reframing the Misappropriation Theory of Insider Trading Liability: A Post-O'Hagan Suggestion*, 59 OHIO ST. L.J. 1223 (1998).

as now, when the Court will determine the scope of investor protection from insider trading, perhaps for generations to come. Rather than simply clarifying the doctrine of joint tipper-tippee liability, the Court should re-conceptualize insider trading law more generally by consolidating its prior classical and misappropriation approaches into a new “fraud on contemporaneous traders” theory. Under this unified and expanded approach, which was first espoused by Chief Justice Warren Burger in his *Chiarella* dissent,⁴⁸ and possibly foreshadowed in a recent Court opinion,⁴⁹ the Rule 10b-5 disclosure obligation would run to the securities investors who traded with the person who obtained an informational advantage through misappropriation or some other improper means.⁵⁰ To be sure, this approach is not cabined by fiduciary principles and the *O’Hagan* decision did not reflect “a theory of that breadth.”⁵¹ But to better serve Congress’s and the SEC’s policy goals of promoting market integrity and investor confidence in securities markets,⁵² and to buttress the congressional determinations to regard insider trading and tipping as a species of securities fraud,⁵³ Rule 10b-5’s insider trading and tipping prohibitions should be construed as broadly as Section 10(b)’s statutory text allows. *Salman* thus provides a unique opportunity for the Court to endorse a “fraud on contemporaneous traders” theory of liability, which would make insider trading law substantially more coherent and legitimate.⁵⁴

The analysis in this Article proceeds in six parts. Part II discusses the rulings in *Newman* and *Salman*, and recounts *Chiarella*’s classical theory and the personal benefit test that the Court developed in *Dirks*. Part III focuses on the misappropriation theory and criticizes *Newman* for considering neither the doctrine nor the policy objectives set out in *O’Hagan*. Part IV shifts the focus to Congress and examines its essential role in the development of insider trading jurisprudence. Part V analyzes Regulation FD and explains why its adoption by the SEC casts a shadow on the rationale that underlies *Dirks*’s personal benefit test. Part VI examines Delaware Supreme Court decisions that construe breaches of the duty of loyalty to include not only self-dealing but also intentional failures to act in good faith, and it links this more expansive notion of fiduciary duty to the federal insider trading and tipping prohibitions arising under Rule 10b-5. Part VII concludes by proposing two alternate resolutions to the critical controversy over gratuitous tipping: a modest path

[hereinafter Nagy, *Reframing Misappropriation*].

48. See *Chiarella v. United States*, 445 U.S. 222, 240–45 (1980) (Burger, C.J., dissenting); see also *infra* note 392 (observing that Justices Brennan, Blackmun, and Marshall agreed with the Chief Justice’s view of the disclosure obligation).

49. See *infra* text accompanying notes 397–398 (analyzing Justice Breyer’s multiple citations to *O’Hagan* in his majority opinion in *Chadbourne & Park LLP v. Troice*, 134 S. Ct. 1058 (2014)).

50. See *infra* Part VII.B.

51. *United States v. O’Hagan*, 521 U.S. 642, 655 n.6 (1997).

52. See *infra* text accompanying notes 144–49, 210, 235 (quoting *O’Hagan* and Exchange Act legislative history).

53. See *infra* Part IV.

54. Indeed, while the Court’s classical and misappropriation approaches can be set out in a few sentences, they have nonetheless resulted in a jurisprudence that is unnecessarily complex. See Peter J. Henning, *What’s So Bad About Insider Trading Law?*, 70 BUS. LAW. 751, 757 (2015) (lamenting that insider trading law has grown “largely in fits and starts, rather than through a clear progression reflecting a coherent conception of the many aspects that make up a violation”); see also Thomas Lee Hazen, *Identifying the Duty Prohibiting Outsider Trading on Material Nonpublic Information*, 61 HASTINGS L.J. 881, 883 (2010) (observing that there are “hundreds of decisions grappling” with Rule 10b-5’s application to insider trading, and emphasizing that many of these decisions “are confusing and inconsistent with one another”).

that would simply clarify joint tipper-tippee liability and a bolder path that would consolidate the classical and misappropriation theories into a unified and expanded theory of insider trading that premises the Rule 10b-5 violation on a “fraud on contemporaneous traders.”

II. *NEWMAN’S AND SALMAN’S APPLICATION OF DIRKS*

A. *The Stock Trading Tips in Newman*

The defendants in *Newman*, Todd Newman and Anthony Chiasson, were portfolio managers at hedge funds holding billions of dollars in client-wealth.⁵⁵ After a six-week trial, a jury found them guilty of securities fraud, and a judge sentenced them to prison terms exceeding five years, for trading stocks based on material nonpublic earnings information related to Dell, Inc. and NVIDIA Corporation.⁵⁶ The defendants received that information indirectly and quite remotely from an insider at each company.⁵⁷ Newman’s stock trading generated more than \$4 million in profits for the funds he managed and Chiasson’s funds reaped profits exceeding \$68 million.⁵⁸

The evidence at trial showed that the confidential earnings information pertaining to Dell and NVIDIA had passed along an elaborate chain of three or four tippees that culminated with Newman and Chiasson.⁵⁹ The first link in the Dell chain was an employee who worked in the company’s investor-relations department.⁶⁰ In multiple conversations occurring primarily at nights or on weekends, the Dell insider provided pre-announcement quarterly earnings information to a securities analyst at Neuberger Berman, who was a former colleague he had known “for years, having both attended business school and worked at Dell together.”⁶¹ The Dell insider also had repeatedly sought out career advice from the Neuberger analyst, and the analyst in turn had edited the Dell insider’s resume and shared it with “a Wall Street recruiter.”⁶² Whether the Dell insider and the securities analyst were in fact “friends” turns on that term’s definition.⁶³ With respect to the stock trading in NVIDIA, the first link in that chain was an employee who had worked in the company’s finance unit.⁶⁴ Over a period of more than two years, the NVIDIA insider relayed quarterly pre-announcement earnings information about the company to a technology executive at Broadcom Corporation who was a “family friend[]” that [he] had met through church.”⁶⁵ Both Dell and NVIDIA had clear policies specifying that quarterly

55. United States v. Newman, 773 F.3d 438, 442–43 (2d Cir. 2014).

56. *Id.* at 443.

57. *Id.*

58. *Id.*

59. *Id.*

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

61. *Id.* at 452.

62. *Id.*

63. See Ethan J. Lieb, *Friendship & the Law*, 54 UCLA L. REV. 631, 638 (2007) (while “the vast majority of us know [our family members], figuring out who constitutes a friend—and when friendship starts and ends—may be a harder task”). Whereas the government asserted that the Dell insider and the securities analyst were “friends,” the defendants contended that that were simply acquaintances who were “not that close.” Reply Brief of Defendant-Appellant Todd Newman at 41, United States v. Newman, 773 F.3d 438 (2d Cir. 2014).

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

65. *Id.* at 452.

earnings information was to remain strictly confidential until the company made a public announcement.⁶⁶

B. The Classical Theory of Insider Trading

The mere fact that Newman and Chiasson traded stock in Dell and NVIDIA on the basis of material nonpublic earnings-related information does not, without more, establish liability for securities fraud. Although the offense of insider trading had been premised at one time on a “parity of information” approach developed by the SEC in *In re Cady, Roberts & Co.*⁶⁷ and endorsed by the Second Circuit in *SEC v. Texas Gulf Sulphur Co.*,⁶⁸ the Supreme Court rejected that expansive view of liability in the landmark case of *Chiarella v. United States*.⁶⁹ In so doing, *Chiarella* entrenched the classical theory of insider trading, which premises securities fraud liability on a person’s silence about material nonpublic information in a securities transaction “when one party has information ‘that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.’”⁷⁰

Chiarella’s focus was on “securities fraud” because Congress has not enacted a federal statute that explicitly prohibits anyone from “insider trading” or “tipping.” Instead, those offenses typically have been prosecuted as a violation of the broad antifraud prohibitions in Section 10(b) and Rule 10b-5.⁷¹ Insider trading law in the United States is thus derived from judicial interpretations of Section 10(b)’s prohibition of deception “in connection with the purchase or sale of any security,”⁷² and when tender offers are at issue, Section 14(e) and Rule 14e-3 as well.⁷³

66. Superseding Indictment, *United States v. Newman*, S2 12 Cr. 121 (RJS), August 28, 2012. Paragraph 8 of the Twelve-Count Superseding Indictment charged that: “[t]he Inside Information . . . was obtained in violation of: (i) fiduciary and other duties of trust and confidence owed by the employees of the Technology Companies to their employers; (ii) expectations of confidentiality held by the Technology companies; (iii) written policies of the Technology Companies regarding the use and safekeeping of confidential business information; and (iv) agreements between the Technology Companies and their employees to maintain information in confidence.” *Id.* ¶8.

67. See *Cady, Roberts & Co.*, 40 S.E.C. 907, No. 8–3925 at * 4 (1961) (holding that the obligation to disclose or abstain from trading rests on two principal elements: “first, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing”).

68. *SEC v. Tex. Gulf Sulphur Co.*, 401 F.2d 833, 848 (2d Cir. 1968) (holding that “anyone in possession of material inside information must either disclose it to the investing public . . . [or] must abstain from trading in or recommending the securities concerned”).

69. *Chiarella v. United States*, 445 U.S. 222 (1980).

70. *Id.* at 228 (emphasis added) (quoting RESTATEMENT (SECOND) OF TORTS § 551(2)(a) (AM. LAW. INST.1977)).

71. See *id.* at 226 (observing that, in *Cady, Roberts*, “[t]he SEC took an important step in the development of § 10(b)”).

72. 15 U.S.C. § 78j(b) (1934).

73. The SEC adopted Rule 14e-3 in 1980, subsequent to the securities transactions at issue in *Chiarella*. Once “substantial steps” toward a tender offer have been taken, the rule prohibits trading by any person in possession of material nonpublic information relating to that tender offer when that person knows or has reason to know that the information is nonpublic and was received from the offeror, the target, or any person acting on behalf of either the offeror or the target. See 17 C.F.R. § 240.14e-3 (2016); see also *United States v. O’Hagan*, 521 U.S. 642, 672–73 (1997) (ruling that Rule 14e-3 qualifies as a “means reasonably designed to prevent” fraud in connection with tender offers within the meaning of Section 14(e) of the Exchange Act).

*Dirks v. SEC*⁷⁴ is the precedent most squarely on point with the facts of *Newman*. *Dirks* involved disclosures made by former and present officers at the insurance company Equity Funding of America (Equity Funding).⁷⁵ Those insiders shared negative nonpublic information about Equity Funding with the securities analyst Raymond Dirks, who in turn advised his clients that they could avoid huge losses by quickly selling their shares in the company.⁷⁶ The information pertained to the company's involvement in a massive fraud, and the insiders (principally its former officer Ronald Secrist) had enlisted Dirks to assist them in their whistleblowing efforts.⁷⁷ Building on *Chiarella*'s classical theory, the Court concluded that the shareholders on the other side of Dirks's clients' transactions could have been deceived and thus defrauded under Rule 10b-5 only if Secrist and the other insiders had breached a fiduciary duty of "trust and confidence" by personally benefitting directly or indirectly from their disclosure.⁷⁸ Evidence of a "personal benefit" required courts to focus on "objective criteria," such as whether an insider's tip would generate a quid pro quo producing "a pecuniary gain or a reputational benefit that will translate into future earnings."⁷⁹ But *Dirks* likewise observed that the "[t]he elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend."⁸⁰

Dirks thus held that securities analysts and other tippees effectively inherit a corporate insider's fiduciary disclosure obligation if—but only if—"the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach."⁸¹ In other words, *Dirks* insisted that Rule 10b-5 liability must turn on proof that the tipper received a personal benefit from the disclosure and, in prosecutions for illegally trading on a tip, proof that the tippee was aware of the tipper's breach of duty.⁸² Thus, to the Court in *Dirks*, any disclosure obligation on the part of the tippee would be "derivative from that of the insider's duty."⁸³

Dirks eschewed a broader reading of Rule 10b-5 because the Court did not want to dissuade securities analysts from "ferret[ing] out and analyz[ing] information" that

74. *Dirks v. SEC*, 463 U.S. 646 (1983).

75. *Id.* at 649.

76. *See id.* at 650 (observing that when Equity Funding's negative news hit the market, its stock price dropped from \$26 to \$15 per share).

77. *Id.*

78. *Id.* at 663.

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

80. *Id.* at 664.

81. *Id.* at 660.

82. *Id.*

83. *Id.* at 659; *see also id.* at 662 (concluding that "[a]bsent some personal gain, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach"). Although *Dirks* stated that a disclosure duty attaches when the tippee "knows or should know that there has been a breach," for a tippee's securities trading to violate Rule 10b-5, there must also be a finding that the tippee acted with scienter. Accordingly, with a view to the scienter requirement, courts often phrase the disclosure obligation as one generated when the tippee knows or is reckless in not knowing that the insider breached a fiduciary duty by disclosing information. *See* Donald C. Langevoort, "Fine Distinctions" in the Contemporary Law of Insider Trading, 2013 COL. BUS. L. REV. 429, 455–56 (observing that "[t]he 'knows or should know' standard in *Dirks* has always been hard to explain" and that courts often "use recklessness here instead"). For an argument that tippee liability requires a mental state beyond recklessness, *see* Joan MacLeod Heminway, *Willful Blindness, Plausible Deniability, and Tippee Liability: SAC, Steve Cohen, and the Court's Opinion in Dirks*, 15 TRANSACTIONS: TENN. J. BUS. L. 47, 54–55 (2013).

contributes to pricing efficiency, which “redounds to the benefit of all investors.”⁸⁴ According to Justice Powell, much of this “necessary” and “commonplace” ferreting was “done by meeting with and questioning corporate officers and others who are insiders”⁸⁵ about “information that corporations may have reason to withhold from the public.”⁸⁶ As Professor Merritt Fox has concluded, “[i]t is clear from the majority opinion that the Court added this personal benefit test for policy reasons.”⁸⁷

Dirks’s apposite concern about personal benefit, however, applies whether the corporation’s information was exchanged for a tangible benefit or merely given away for the personal benefit of its recipient. Either way, an insider’s disclosure would involve “inherent unfairness” because the insider would be taking “‘advantage’ of ‘information intended to be available only for a corporate purpose and not for the personal benefit of anyone.’”⁸⁸

But even if the Court had left a doubt in *Dirks* as to whether an insider benefits personally when he or she gives a principal’s information as a gift, the Court clarified that point less than two years later in *Bateman Eichler, Hill Richards, Inc. v. Berner*.⁸⁹ The facts of *Bateman Eichler* prompted the Court to revisit its test for joint tipper-tippee liability in the course of deciding whether to recognize an *in pari delicto* (unclean hands) defense, which would have barred the plaintiff investors from recovering under Rule 10b-5 the damages they incurred from purchasing stock on the basis of what amounted to false tips by the defendants.⁹⁰ The Court viewed the plaintiffs as “unwitting dupes” in the defendants’ market manipulation scheme and ultimately concluded that there was no basis for applying the defense at such an early stage of the litigation.⁹¹ But notably, in reaching that conclusion, it quoted *Dirks*’s holding that tippee liability turns on whether a tipper “‘benefit[s] directly or indirectly, from his disclosure,’”⁹² and expressly observed that “[s]uch benefit can derive from the insider’s use of information to secure a ‘pecuniary

84. *Dirks*, 463 U.S. at 658 n.17; see also *id.* at 659 (emphasizing that the “information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation’s securities” and that “[i]t is the nature of this type of information, and indeed of markets themselves, that such information cannot be made simultaneously available to all of the corporation’s stockholders or the public generally”).

85. *Id.* at 658.

86. *Id.* at 658 n.18.

87. See Merritt B. Fox, *Regulation FD and Foreign Issuers: Globalization’s Strains and Opportunities*, 41 VA. J. INT’L L. 653, 660 (2001) (observing that “[t]he Court felt that the analyst interview is a socially valuable practice that would be chilled by a Rule 10b-5 prohibition against any selective revelations of material non-public information that might occur during such an interview”).

88. *Dirks*, 463 U.S. at 654 (quoting *In re Merrill Lynch, Inc.*, 43 S.E.C. 933, 936 (1968)).

89. *Bateman Eichler v. Berner*, 472 U.S. 299 (1985).

90. The *Bateman Eichler* defendants were a securities brokerage and the president of the corporation that had issued the stock. The plaintiffs alleged that these defendants had fraudulently induced their stock purchases by communicating false and misleading information about the corporation under the ruse that they were conveying reliable, material nonpublic information. See *id.* at 301–02. The plaintiffs admitted in their complaint that they purchased the stock “on the premise that their broker “‘was privy to certain information not otherwise available to the general public.’” *Id.* at 302 (quoting complaint).

91. The Court had assumed, for purposes of its decision, that the defendants were correct in viewing the plaintiffs as “tippees” who had traded in violation of Rule 10b-5. But in the Court’s view, there were “important distinctions between the relative culpabilities of tippers, securities professionals, and tippees in these circumstances,” based in part on the fact that insider-tippers typically defraud not only the shareholders on the other side of a tippee’s transaction but also the corporation that entrusted the insiders with the material nonpublic information. See *id.* at 313–14; see also *infra* text accompanying notes 184–186 (discussing culpability issues).

92. *Bateman Eichler*, 472 U.S. at 310 n.21 (quoting *Dirks*, 463 U.S. at 663).

gain,’ a ‘reputational benefit that will translate into future earnings,’ or *simply to confer ‘a gift of information to a trading relative or friend.’*”⁹³ Beyond that, in questioning whether the facts established that the investors “were aware” the insider breached a fiduciary duty by disclosing material nonpublic information to their broker (who in turn relayed the tips to them), the Court looked to whether the investors “had a basis to believe” that the insider provided the information to the broker “*as a favor* or otherwise acted against the shareholders’ interests.”⁹⁴ As the SEC emphasized in a 1985 special report to Congress, *Bateman Eichler’s* discussion of *Dirks* in the course of its ruling confirms the Court’s contemporaneous view that gratuitous tipping violates Rule 10b-5.⁹⁵

C. Newman’s Novel Reading of Dirks

Although the jury in *Newman* concluded that the insiders at Dell and NVIDIA had benefitted from their disclosures of the confidential earnings-related information,⁹⁶ the Second Circuit overturned that finding because, in its view, the “circumstantial evidence in this case was simply too thin to warrant the inference that the corporate insiders received any personal benefit in exchange for their tips.”⁹⁷ As the court saw it, if the facts presented by the government constituted “a ‘benefit,’ practically anything would qualify.”⁹⁸ The court acknowledged *Dirks’s* suggestion that “a personal benefit may be inferred from a personal relationship between the tipper and tippee.”⁹⁹ But it then held that “such an inference is impermissible in the absence of proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.”¹⁰⁰ The court also emphasized what it drew as a “fundamental insight” from *Dirks*: “that, in order to form the basis for a fraudulent breach, the personal benefit received in exchange for confidential information must be of some consequence.”¹⁰¹ The court therefore concluded that the government cannot prove the existence of a tipper’s personal benefit “by the mere fact of a friendship, particularly of a casual or social nature.”¹⁰² Although *Newman* acknowledged *Dirks’s* reference to an informational gift, the court failed to quote *Dirks’s* key “gift” sentence, and then it compounded that error by overlooking entirely the Court’s restatement of that “gift” language in *Bateman Eichler*.¹⁰³

93. *Id.* (emphasis added).

94. *Id.* (emphasis added).

95. See *infra* text accompanying notes 227–34 (discussing the Insider Trading Sanctions Act of 1984 and the House Committee on Commerce and Energy’s mandate for a follow-up study by the SEC).

96. *United States v. Newman*, 773 F.3d 438, 444 (2d Cir. 2014). The district court instructed that the jury must consider “‘whether the [G]overnment has proven beyond a reasonable doubt that [the Dell and NVIDIA insiders] intentionally breached that duty of trust and confidence by disclosing material nonpublic information for their own benefit.’” *Id.* (quoting Tr. 4030).

97. *Id.* at 451–52.

98. *Id.* at 452.

99. *Id.*

100. *Newman*, 773 F.3d at 452.

101. *Id.*

102. *Id.*

103. See *supra* note 93 and accompanying text (quoting *Bateman Eichler*). In addition, the *Newman* court made no attempt to reconcile its tangible benefit requirement with the Second Circuit’s contrasting statement in *SEC v. Warde*, 151 F.3d 42, 48 (2d Cir. 1998) (concluding that the government “need not show that the tipper expected or received a specific or tangible benefit in exchange for the tip”).

The Second Circuit also took issue with the jury's determination that the government proved beyond a reasonable doubt the requisite knowledge on the part of the defendants. The trial court's instruction had allowed the jury to consider whether the defendants knew that the information about Dell and NVIDIA "was originally disclosed by the insider in violation of a duty of confidentiality."¹⁰⁴ The court deemed that instruction erroneous because to satisfy *Dirks*'s knowledge requirement, the government had to prove that Newman and Chiasson, as remote tippees, either knew or should have known of "the tipper's breach of fiduciary duty."¹⁰⁵ And as the court saw it, "the exchange of confidential information for personal benefit . . . is the fiduciary breach that triggers liability for securities fraud under Rule 10b-5."¹⁰⁶ It therefore held that "without establishing that the tippee knows of the personal benefit received by the insider in exchange for the disclosure, the Government cannot meet its burden of showing that the tippee knew of a breach."¹⁰⁷ The court then focused on an evidentiary failing that it deemed fatal to the government's case: according to the court, the government failed to present any "testimony or any other evidence that [the defendants] knew . . . that those insiders received any benefit in exchange for such disclosures."¹⁰⁸ The court thus reversed the defendants' convictions and dismissed their indictments because "no rational jury would find that the tips were so overwhelmingly suspicious that [the defendants] either knew or consciously avoided knowing that the information came from corporate insiders or that those insiders received any personal benefit in exchange for the disclosure."¹⁰⁹

After the government unsuccessfully sought to have *Newman* reheard,¹¹⁰ its last resort appeared to be review by the Supreme Court. The Solicitor General petitioned for a writ of certiorari, which presented the question whether *Newman*'s interpretation of personal benefit constituted an erroneous departure from the "gifting theory" in *Dirks*.¹¹¹ The government contended that *Newman*, in the "guise of interpreting" *Dirks*, had actually "crafted a newer, stricter personal benefit test" that essentially collapsed the dual categories of quid pro quos and gifts into a single category that rendered *Dirks*'s entire "gift" discussion superfluous.¹¹² However, once the Court announced the denial of certiorari,¹¹³

104. *Newman*, 773 F.3d at 444 (quoting jury instructions at Tr. 4033:14-22).

105. *Id.* at 447 (citing *Chiarella v. United States*, 445 U.S. 222, 233 (1980)).

106. *Id.* at 447-48 (emphasis in original).

107. *Id.* at 448.

108. *Id.* at 453.

109. *Newman*, 773 F.3d at 455.

110. *See United States v. Newman*, No. 13-1837L, 2015 WL 1954058 (2d Cir. April 3, 2015) (denying the government's petition for a panel rehearing, or in the alternative, for a rehearing en banc).

111. U.S. Petition for a Writ of Certiorari at i, *United States v. Newman*, 136 S. Ct. 242 (2015) (No. 15-137). The sole question presented was: "whether the court of appeals erroneously departed from this Court's decision in *Dirks* by holding that liability under a gifting theory requires 'proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.'" *Id.*

112. *Id.* at 18-19. The government's petition did not seek review of the Second Circuit's ruling concerning the insufficiency of evidence pertaining to the defendants' knowledge of the tippers' personal benefits. Several commentators questioned this tactical move and predicted that the Court would deny the government's petition because it amounted to a request for an advisory opinion on the personal benefit issue. *See* Roger Parloff, *Why the Supreme Court Might Not Hear a Crucial Insider Trading Case*, *FORTUNE* (Sept. 23, 2015), <http://fortune.com/2015/09/23/supreme-court-insider-trading-newman/> (observing that "federal courts aren't supposed to render 'advisory opinions' . . . even if such an opinion might give helpful guidance in future cases").

113. *United States v. Newman*, 773 F.3d 438, 446 (2d Cir. 2014), *cert. denied*, 136 S. Ct. 242 (2015).

the government turned to developing a litigation strategy that accentuates tangible benefits on the part of tippers, whenever possible.¹¹⁴

D. The Grant of Certiorari in *Salman*

In contrast to *Newman*'s multi-layered tipping chains and the controverted evidence pertaining to the tippers' motives, the facts of *Salman* are relatively straightforward. Over a period of more than three years, Bassam Salman repeatedly received stock trading tips from Michael Kara, whose younger brother, Maher Kara, was an investment banker employed by Citigroup Global Markets, Inc.¹¹⁵ Maher (who pled guilty to charges of conspiracy and securities fraud) admitted that he breached duties owed to Citigroup and its M&A clients when he secretly shared confidential information with his older brother Michael, knowing that Michael was using that information to purchase securities in the targets.¹¹⁶ Maher further "testified that he 'love[d] [his] brother very much' and that he gave Michael the inside information in order to 'benefit him' and to 'fulfill [] whatever needs he had.'"¹¹⁷ Michael, in turn, shared the confidential information with Salman (a close friend who later became an in-law), and encouraged Salman to "mirror-imag[e]" his trading activity.¹¹⁸ Salman did so, but rather than trade securities through a brokerage account in his own name, Salman deposited money into an account owned by his sister and her husband, and arranged with the husband to split the trading profits, which totaled approximately \$1.7 million.¹¹⁹ Michael, who also pled guilty, testified that he told Salman that the M&A information was coming from Maher.¹²⁰ The court thus observed that the government "presented evidence that Salman knew full well that Maher Kara was the source of the information."¹²¹ After a jury found Salman guilty of conspiracy and securities

114. See Richard Hill, *SEC Still Bringing Insider Trading Cases Despite Newman Loss*, 47 SEC. REG. L. REP. 2397 (Dec. 21, 2015) (quoting the SEC's Associate Director of Enforcement statement that after *Newman*, the agency is having to "work harder to establish a relationship that helps satisfy the court's personal benefit standard").

115. United States v. *Salman*, 792 F.3d 1087, 1089 (9th Cir. 2015).

116. *Id.* Notably, Citigroup represented the *acquiring company* in three of the four impending acquisitions that generated the investment banker's gratuitous tips about the securities of the acquisition targets. See Brief for Petitioner at 6, 12-15, *Salman v. United States*, (No. 15-628), 2106 WL 2732058 (filed May 6, 2016) (stating that Salman was convicted of four substantive counts of insider trading, which pertained to his trades in securities of Biosite Incorporated (with Citigroup representing the acquiring company) and United Surgical Partners International, Inc. (with Citigroup representing a private equity firm that was interested in buying out the other USPI shareholders); see also *id.* at 12 (observing that Salman was also convicted of a single count of conspiracy to engage in insider trading, which pertained to his securities purchases in USPI and Biosite as well as in Andrx Corporation (with Citigroup representing the acquirer) and Bone Care International, Inc (with Citigroup representing the acquisition target in the company's sale to Genzyme). Thus, only a fraction of the petitioner's illegal profits resulted from a transaction in which Citigroup represented, and thereby owed fiduciary-like duties to, the target company's shareholders—the lion's share of the illicit gains resulted from "outsider" tipping and trading. See Brief of Respondent United States at 6, *Salman v. United States* (No. 78-15628), 2016 WL 4088380 (filed Aug. 1, 2016) (observing that nearly \$1 million of petitioner's profits came from the investment banker's "tip that Biosite was about to be acquired by a Citigroup client").

117. *Salman*, 792 F.3d at 1089 (quoting testimony introduced at Salman's trial).

118. *Id.*

119. *Id.*

120. *Salman*, 792 F.3d at 1089 (observing that the Kara and Salman families were very close—in 2003, Maher became engaged to Salman's sister and they were married in 2005).

121. *Id.*

fraud, the district court sentenced him to three years in prison.

In view of these facts, the Ninth Circuit concluded that the case was governed by the gift-giving holding in *Dirks*, which the court found to apply in a misappropriation theory case, “like the instant case, where the fiduciary duty is owed, not to the shareholders, but to the tipper’s employer, client, or the like.”¹²² Specifically, the court emphasized *Dirks*’s statement that “[t]he elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend.”¹²³ As the Ninth Circuit saw it, “Maher’s disclosure of confidential information to Michael, knowing that he intended to trade on it, was precisely the ‘gift of confidential information to a trading relative’ that *Dirks* envisioned.”¹²⁴

The Ninth Circuit then confronted—and rejected—the defendant’s arguments that his conviction could not be sustained in the absence of proof that Maher received a “tangible benefit” for the information gifted to Michael, and that the ruling in *Newman* requires “the exchange of information [to] include ‘at least a potential gain of a pecuniary or similarly valuable nature.’”¹²⁵ The court stated plainly that “[t]o the extent *Newman* can be read to go so far, we decline to follow it.”¹²⁶ In the court’s view, insistence of proof of a tangible benefit would require it “to depart from the clear holding of *Dirks* that the element of breach of fiduciary duty is met where an ‘insider makes a gift of confidential information to a trading relative or friend.’”¹²⁷ And where there is evidence of a gift, reading *Dirks* to also require a “tangible benefit” would create a troubling loophole: “a corporate insider or other person in possession of confidential and proprietary information would be free to disclose that information to her relatives, and they would be free to trade on it, provided only that she asked for no tangible compensation in return.”¹²⁸ The Ninth Circuit therefore concluded that “[p]roof that the insider disclosed material nonpublic information with the intent to benefit a trading relative or friend is sufficient to establish the breach of fiduciary duty element of insider trading.”¹²⁹

Salman’s petition for a writ of certiorari to the Ninth Circuit did not challenge the sufficiency of the evidence that he purchased securities in acquisition targets on the basis of M&A information misappropriated by Maher from Citigroup and its clients. Instead, the petition emphasized that here, in contrast to *Newman*, the resolution of the issue of gratuitous tipping was “indisputably outcome-determinative.”¹³⁰ That is, the petition argued that:

If a close family relationship between the insider and the tippee is enough to establish a personal benefit for the insider, as the Ninth Circuit held here, then Salman loses. But if there must be “an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature,” as the Second Circuit held in *Newman*, then Salman prevails, because

122. *Id.* at 1092 n.4.

123. *Id.* at 1092 (quoting *Dirks v. SEC*, 463 U.S. 646, 664 (1983)).

124. *Id.*

125. *Salman*, 792 F.3d at 1093 (quoting *United States v. Newman*, 773 F.3d 438, 452 (2d Cir. 2014)).

126. *Id.*

127. *Id.* (quoting *Dirks*, 463 U.S. at 663).

128. *Id.* at 1094.

129. *Id.*

130. *Salman v. United States*, 792 F.3d 1087, *petition for cert.*, 2015 WL 7180648, at *2 (9th Cir. Nov. 10, 2015) (No. 15-628).

there is no evidence of such an exchange here between the insider and the tippee.¹³¹

The government countered that “[f]urther review [was] not warranted” because the Ninth Circuit’s decision on the personal benefit issue was correct and “fully consistent with this Court’s decision in *Dirks*.”¹³² But early in 2016, the Court agreed to hear the case of *Salman v. United States*,¹³³ noting that the grant was “limited to Question 1 presented by the petition.”¹³⁴ Thus, the government will attempt to persuade the Court to eradicate *Newman*’s unreasonably high hurdle for proving a personal benefit under the test in *Dirks*.

III. MISAPPROPRIATION THEORY—DOCTRINE AND POLICY

Although the DOJ and the SEC have been steadfast in their view that the Second Circuit’s stricter personal benefit standard cannot be reconciled with *Dirks*, the government has thus far failed to dispute the operating premise that joint tipper-tippee liability turns entirely on *Dirks*’s precedent.¹³⁵ But using *Dirks* as the sole determinant of joint tipper-tippee liability marginalizes the groundbreaking decision in *United States v. O’Hagan*,¹³⁶ and improperly privileges the policy views of Justice Powell and the *Dirks* majority over the ensuing views of Justice Ginsburg and the five other justices who joined in her opinion.¹³⁷ Disloyal fiduciaries who breach their duties of trust and confidence by secretly disclosing confidential information to securities traders are “misappropriators,” and they should be viewed as such regardless of whether the tipper stands as an insider under the classical theory or an outsider under the misappropriation theory.

A. The Misappropriation Theory of Insider Trading

Both the facts and the holding in *O’Hagan* are very well known. The case involved a partner at a national law firm who purchased stock in a takeover target on the basis of material nonpublic information that he learned from his law firm and its client, which had been planning the hostile acquisition. *Chiarella* and *Dirks*’s classical theory would not have supported the attorney’s prosecution because he stood as an outsider to the target corporation and thus did not owe its shareholders a disclosure duty grounded in a

131. *Id.*

132. Brief for the United States in Opposition, at *9, *Salman v. United States*, 792 F.3d 1087 (9th Cir. Dec. 14, 2015) (No. 15-628), 10872015 WL 8959421.

133. *Salman v. United States*, No. 15-628, 2016 WL 207256 (*cert. granted*, Jan. 19, 2016).

134. *Id.* Question 1 in the petition reads in full: “[d]oes the personal benefit to the insider that is necessary to establish insider trading under *Dirks v. SEC*, 463 U.S. 646 (1983), require proof of ‘an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature,’ as the Second Circuit held in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), *cert. denied*, No. 15-137 (U.S. Oct. 5, 2015), or is it enough that the insider and the tippee shared a close family relationship, as the Ninth Circuit held in this case?” Petition for a Writ of Certiorari, *supra* note 130, at i.

135. *But see infra* note 174 (discussing unsuccessful attempts by the DOJ and SEC to convince courts that the personal benefit test applies only in classical cases and not to tipper-tippee cases brought under a misappropriation theory).

136. *United States v. O’Hagan*, 521 U.S. 642 (1997).

137. In addition to Justices Breyer and Kennedy, the three others in the *O’Hagan* majority were Justices Sandra Day O’Connor, David Souter, and John Paul Stevens. Justice Clarence Thomas authored a dissenting opinion in which Chief Justice William Rehnquist joined and Justice Antonin Scalia authored a separate dissenting opinion.

relationship of trust and confidence. The Court, however, had little trouble affirming the jury's verdict that the attorney's securities trading had violated Rule 10b-5 by deceiving and defrauding his law firm and its client "in connection with" his purchases of stock and options in the takeover target. The Court viewed the attorney as a misappropriator who "deal[t] in deception."¹³⁸ That is, in the Court's view, "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"¹³⁹ satisfies Rule 10b-5's deception requirement because the fiduciary "feign[s] fidelity,"¹⁴⁰ and thereby "defrauds the principal of the exclusive use of that information."¹⁴¹ The Court also found that this deception satisfies Rule 10b-5's "in connection with" requirement "because the fiduciary's fraud is consummated, not when the fiduciary gains the confidential information, but when, without disclosure to his principal, he uses the information to purchase or sell securities."¹⁴² Thus, the fiduciary's breach of loyalty "coincide[s]" with his securities transaction.¹⁴³

While *O'Hagan* grounded its holding in Section 10(b)'s text, the Court also bolstered its statutory analysis with the "congressional purposes underlying § 10(b)."¹⁴⁴ In so doing, Justice Ginsburg framed the "fraud on the source" misappropriation theory to advance the important policy objectives of ensuring "honest securities markets" and promoting "investor confidence."¹⁴⁵ These objectives went far beyond Justice Powell's objective in *Dirks*, which was to ensure that insiders did not profit directly or indirectly from their informational advantage in securities transactions with the corporation's shareholders.¹⁴⁶ Although it was hardly a complete return to the parity of information approach, Justice Ginsburg masterfully reconnected the federal insider trading prohibition to some of the fairness principles that had punctuated those pre-*Chiarella* decisions.¹⁴⁷ That is, Justice Ginsburg observed that "investors likely would hesitate to venture their capital in a market where trading based on misappropriated nonpublic information is unchecked by law."¹⁴⁸ She therefore concluded that "considering the inhibiting impact on market participation of

138. *O'Hagan*, 521 U.S. at 653–54.

139. *Id.* at 652.

140. *Id.* at 655.

141. *Id.* at 652; *see also id.* at 664 (quoting *Carpenter v. United States*, 484 U.S. 19, 27 (1987) (observing that "[a] company's confidential information . . . qualifies as property to which the company has a right of exclusive use" and that "[t]he undisclosed misappropriation of such information, in violation of a fiduciary duty . . . constitutes fraud akin to embezzlement—the fraudulent appropriation to one's own use of the money or goods entrusted to one's care by another")).

142. *O'Hagan*, 521 U.S. at 655–56.

143. *Id.* The *O'Hagan* Court recognized, however, that "full disclosure forecloses liability under the misappropriation theory." *Id.* at 655. That is, "if the fiduciary discloses to the source that he plans to trade on the nonpublic information, there is no 'deceptive device' and thus no § 10(b) violation." *Id.*

144. *Id.* at 659.

145. *O'Hagan*, 521 U.S. at 658 (observing that the misappropriation theory was "well-tuned to an animating purpose of the Exchange Act").

146. *See* 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, 43 (1998) (observing that "[p]olicy concerns and congressional intent, not the common law of deceit followed by Powell in *Chiarella* and *Dirks*, guided the Court's decision in *O'Hagan*"); Stephen M. Bainbridge, *Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud*, 52 SMU L. REV. 1589, 1648 (1999) (depicting *O'Hagan* as an "arguable revival of the long-discredited equal access theory of liability").

147. *See supra* text accompanying notes 67–68 (discussing the SEC's decision in *Cady, Roberts* and the Second Circuit's decision in *Texas Gulf Sulphur*).

148. *O'Hagan*, 521 U.S. at 658.

trading on misappropriated information” it would “make[] scant sense to hold a lawyer like O’Hagan a § 10(b) violator if he works for a law firm representing the target of a tender offer, but not if he works for a law firm representing the bidder.”¹⁴⁹ O’Hagan was clear, however, that the misappropriation theory had an outward limit insofar as it applied only “to those who breach[ed] a recognized duty” owed to the information’s source.¹⁵⁰

Had Justice Powell remained on the bench for the O’Hagan decision, he almost certainly would have disagreed with Justice Ginsburg’s “fraud on the source” analysis, both with respect to her textual interpretation and her normative evaluation. As we know from Professor Pritchard’s historical research,¹⁵¹ shortly before Powell’s retirement, the Justice had urged his colleagues to grant certiorari in *Carpenter v. United States*.¹⁵² As Professor Pritchard explains, Justice Powell viewed the petition as a prime opportunity to overturn the misappropriation theory that was well ensconced in the Second Circuit.¹⁵³ Because the Court initially intended to deny certiorari, Justice Powell wrote a draft dissent, which he later withdrew when the Court re-voted to hear the case. But his draft had emphasized what he regarded as the misappropriation theory’s tension with *Chiarella* and *Dirks* as well as its inconsistency with Section 10(b)’s requirement that the fraud be “in connection with” the purchase or sale of a security.¹⁵⁴ Accordingly, in all likelihood, Justice Powell would have sided with the three O’Hagan dissenters who rejected the misappropriation theory,¹⁵⁵ and likely would have shared their view that while the attorney deceived his law firm and his client, such a fraud on the information’s source was not sufficiently “integral” to the securities transactions to fall within the prohibition of Rule 10b-5.¹⁵⁶ Justice Powell may likewise have shared the O’Hagan dissenters’ skepticism as to “whether removing that aspect of fraud . . . has anything to do with the confidence or integrity of the market.”¹⁵⁷

B. Tippers as Misappropriators

Because the attorney in O’Hagan used his law firm’s confidential client information to procure securities trading profits for himself, an additional step must be undertaken to

149. *Id.* at 659.

150. *Id.* at 666. Three years after O’Hagan, the SEC codified the Court’s complementary approaches to insider trading liability in Rule 10b5-1, which sets out a general principle that the “manipulative and deceptive devices” prohibited by Section 10(b) and Rule 10b-5 shall include, among other things, securities trading “on the basis of material nonpublic information . . . in breach of a duty of trust or confidence that is owed . . . to the issuer of that security or the shareholders of that issuer, or to any other person who is the source of the material nonpublic information.” 17 C.F.R. § 240.10b5-1(a) (2016).

151. Pritchard, *supra* note 146, at 32–34.

152. *Carpenter v. United States*, 484 U.S. 19 (1987). The Wall Street Journal reporter in *Carpenter* had misappropriated confidential information from his “Heard on the Street” columns by tipping others to trade and secretly sharing in the profits. *Id.* at 22–23.

153. Pritchard, *supra* note 146, at 33.

154. *See id.* at 58 (reprinting Justice Lewis F. Powell, Jr.’s Draft Dissent from Denial of Certiorari, *Carpenter v. United States* (Dec. 10, 1986)). According to Justice Powell, “the duty of an individual to his employer alone is insufficient to support an action under Rule 10b-5.” *Id.* Thus, Section 10(b) “‘must instead focus on the petitioner’s relationship with the sellers of the . . . securities.’” *Id.*

155. *See supra* note 137.

156. *United States v. O’Hagan*, 521 U.S. 642, 691 (1997) (Thomas, J., Rehnquist, C.J., dissenting); *see also id.* at 679 (Scalia, J. dissenting) (contending that under the “principle of lenity,” Section 10(b)’s text “must be construed to require the manipulation or deception of a party to a securities transaction”).

157. *Id.* at 691 (Thomas, J., Rehnquist, C.J., dissenting).

appreciate why tipping and trading on misappropriated information is likewise a fraud that violates Rule 10b-5. As then-Second Circuit Judge Sonia Sotomayor recognized in *United States v. Falcone*,¹⁵⁸ “the coincidence of a securities transaction and breach of duty” is not present where a tipper conveyed confidential information to a third party but did not himself trade.¹⁵⁹ She emphasized, however, that “*O’Hagan* did not purport to set forth the sole combination of factors necessary to establish the requisite connection in all contexts” and observed that Second Circuit courts had applied the misappropriation theory even to schemes involving nontrading tippees.¹⁶⁰ Then-Judge Sotomayor also recognized that “*O’Hagan*’s requirement that the misappropriated information ‘ordinarily’ be valuable due to ‘its utility in securities trading’ appears to be a more generally applicable factor in determining whether section 10(b)’s ‘in connection with’ requirement is satisfied.”¹⁶¹ Thus, in a case against a fiduciary-tipper, the government is “simply required to prove a breach by . . . the tipper, of a duty owed to the owner of the misappropriated information.”¹⁶² And in a case against the tippee, the government must prove those elements as well as the tippee’s “knowledge that the tipper had breached the duty.”¹⁶³

The Ninth Circuit in *Salman* had little to say about the decision in *O’Hagan*, but that fact is hardly surprising. As the court saw it, the personal benefit test set out in *Dirks* applied to misappropriation cases as well as to the classical theory.¹⁶⁴ And once it concluded that Maher intended to give Michael the “gift” of confidential information misappropriated from Citigroup’s clients, its analysis under *Dirks* was complete. Had the Ninth Circuit discussed *O’Hagan* in any detail, that analysis would have only bolstered the court’s conclusion that the evidence was sufficient to sustain *Salman*’s Rule 10b-5 conviction as a co-participant in Maher’s deceptive breach of the duty of loyalty owed to the sources of the information.

The Second Circuit in *Newman*, however, committed a serious error when it reversed the hedge fund managers convictions based solely on its reading of *Dirks*, without regard for the decision in *O’Hagan*. Specifically, in redefining the scope of *Dirks*’s personal benefit test for joint tipper-tippee liability, the *Newman* court neglected to consider the important policy objectives from *O’Hagan* that militate against such a restrictive interpretation of the Rule 10b-5 prohibition. Instead of focusing on the ways in which tipping and trading undermine investor confidence in the fairness and integrity of securities markets, the Second Circuit harkened back to Justice Powell’s preference for promoting informational “efficiency in the nation’s securities markets.”¹⁶⁵ *Newman* went so far as to reference a property-rights rationale for the insider trading prohibition,¹⁶⁶ notwithstanding

158. *United States v. Falcone*, 257 F.3d 226 (2d Cir. 2001).

159. *Id.* at 233.

160. *Id.* (citing *United States v. McDermott*, 245 F.3d 133 (2d Cir. 2001)) (finding sufficient evidence to support jury’s conviction of a nontrading tipper, an investment banking executive, who disclosed confidential information for trading purposes to a woman with whom he was having an affair).

161. *Id.* at 233.

162. *Id.* at 234.

163. *Falcone*, 257 F.3d at 234.

164. *United States v. Salman*, 792 F.3d 1087, 1092 n.4 (9th Cir. 2015).

165. *United States v. Newman*, 773 F.3d 438, 449 (2d Cir. 2014).

166. *See id.* (citing *United States v. Chestman*, 947 F.2d 551, 578 (2d Cir. 1991) (Winter, J., concurring in part and dissenting in part). As his opinion in *Chestman* makes clear, Judge Winter’s views were influenced substantially by then-Professor, now-Judge Frank Easterbrook’s scholarship. *See Chestman*, 947 F.2d at 572, 576 (crediting Easterbrook for the development of the “business-property rationale for banning insider trading” and

O'Hagan's failure to endorse it and its incongruity with the zones of interest of federal securities regulation.¹⁶⁷ The *Newman* decision also quoted a statement from Judge Ralph Winter (who was one of the three judges on the panel) reflecting a view he expressed 25 years ago that "[e]fficient capital markets . . . require that persons who acquire and act on information about companies be able to profit from the information they generate."¹⁶⁸ Since *O'Hagan* came after *Dirks*, and undoubtedly trumps Judge Winter's opinion in *Chestman*, the Second Circuit should have evaluated the jury's findings in light of the policy concerns set out in Justice Ginsburg's opinion.

Had *Newman* done so—that is, had the Second Circuit seriously considered “the inhibiting impact on market participation of trading on misappropriated information, and the congressional purposes underlying § 10(b)”¹⁶⁹—the court may have been more compelled to accept the jury's finding that the insiders at Dell and NVIDIA had “intentionally breached th[eir] duty of trust and confidence by disclosing material nonpublic information for their own benefit.”¹⁷⁰ Indeed, to paraphrase *O'Hagan*, it would make “scant sense to hold an insider a § 10(b) violator if he” tips confidential information to a meaningfully close friend or relative in exchange for a tangible benefit “but not if” that insider intentionally gives away entrusted information to a casual friend to advantage her over other traders in the market.¹⁷¹ *Newman's* unduly narrow interpretation of *Dirks's* personal benefit requirement compounded *Dirks's* restrictive reading of Rule 10b-5 in a way that produces a disturbing loophole.

Apart from its policy justifications for a broad reading of the Rule 10b-5 insider trading prohibition, *O'Hagan* also built on *Dirks* in a way that facilitates the doctrinal analysis of joint tipper-tippee liability, regardless of whether the tipper stands as an insider or an outsider to the securities issuer. Although *O'Hagan* depicted its misappropriation theory as a “complement” to the classical theory, there is no reason for eschewing a misappropriation analysis simply because an insider-tipper owes disclosure duties to the corporation's shareholders as well the corporation that entrusted him with the information. Indeed, as other securities scholars have observed, “[v]irtually all cases that could be brought [under the classical theory] can also be styled as ‘misappropriation’ cases.”¹⁷²

quoting from his article, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 SUP. CT. REV. 309); see also JONATHAN R. MACEY, INSIDER TRADING: ECONOMICS, POLITICS, AND POLICY 67 (1991) (“[T]he only conceivable justification for banning insider trading is that such trading involves the theft of valuable corporate property from its rightful owner.”).

167. See Roberta S. Karmel, *Outsider Trading on Confidential Information – A Breach in Search of a Duty*, 20 CARDOZO L. REV. 83, 113 (1998) (“The easiest criticism of the property rights theory is that when Congress passed and subsequently amended the Exchange Act, it was concerned about fairness and the protection of investors, not the protection of property rights in information . . .”).

168. *Newman*, 773 F.3d at 449 (quoting *Chestman*, 947 F.2d at 578) (Winter, J., concurring in part and dissenting in part). A property rights rationale for the regulation of insider trading also has roots in the Second Circuit's decision that first endorsed a misappropriation alternative to *Chiarella's* classical theory: *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir. 1983), *cert. denied*, 464 U.S. 863 (1983). See Jonathan R. Macey, *From Fairness to Contract: The New Direction of the Rules against Insider Trading*, 13 HOFSTRA L. REV. 9, 27 n.96 (1984) (noting that the Second Circuit's endorsement of the misappropriation theory “relie[d] squarely on a property theory to find liability under [Rule] 10b-5”).

169. *United States v. O'Hagan*, 521 U.S. 642, 659 (1997).

170. *Newman*, 773 F.3d at 444; see also *supra* text accompanying note 96 (quoting jury instructions).

171. *O'Hagan*, 521 U.S. at 689.

172. DONALD C. LANGEVOORT, INSIDER TRADING: REGULATION, ENFORCEMENT & PREVENTION § 6.1 (West vol. 18, 2015); see also WILLIAM K.S. WANG & MARC I. STEINBERG, INSIDER TRADING 492 (3d ed. 2010)

Because *Newman* recognized 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,”¹⁷³ its narrow interpretation of the personal benefit requirement might have resulted from a misappropriation analysis as well.¹⁷⁴ On the other hand, had the court conceptualized the Rule 10b-5 fraud as one that was *also* perpetrated on Dell and NVIDIA, the insiders’ lack of any legitimate corporate purpose for their repeated instances of disclosure may have given the court more pause. Indeed, as the Seventh Circuit observed in *SEC v. Maio*,¹⁷⁵ absent some “legitimate reason” for the insider’s disclosure, the inference that information was “improper[ly] gift[ed]” may be “unassailable.”¹⁷⁶ The *Maio* case also emphasized that a misappropriator’s personal benefit—that is, his or her self-serving use of a principal’s information—can be shown whether the tip is deemed a *quid pro quo* or simply a gift to a trading relative or friend.¹⁷⁷ No court, prior to *Newman*, has

(“[I]n most instances, both the Commission and private plaintiffs could recast a classical special relationship cases as involving misappropriation.”). There is at least one, albeit rare, scenario whereby the classical theory would capture insider trading that would not also violate the misappropriation theory: although an insider’s full disclosure to the corporation would negate liability under the misappropriation theory, it would not absolve the “classical” disclosure duties owed to the shareholders on the other side of the insider’s securities transaction. Of course, to provide defendants with fair notice of the claims against them, the government should be clear in articulating its litigation position. See *SEC v. Bauer*, 42 F. Supp. 3d 923, 930 (N. D. Ill. 2014) (granting defendant’s motion for summary judgment in part because the SEC’s initial decision to frame its case solely under the classical theory—and its failure to raise the misappropriation theory at any time “in the eight years that [the] case remained pending”—precluded the SEC from substituting theories), *on remand from*, 723 F.3d 758 (7th Cir. 2013). Although both *Bauer* opinions suggest in places that the misappropriation theory applies exclusively to outsiders, no court has held that explicitly. See *LANGEVOORT*, *supra*, at § 6.1 (stating that “[t]he better reading of the case law is that either or both theories may apply, so long as the required elements fit the case”).

173. *United States v. Newman*, 773 F.3d 438, 446 (2d Cir. 2014) (referencing *SEC v. Obus*, 693 F.3d 276, 285–86 (2d Cir. 2012)).

174. Although the government has argued on occasion that *Dirks*’s personal benefit test applies only in classical theory cases, no post-*O’Hagan* court has accepted that argument. See *SEC v. Obus*, 693 F.3d 276, 286 (2d Cir. 2012) (holding that *Dirks*’s personal benefit test for joint tipper-tippee liability also “governs in a misappropriation case”); see, e.g., *SEC v. Yun*, 327 F.3d 1263, 1279–80 (11th Cir. 2003) (requiring the government to “prove that a misappropriator expected to benefit from the tip” and observing that “*O’Hagan* explicitly states or implicitly assumes that a misappropriator must gain personally from his trading on the confidential information”). Both the DOJ and SEC attempted to resurrect that argument in the wake of *Newman*, but it was flatly rejected. See *United States v. Salman*, 792 F.3d. 1087, 1092 n.4 (9th Cir. 2015) (ruling that the personal benefit test applies in misappropriation theory cases “like the instant case”); *SEC v. Payton*, 97 F. Supp. 3d 558, 563 (S.D.N.Y. Apr. 6, 2015) (acknowledging that the SEC’s argument may have “abstract merits,” but adhering to *Obus* and *Newman*’s conclusion that the elements of tipping liability are identical, regardless of whether the tipper’s duty arises under the classical or the misappropriation theory).

175. *SEC v. Maio*, 51 F.3d 623, 633 (7th Cir. 1995) (“After all, [the tipper] did not have to make any disclosure, so why tell [the initial tippee] anything?”).

176. *Id.* at 633.

177. *Id.* at 632 (citing *Dirks* and emphasizing the district court’s finding that the tipper’s disclosure “was an improper gift of inside information to . . . a trading friend”). *Newman*’s demand for evidence of a “meaningfully close personal relationship” also imposes a higher evidentiary standard for gift-giving than SEC Rule 10b5-2 imposes to justify a finding of a “relationship of trust or confidence.” That is, Rule 10b5-2 provides a non-exclusive list of three situations in which a person has “a duty of trust or confidence” for purposes of the misappropriation theory: (1) when the person receiving the information “agrees to maintain [that] information in confidence;” (2) when the persons involved in the communication “have a history, pattern, or practice of sharing confidences” that results in a reasonable expectation of confidentiality; and (3) a rebuttable presumption is provided when the person receives such information from a “spouse, parent, child or sibling.” 17 C.F.R. § 240.10b5-2 (2016). *Newman*’s exacting criteria for gratuitous tipping is instead reminiscent of the high hurdles

gone so far as to hold that an inference of gift-giving is permissible only in the context of a “meaningfully close personal relationship” and then only when the misappropriator expected a tangible benefit.¹⁷⁸

C. Classical Insiders Viewed Under a Misappropriation Lens

As the Court itself recognized in *Bateman Eichler*, including a misappropriation charge in a classical tipper-tippee insider trading case can be accomplished simply by a determination on the part of the government to identify the entrusting corporation as an additional victim of the fraudulent deception.¹⁷⁹ That is, building on the trial court’s instructions to the *Newman* jury, the DOJ could have sought an additional determination as to whether the Dell and NVIDIA insiders had “pretend[ed] loyalty . . . while secretly converting the principal’s information for personal gain.”¹⁸⁰ If the jury had reached an affirmative answer to this misappropriation question, that conclusion would have supported a finding that Dell and NVIDIA had been deceived and defrauded by the insiders and, with proof of their knowledge of that breach of loyalty, their insiders’ tippees as co-participants. To be sure, it would be the rare case where an insider’s Rule 10b-5 liability would turn (as a matter of law) on a decision to prosecute under one insider trading theory instead of the other.¹⁸¹ But there are nonetheless several good reasons for viewing a classical insider’s trading tip to a friend or relative under a misappropriation lens.

First, the framing of a classical insider tipping case in misappropriation terms facilitates the administration of justice. If the government is not convinced that a classical insider has misappropriated his corporation’s confidential information so that someone else can profit in securities trading, then the government should not prosecute the insider’s

some states place upon shareholders seeking to challenge the independence of a director. See Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127, 147–48 (2010) (observing that “even lengthy friendships or professional interactions among directors are not alone given serious consideration when analyzing a director’s independence”).

178. The case that is closest is *SEC v. Maxwell*, 341 F. Supp. 2d 941 (S.D. Ohio 2004), a classical theory decision which granted the defendant’s motion for summary judgment. The court placed the burden on the SEC to show precisely how and why a corporate executive stood “to gain” from disclosing highly confidential information about an upcoming merger to his barber, whom he had known for fifteen years. *Id.* at 948–49. Although the court acknowledged that “the requisite personal benefit may be shown by the intent to provide a gift to benefit the tippee,” it nonetheless concluded that “there is absolutely no evidence that [the insider] had any reason or intent to give a gift—especially a gift of this magnitude to [his barber].” *Id.* at 949. The court seemed to place much emphasis on the “parties relative stations in life.” *Id.* at 948. But had *Maxwell* focused instead on the lack of legitimate reasons for a corporate executive’s disclosure of confidential merger-related information to his barber, the court may well have found the SEC’s asserted inference of gift-giving more compelling. In addition, *Maxwell*’s result could have been different had the court considered the corporate executive’s “self-regarding gain,” which Professor Sung Hui Kim defines as “supererogatory gain to the individual or her relatives, friends, or acquaintances.” Sung Hui Kim, *Insider Trading As Private Corruption*, 61 UCLA L. REV. 928, 934 (2014). A gain is supererogatory if it is “neither part of the explicit compensation allocated to the individual nor culturally viewed as an acceptable or unavoidable perquisite of the role.” *Id.* at 956.

179. See *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 313 (1985) (observing that while an insider “shares responsibility” in the tippee’s Rule 10b-5 fraud against individual shareholders, “the insider, in disclosing such information, also frequently breaches fiduciary duties toward the issuer itself”).

180. *United States v. O’Hagan*, 521 U.S. 642, 653 (1997); see *supra* note 96 (quoting the *Newman* trial court’s instruction that required the jury to determine whether the Dell and NVIDIA insiders had “intentionally breached [a] duty of trust and confidence by disclosing material, nonpublic information for their own benefit”).

181. See *supra* note 172 (citing sources).

tippee under the classical theory.¹⁸² Based on their arguments for a rehearing and in the certiorari petition, the prosecutors in *Newman* appeared convinced that misappropriations of confidential information occurred. But had the initial prosecution against the remote tippees been framed around the Dell and NVIDIA insiders' betrayals of trust through "embezzlement,"¹⁸³ there almost certainly would have been more evidence introduced at trial developing the "gift theory" that featured so prominently in the later stages of the litigation.

Relatedly, viewing insider tipping as an unlawful misappropriation might spur the SEC and DOJ to take a harsher stance against the gratuitous tippers who betray their duties of loyalty by giving friends and relatives a securities trading advantage over others in the market. Indeed, the ruling in *Newman* pertaining to the insiders' "scant" personal benefits was likely catalyzed by the government's decision to forego filing any civil or criminal charges of wrongdoing against the Dell insider and to forgo filing any criminal charges against the insider at NVIDIA.¹⁸⁴ As Professor Jill Fisch has lamented, the government's decision to aggressively prosecute "the hedge fund end users of inside information" rather than their tippers may be fueling a perception that disloyal insiders will not be held "sufficiently accountable" for betraying their duties of trust and confidence.¹⁸⁵ Notably, the government's inclination to treat end-users of entrusted information more harshly than the insiders who disclosed that information runs diametrically opposite to the Court's view in *Bateman Eichler* that "in the context of insider trading, . . . a person whose liability is solely derivative . . . [is not] as culpable as one whose breach of duty gave rise to that liability in the first place."¹⁸⁶

182. A similar principle should apply to juries and courts: absent a finding that an insider has misappropriated the corporation's information for the purpose of facilitating an outsider's securities trading, there should be no Rule 10b-5 liability for the tippee's trading. See Nagy, *Fiduciary Principles*, *supra* note 47, at 1347-48 (criticizing *United States v. Evans*, 486 F.3d 315 (7th Cir. 2007), a decision in which the court affirmed the criminal conviction of a tippee who was retried after the insider-friend who allegedly tipped him had been acquitted in the previous trial).

183. See *supra* note 141 (referencing *O'Hagan's* citation to *Carpenter v. United States*, 484 U.S. 19, 27 (1987)).

184. *United States v. Newman*, 773 F.3d 438, 443 (2d Cir. 2014). The NVIDIA tipper ultimately agreed to settle an SEC enforcement action that charged him with violations of Section 10(b) and Rule 10b-5 as well as Section 17(a) of the Securities Act of 1933. Without admitting or denying the allegations, he agreed to be permanently enjoined from future violations of these provisions and agreed to pay a \$30,000 penalty and be barred from serving as an officer or director of a public company for five years. See Press Release 2014-82, SEC, SEC Charges Technology Company Insider in California with Tipping Confidential Information Exploited by Hedge Funds (Apr. 23, 2014), <https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370541624596>. The NVIDIA tipper also consented to an order under SEC Rule 102(e) under which he was suspended from appearing or practicing before the SEC as an accountant for a period of at least five years. See Chris Choi, Exchange Act Release No. 72494 (June 27, 2014), <http://www.sec.gov/litigation/admin/2014/34-72494.pdf>.

185. Jill E. Fisch, *Newman Reins in Criminal Prosecution of Remote Tippees for Insider Trading*, CLS BLUE SKY BLOG (January 28, 2015), <http://clsbluesky.law.columbia.edu/2015/01/28/newman-reins-in-criminal-prosecution-of-remote-tippees-for-insider-trading>.

186. *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 313 (1985) (emphasizing that "insiders and broker-dealers who selectively disclose material non-public information commit a potentially broader range of violations than do tippees who trade on the basis of that information"); see also *id.* at 313 n.23 (observing that its view on the relative culpability of tippers and tippees "is reinforced" by Congress's recent enactment of ITSA, "which imposes civil penalties on nontrading tippers out of the belief that, '[a]bsent the tipper's misconduct, the tippee's trading would not occur' and that a tipper is therefore 'most directly culpable in a violation,'" citing H.R. REP. NO. 98-355, at 9 (1983)).

Conceptualizing gratuitous tipping as an unlawful misappropriation has a third significant advantage: it will put securities traders (whether first level tippees or others down a chain) on clearer notice that securities transactions prompted by surreptitious tips could render them complicit in an insider's fraud on the source of the information. Although a downstream recipient of a single misappropriated disclosure may have no reason to believe that the information in his possession was conveyed unlawfully, multiple instances of highly lucrative leaks transmitted through the same conduit would alert any reasonable person to the fact that his informational advantage has turned from fortuitous to nefarious.¹⁸⁷ Thus, tippees like the defendants in *Salman* and *Newman* could be viewed as possibly complicit pawn brokers who resell stolen property:¹⁸⁸ if they know or are reckless in not knowing that their informational tips were misappropriated in breach of a duty of loyalty, and if they trade with scienter, they should incur liability under Rule 10b-5 as a co-participant in an insider's deception of the information's source.¹⁸⁹

Finally, viewing insider tipping as an unlawful misappropriation widens the scope of the conduct that constitutes securities fraud under Rule 10b-5. That is, because the deceptive activity turns on the secret betrayal of loyalty that deprives the corporation "of the exclusive use of [its] information,"¹⁹⁰ Rule 10b-5's misappropriation theory could extend to any deceptive breach of an insider's duty of loyalty, insofar as the breach relates to an unauthorized disclosure that is shared with others for securities trading purposes.¹⁹¹

187. Cf. *United States v. Werner*, 160 F.2d 438, 441 (2d Cir. 1947) (observing that "[t]he receivers of stolen goods almost never 'know' that they have been stolen, in the sense that they could testify to it in a court room" and emphasizing that thieves rarely "admit their theft to the receivers [because] that would much impair their bargaining power").

188. See *SEC v. Musella*, 578 F. Supp. 425, 442 (S.D.N.Y. 1984) (observing that the tippee "could only regard [tipper] as a trafficker in stolen goods"); In the Matters of Inv'r's Mgmt. Co., 44 S.E.C. 633, *11 n.2 (Comm'r Smith, concurring) (equating tippees to those who "knowingly receive stolen goods"); see also *Federal Sentencing Guidelines* § 2B1.1 (introductory comment grouping together "basic forms of property offenses: theft, embezzlement, fraud, forgery, counterfeiting . . . insider trading, transactions in stolen goods, and simple property damage or destruction") (emphasis added). Professor Richard Epstein has likewise emphasized that under a theory of unjust enrichment, "any party who is in possession of stolen information that he knows is not his" is under a constructive trust to preserve the asset value for its rightful owner. See Richard A. Epstein, *Returning to Common-Law Principles of Insider Trading After United States v. Newman*, 125 YALE L.J. 1482, 1506 (2016).

189. Although the defendant in *Salman* likens gratuitous tipping to the fiduciary misconduct at issue in *Skilling v. United States*, 561 U.S. 358 (2010) and *McDonnell v. United States*, 136 S. Ct. 2355 (2016), and invokes the principle of lenity, those decisions are inapposite. *Skilling* and *McDonnell* involved prosecutions under 18 U.S.C. § 1346, the federal statute that criminalizes "honest services fraud," a concept that implicates "the due process concerns underlying the vagueness doctrine," when applied to fiduciary misconduct that does not involve the "seriously culpable conduct" at issue in bribery or kickback cases. *Skilling*, 561 U.S. at 408, 411. Tippees like the defendant in *Salman* are not being punished for securities fraud simply because of their involvement in, or their enrichment from, fiduciary misconduct. On the contrary, they are being punished for their knowing or reckless participation in a deception of the source of the misappropriated information, in connection with securities transactions that "undermines the integrity of, and investor confidence in, securities markets," *United States v. O'Hagan*, 521 U.S. 642, 658 (1997). And the Court in *O'Hagan* left no doubt that willful trading on the basis of misappropriated information constitutes a crime under Section 10(b) and Rule 10b-5, as well as a property-based crime under 18 U.S.C. § 1341, the federal mail fraud statute. See *O'Hagan*, 521 U.S. at 677–78 (observing that its rulings on the securities fraud issues require its reversal of the Eighth Circuit's judgment "on the mail fraud counts as well").

190. *O'Hagan*, 521 U.S. 642, 652 (1997).

191. See James J. Park, *Rule 10b-5 and the Rise of the Unjust Enrichment Principle*, 60 DUKE L.J. 345, 409 (2010) (contending that "the Supreme Court's decision in *O'Hagan* suggests a doctrinal foundation that can be

As we shall see, state law has recently experienced a “sea change” with respect to the scope of the duty of loyalty,¹⁹² and at least under Delaware law, breaches of the duty of loyalty are no longer limited to instances of self-dealing or other conflicting interests. Breaches of loyalty can also be shown when a fiduciary deliberately fails to act in good faith, such as “where the fiduciary acts with the intent to violate applicable positive law.”¹⁹³

IV. LEGISLATIVE DEVELOPMENTS

When the Supreme Court decided *Chiarella* and *Dirks* in the early 1980s, it did so against a statutory backdrop that directly addressed, through Exchange Act Section 16(b),¹⁹⁴ only a single narrow type of insider trading—namely, the “vicious practices” of directors, officers, and controlling shareholders who used their positions with the corporation to “acquire and profit [from] information not available to others” by purchasing and selling the corporation’s stock within a six-month timespan.¹⁹⁵ Although *Chiarella*’s classical theory construed Section 10(b) and Rule 10b-5’s proscription of fraud to reach securities transactions that fell outside of Section 16(b)’s short-swing profit provision, “absent some explicit evidence of congressional intent,” the Court was unwilling to extend such liability beyond disloyal insiders and their tippees.¹⁹⁶ As Justice Powell expounded in a letter to Chief Justice Burger, he was confident “that Congress never had the slightest intention – back in 1933 and 1934 – to extend the Securities Acts to [*Chiarella*’s outsider] type situation.”¹⁹⁷

But the Supreme Court in *Salman* now has before it the explicit evidence that *Chiarella* and *Dirks* found to be lacking: Congress has enacted three statutes that ratify, and build upon, the Court’s holdings that Section 10(b) and Rule 10b-5 prohibit insider trading and tipping. Specifically, Congress added a host of new insider-trading related provisions to the Exchange Act as part of the Insider Trading Sanctions Act of 1984 (ITSA),¹⁹⁸ the Insider Trading and Securities Fraud Enforcement Act of 1988 (ITSFEA),¹⁹⁹ and the Stop Trading on Congressional Knowledge (STOCK) Act of 2012.²⁰⁰ At each juncture, Congress determined to follow the SEC’s considered judgment that insider trading and tipping should continue to be proscribed as fraudulent practices

modified so that a workable Rule 10b-5 unjust enrichment principle can continue to develop”).

192. See Andrew S. Gold, *The New Concept of Loyalty in Corporate Law*, 43 U.C. DAVIS L. REV. 457, 464 (2009) (“The past few years have witnessed a sea change in the Delaware courts’ understanding of the fiduciary duty of loyalty.”).

193. See *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 369 (Del. 2006) (quoting *The Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006)).

194. 15 U.S.C. § 78p(b) (2011).

195. STOCK EXCHANGE PRACTICE, REPORT OF COMMITTEE ON BANKING AND CURRENCY, S. REP. NO. 73-1455, 73d Cong., 2d Sess., at 55 (1934).

196. *Chiarella v. United States*, 445 U.S. 222, 233 (1980).

197. Letter from Justice Lewis F. Powell, Jr., to Chief Justice Warren E. Burger 1 (Feb. 4, 1980) (quoted in Adam C. Pritchard, *Justice Lewis F. Powell, Jr., and the Counterrevolution in the Federal Securities Laws*, 52 DUKE L.J. 841, 934 n.568 (2003)).

198. Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (1984) (codified as amended in scattered sections of 15 U.S.C. § 78).

199. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (1988) (codified as amended in scattered sections of 15 U.S.C. § 78).

200. Stop Trading on Congressional Knowledge Act, Pub. L. No. 112-105, 126 Stat. 291 (2012).

through interstitial lawmaking,²⁰¹ rather than as offenses with new statutorily defined elements. Thus, while the federal prohibitions of insider trading and tipping may derive their lineage from judicially implied claims, it is wrong to contend that insider trading is a judicially-established crime. *Chiarella* and *Dirks* merely mark the start of what Professor Jill Fisch has aptly termed a “lawmaking partnership” among Congress, the Court, and the SEC.²⁰²

A. The Insider Trading Sanctions Act of 1984 (ITSA)

Although ITSA does not contain an express codification of the Court’s antifraud approach to insider trading liability (that occurred decades later with the STOCK Act’s amendments to the Exchange Act),²⁰³ ITSA’s principal provisions were clearly predicated on insider trading as a fraud. Indeed, the House Committee on Energy and Commerce’s Report,²⁰⁴ which is the only written report accompanying ITSA, is replete with references to *Chiarella*, *Dirks*, and lower court precedents.²⁰⁵ *Dirks*, however, commanded particular attention because the Court announced that decision in the midst of ITSA’s development. The House Report devotes well over a page to the “impact of *Dirks* on future Commission enforcement actions” and reflects the Committee’s concern about whether the decision might limit the SEC’s “ability to pursue inside trading cases”²⁰⁶ But the Committee ultimately opted against a statutory override because it was mollified by *Dirks*’s “unique facts” as well as the Court’s expression of “a continued, firm disapproval of insider trading.”²⁰⁷ The Report thus reflects ITSA’s drafters’ belief “that if the *Dirks* decision is properly and narrowly construed by the courts, the Commission’s insider trading program will not be adversely affected.”²⁰⁸

As the legislation’s title reflects, ITSA sought to intensify insider trading sanctions, both criminal and civil, “in order to increase deterrence of violations.”²⁰⁹ Its drafters emphasized that “[c]apital formation and our nation’s economic growth and stability depend on investor confidence in the fairness and integrity of our capital markets” and concluded that insider trading “threatens these markets by undermining the public’s expectations of honest and fair securities markets where all participants play by the same rules.”²¹⁰ Seeking to satisfy these deterrence objectives, ITSA increased the maximum criminal fine for Exchange Act violations from \$10,000 to \$100,000²¹¹ and, for the first

201. Cf. *United States v. Little Lake Misere Land Co.*, 412 U.S. 580, 593 (1973) (observing that “the inevitable incompleteness presented by all legislation means that interstitial federal lawmaking is a basic responsibility of the federal courts”).

202. See Jill E. Fisch, *Federal Securities Fraud Litigation as a Lawmaking Partnership*, 93 WASH. U.L. REV. 453, 476 (2015) (depicting “the development of the legal prohibition on insider trading” as “[p]erhaps the most compelling example of [a] lawmaking partnership”).

203. See *infra* note 264 and accompanying text (quoting STOCK Act).

204. HOUSE COMMITTEE ON ENERGY AND COMMERCE, H.R. REP. NO. 98-355, at 1 (1983).

205. See *id.* at 13 n.20 (identifying civil and criminal actions brought against corporate “outsiders” pursuant to the misappropriation theory).

206. *Id.* at 14.

207. *Id.* at 15.

208. *Id.*

209. H.R. REP. NO. 98-355, at 1.

210. *Id.* at 2.

211. Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264, (1984) § 3 (codified as amended in scattered sections of 15 U.S.C. § 78).

time ever under the Act, authorized court-ordered civil monetary penalties.²¹² More specifically, ITSA's insider trading penalty provision (which is now codified in Section 21A(a)) authorized the SEC to seek a civil monetary penalty in federal district court of "up to three times the profit gained or loss avoided" whenever it shall appear to the SEC that any person has violated any provision of the Exchange Act or rule thereunder "by purchasing or selling a security . . . while in possession of material, nonpublic information" or by "communicating such information in connection with" a securities transaction.²¹³ The House Report left no doubt that Congress recognized federal prohibitions against insider trading and tipping, and that it grounded those prohibitions in what it identified as the Exchange Act's "broad general antifraud provision, section 10(b) and . . . Rule 10b-5."²¹⁴

ITSA also amended the Exchange Act to close what was perceived as an options-trading loophole in the Court's classical theory. Such a loophole arose because options and other derivative securities are frequently sold by persons who are not also shareholders of the company that issued the underlying security.²¹⁵ As such, purchasing options on the basis of material nonpublic information typically would not trigger a fiduciary-like disclosure duty owed to the counterparty-seller.²¹⁶ ITSA plugged this hole by adding a new Section 20(d) to the Exchange Act, which expressly prohibited insider trading in options and other derivatives whenever it would be illegal for a person to trade, or communicate information about, the underlying security.²¹⁷ Doing so effectively displaced the fiduciary principle announced in *Chiarella* and *Dirks*,²¹⁸ though Section 20(d)'s express statutory prohibition soon became superfluous when courts began to recognize insider trading in options as a fraud on the source of entrusted information, and therefore a "primary" violation of Rule 10b-5 under the misappropriation theory.²¹⁹

212. *Id.* at § 2.

213. 15 U.S.C. § 78u-1 (2012).

214. H.R. REP. NO. 98-355, at 4 (observing that since its creation, "the Commission has appropriately used the antifraud provisions to remedy unlawful trading and tipping by persons in a variety of positions of trust and confidence who have illegally acquired or illegally used material non-public information"). The Committee also expressly noted the "broad antifraud remedy under section 14(e)" as well as the SEC's adoption of Rule 14e-3. *Id.*

215. *See, e.g.,* Laventhall v. Gen. Dynamics, 704 F.2d 407, 410-11 (8th Cir. 1983) (observing that the purchase of options "does not represent contribution of capital to the corporation").

216. *Id.*; *see also* O'Connor & Assocs. v. Dean Witter Reynolds, Inc., 529 F. Supp. 1179, 1184-85 (S.D.N.Y. 1981) (stating that an option-holder "is owed no special duty by the officers and directors of the corporation because, quite simply, the corporation is not run for his benefit").

217. *See* 15 U.S.C. § 78t(d) (2011) ("Wherever communicating, or purchasing or selling a security while in possession of, material nonpublic information would violate, or result in liability to any purchaser or seller of the security under any provisions of this chapter, or any rule or regulation thereunder, such conduct in connection with a purchase or sale of a put, call, straddle, option, [or] privilege . . . with respect to such security . . . shall also violate and result in comparable liability to any purchaser or seller of that security under such provision, rule, or regulation.").

218. *See* LANGEVOORT, *supra* note 172, § 3-11 (observing that Section 20(d) demonstrates that while ITSA's drafters "were prepared in some respects to ratify the prevailing tests for insider trading liability, they believed that, as a policy matter, the Court's rule can result in too narrow a prohibition").

219. The defendant-attorney in *O'Hagan*, for example, reaped the lion's share of his four million dollars in profits through options trading based on the material nonpublic information he had misappropriated from his law firm and its client. *United States v. O'Hagan*, 521 U.S. 642, 648 (1997). The Court affirmed his conviction for violating Section 10(b) and Rule 10b-5, without once referencing the express statutory prohibition in Section 20(d). *Id.* at 666.

Congress's determination to build on top of the Supreme Court's precedents, rather than start anew with a legislative definition of insider trading, was a well-considered decision that deserves both acknowledgement and respect. Although ITSA's drafters had seriously contemplated adding into the bill a provision that would have defined insider trading (and then revisited that decision in the wake of *Dirks*), the House Committee ultimately opted against a statutory definition, in large part out of deference to the SEC's expert judgment that grounding the offense in existing judicial precedents avoided "the problems of freezing into law either a definition which is too broad or too narrow to deal with newly emerging issues."²²⁰ The Committee also took seriously the warning that "unscrupulous traders would skirt around any definition constructed."²²¹ It thus spoke approvingly of the fact that the government would be pursuing the heightened criminal fines and the new civil penalties through "case-by-case" judicial interpretations of the "broad anti-fraud provisions of the federal securities,"²²² and it ultimately concluded that those "well-developed" interpretations provided "adequate guidance" as to when the misuse of material nonpublic information would run afoul of the federal insider trading prohibitions.²²³

After the House passed the Committee's bill without objection, the Senate's Subcommittee on Securities held hearings on a companion bill that included a statutory definition of the conduct that would have been subject to ITSA's civil penalty provision. Although the Subcommittee's Chairman Senator Alfonse D'Amato was a strong proponent of a statutory definition, his committee took seriously the SEC's concern that a move away from an antifraud rubric would introduce "new terms and concepts that would generate a significant amount of litigation" and would limit its flexibility "to deal with future abuses."²²⁴ As Senator D'Amato explained just prior to the companion bill's passage by a voice vote in the Senate, "[i]n view of the complexity of the undertaking, and the necessity for a prompt action on the bill, the committee determined not to include a definition of insider trading in this legislation."²²⁵ The House then accepted the Senate's amendments to its ITSA bill, thus eliminating the need for a joint conference, and President Ronald Reagan signed the legislation into law.²²⁶

After ITSA's adoption, Chairman John Dingell and the other members of the House Committee on Energy and Commerce continued to evaluate whether *Dirks*'s test for joint tipper-tippee liability should be subject to a statutory override. As the House Report reflects, the Committee directed the SEC to "report back" on how lower courts were interpreting *Dirks* and the ways in which the decision's language was being used "by potential targets and defendants."²²⁷ The SEC's Report, which followed two years later,

220. H.R. REP. NO. 98-355, at 32 (reprinting letter from SEC Chairman John S. R. Shad to the Honorable Timothy E. Wirth, Chairman, Subcommittee on Telecommunications, Consumer Protection and Finance, House Committee on Energy and Commerce).

221. *Id.* at 13 (citing testimony by Arnold S. Jacobs).

222. *Id.*

223. *Id.*

224. See CONG. REC. S8912-8913 (June 29, 1984) (remarks of Senator Alfonse D'Amato).

225. *Id.*

226. See Donald C. Langevoort, *The Insider Trading Sanctions Act of 1984 and Its Effect on Existing Law*, 37 VAND. L. REV. 1273, 1277-78 (1984) (discussing ITSA's legislative process).

227. H.R. REP. NO. 98-355, at 15 (specifying that the SEC's report should include: "(1) the number of insider trading cases brought, settled, and tried; (2) the propositions for which counsel cites *Dirks* in representation of clients accused of insider trading; and (3) a summary and analysis of lower court decisions citing and interpreting

assured the Committee that *Dirks* “had not adversely affected, to a significant degree, the Commission’s enforcement program.”²²⁸ Although it acknowledged that *Dirks*’s demand for “additional elements of proof” posed some “conceptual challenges” in the development of its cases, the SEC remained steadfast in its view that successful civil and criminal prosecutions for insider trading and tipping were continuing under the antifraud parameters established in *Chiarella* and *Dirks*, as supplemented by Rule 14e-3 in tender offer cases and the misappropriation theory under Rule 10b-5 for outsider trading.²²⁹ The Report also called the Committee’s attention to the Court’s opinion in *Bateman Eicher*,²³⁰ which the SEC credited for clarifying some of the principles underlying *Dirks* and “removing certain potential ambiguities.”²³¹ In the SEC’s view, *Bateman Eicher*’s reference to disclosures “simply to confer ‘a gift of confidential information to a trading relative or friend’”²³² removed any doubt that such gift-giving would “giv[e] rise to tippee liability without the necessity of showing that the insider received any additional benefit.”²³³ The SEC Report thus confidently predicted that the *Bateman Eicher* opinion would foreclose certain arguments made in the past by defense counsel and would “make it unlikely that future court decisions will interpret *Dirks* to narrow, to any significant degree, the scope of the insider trading prohibitions.”²³⁴ Had the SEC a crystal ball in 1985 that could have revealed the Second Circuit’s re-interpretation of *Dirks* in its 2015 *Newman* decision, the SEC almost certainly would have delivered to Congress a markedly different report and recommendation.

B. Insider Trading and Securities Fraud Enforcement Act of 1988 (ITSFEA)

Four years after ITSA, Congress reaffirmed its view that “[i]nsider trading damages the legitimacy of the capital market and diminishes the public’s faith” and expressed its continued support for a robust civil and criminal enforcement program.²³⁵ But that congressional support need not be merely inferred from the House Committee on Energy and Commerce’s Report or the floor debates leading up to the passage of ITSFEA. Instead, the Act itself contains express statutory findings that reflect Congress’s ratification of the federal insider trading prohibitions arising under Rule 10b-5 and Rule 14e-3. Specifically, Congress declared a finding that “[t]he rules and regulations of the Securities and Exchange Commission under the Securities Exchange Act of 1934 governing trading while in possession of material nonpublic, information” satisfy the statutory command that they be “necessary and appropriate in the public interest and for the protection of investors.”²³⁶

Dirks”).

228. See REPORT OF THE SECURITIES AND EXCHANGE COMMISSION TO THE HOUSE COMMITTEE ON ENERGY AND COMMERCE ON *DIRKS V. SECURITIES AND EXCHANGE COMMISSION* (Aug. 23, 1985) reprinted in LANGEVOORT, *supra* note 172, at App. B-1 [hereinafter SEC REPORT reprinted in LANGEVOORT].

229. See *id.*, at B-2 to B-3.

230. *Bateman Eichler v. Berner*, 472 U.S. 299 (1985); see *supra* text accompanying notes 89–94 (discussing *Bateman Eicher*).

231. See SEC REPORT reprinted in LANGEVOORT, *supra* note 228, at App. B-3.

232. *Bateman Eicher*, 472 U.S. at 319 n.21 (quoting *Dirks v. SEC*, 463 U.S. 646, 663–64 (1983)).

233. See SEC REPORT reprinted in LANGEVOORT, *supra* note 228, at App. B-1.

234. *Id.*

235. H.R. REP. NO. 100-910, at 8 (1988); see also *id.* at 7–8 (emphasizing that “the small investor will be—and has been—reluctant to invest in the market if he feels it is rigged against him”).

236. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, §2(1), 102 Stat. 4677 (1988).

Congress further declared that the SEC has “enforced such rules and regulations vigorously, effectively, and fairly.”²³⁷ As Professor Steve Thel has observed, “[g]iven the heat of the debate over how much power Congress has given the SEC to regulate insider trading, it is remarkable that a statute directly addressed to that issue has been ignored for all practical purposes.”²³⁸ Because that debate has only intensified in the 19 years since the Court decided *O’Hagan*, the *Salman* case provides an important opportunity for it to acknowledge ITSFEA’s findings as well as Congress’s essential role in the development of insider trading jurisprudence.

ITSFEA contained several important provisions that amended the Exchange Act by: raising the maximum criminal penalties under Section 32(a) from a fine of \$100,000 and/or five years in prison, to a fine of \$1 million and/or ten years in prison;²³⁹ modifying ITSA’s penalty provision to clarify that tippers may be subject to civil penalties for any tipping activity that involves a violation of the law, irrespective of the tippee’s liability;²⁴⁰ extending the civil penalty provision to “controlling persons” who recklessly disregard the likelihood that an employee or agent is engaging in illegal tipping or trading;²⁴¹ requiring that broker-dealers and investment advisers establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, nonpublic information;²⁴² initiating a “bounty” program giving the SEC discretion to reward informants providing valuable information in insider trading cases;²⁴³ and establishing an express private right of action for investors who traded contemporaneously with a person found to have violated an Exchange Act provision or rule by “by purchasing or selling any security while in possession of material, nonpublic information,”²⁴⁴ or for unlawfully communicating such information to a person who uses it to trade.²⁴⁵

The express right of action for contemporaneous traders, which ITSFEA codified at Section 20A of the Exchange Act, reflected another determination by Congress to depart from the fiduciary principle at the core of *Chiarella* and *Dirks*. As the House Report explained, Section 20A was “specifically intended to overturn court cases which have precluded recovery for plaintiffs where the defendant’s violation is premised upon the

237. *Id.* at § 2(2).

238. Steve Thel, *Statutory Findings and Insider Trading Regulation*, 50 VAND. L. REV. 1091, 1095 (1997). However, as Professor Thel observes, the *O’Hagan* Court did not have to rule on the effect of ITSFEA’s findings “because it decided the case before it in the way the findings dictated.” *Id.* at 1116; see *United States v. O’Hagan*, 521 U.S. 642, 666 n.11(1997) (observing that because it “upheld the misappropriation theory on the basis of § 10(b) itself [it] need not address ITSFEA’s relevance”); *id.* at 677 n.22 (observing that because it upheld “Rule 14e-3(a) on the basis of § 14(e) itself [it] need not address ITSFEA’s relevance”).

239. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, § 4, 102 Stat. 4677 (1988). In 2002, these maximum criminal penalties were again increased with the enactment of the Sarbanes-Oxley Act, Pub. L. No. 107-204, § 1106, 116 Stat. 745 (2002), and Section 32(a) of the Exchange Act, 15 U.S.C. § 78ff(a), currently provides for fines of not more than \$5 million and/or imprisonment of not more than 20 years.

240. See H.R. REP. NO. 100-910 at 18 (explaining the necessity of “a technical amendment to ITSA to reflect more accurately its original intent”).

241. Exchange Act § 21A(b)(1), 15 U.S.C. § 78u-1(b)(1) (2012).

242. Exchange Act § 15(g), 15 U.S.C. § 78o(g) (2012); Investment Advisers Act § 204A, 15 U.S.C. § 80b-4a (2012).

243. Insider Trading and Securities Fraud Enforcement Act, § 3(a)(2).

244. Exchange Act § 20A(a), 15 U.S.C. § 78t-1(a) (2012).

245. Exchange Act § 20A(c), 15 U.S.C. § 78t-1(c) (2012).

misappropriation theory.”²⁴⁶ The House Report pointed in particular to the Second Circuit’s decision in *Moss v. Morgan Stanley Inc.*²⁴⁷ which, notwithstanding the prior criminal convictions of the defendants for illegal insider trading and tipping, affirmed a district court’s dismissal of a Rule 10b-5 damage action brought by former shareholders of a tender offer target.²⁴⁸ ITSFEA’s drafters clearly disagreed with the Second Circuit’s conclusion that such contemporaneous traders should not be able to ride “‘piggyback upon the duty owed by defendants’” to their investment bank employers who were advising the acquiring companies.²⁴⁹ Notably, Section 20A embodies the position that Chief Justice Burger articulated in his *Chiarella* dissent: that a person who misappropriates information owes by virtue of that fact an affirmative duty of disclosure to the parties on the other side of his securities transactions.²⁵⁰

As with ITSA, the period leading up to the passage of ITSFEA evidences Congress’s serious consideration of the costs and benefits of adding into the bill an express statutory prohibition against trading securities on the basis of material nonpublic information. Over the period from 1986 to 1988, Congress held four sets of hearings devoted to the topic of insider trading regulation and considered multiple proposals for statutory definitions.²⁵¹ But while ITSFEA’s drafters continued to be “cognizant of the importance of providing clear guidelines for behavior which may be subject to stiff criminal and civil penalties,”²⁵² they ultimately concluded that the legal principles were “well-established and widely-known,” and that “a statutory definition could potentially be narrowing, and in an unintended manner facilitate schemes to evade the law.”²⁵³

Along the way, however, when the misappropriation theory appeared in jeopardy of being struck down by a possible five-justice majority,²⁵⁴ the movement for an express statutory prohibition picked up steam. Consensus in the Senate began to build around a proposed bill entitled the “Insider Trading Proscriptions Act of 1987.”²⁵⁵ The bill, as it was later reconciled with an alternative version submitted by the SEC, proposed adding a new Section 16A to the Exchange Act, making it unlawful:

[F]or any person, directly or indirectly, to purchase, sell or cause the purchase or sale of, any security, while in possession of material, nonpublic information relating thereto (or relating to the market therefor), if such person knows (or recklessly disregards) that such information has been obtained wrongfully, or

246. H.R. REP. NO. 100-910 at 26.

247. *Moss v. Morgan Stanley Inc.*, 719 F.2d 5 (2d Cir. 1983).

248. *Id.* at 9 n.6.

249. *Id.* at 13 (quoting *Moss v. Morgan Stanley Inc.*, 553 F. Supp. 1347, 1353 (S.D.N.Y. 1983)).

250. See LANGEVOORT, *supra* note 172, § 9.7; see also *infra* text accompanying notes at 386–404 (discussing Chief Justice Burger’s dissent in *Chiarella* and proposing a unified and expanded theory of insider trading that is premised on “fraud on contemporaneous traders”).

251. See Thomas W. Joo, *Legislation and Legitimation: Congress and Insider Trading in the 1980s*, 82 IND. L.J. 575, 576 (2007) (discussing a Congress that was “preoccupied with insider trading”).

252. H.R. REP. NO. 100-910 at 11 (1988).

253. *Id.*

254. See *supra* text accompanying notes 151–54 (discussing the grant of certiorari in *Carpenter v. United States*, 484 U.S. 19 (1987)).

255. S. 1380, 100th Cong. (1987). The bill was introduced by Senators Donald Riegle and Alfonse D’Amato based on recommendations by a committee of securities-law practitioners headed by Harvey Pitt, who many years later became Chair of the SEC. Harvey L. Pitt & Karen L. Shapiro, *Securities Regulation by Enforcement: A Look at the Next Decade*, 7 YALE J. REG. 149, 227–28 n.332 (1990).

that such purchase or sale would constitute a wrongful use of such information.²⁵⁶

However, when the Court's 4–4 affirmance in *Carpenter v. United States* left the misappropriation theory intact,²⁵⁷ the apparent need for a statutory definition subsided.²⁵⁸ Congress and the SEC soon returned to the view that insider trading jurisprudence could better develop through interstitial lawmaking in the context of civil and criminal prosecutions for violations of Section 10(b) and Rule 10b-5, as well as Section 14(e) and Rule 14e-3 in cases involving tender offers.

C. *The Stop Trading on Congressional Knowledge (STOCK) Act of 2012*

The STOCK Act codified for the first time an explicit legislative recognition that the Exchange Act encompasses insider trading prohibitions that arise under Section 10(b) and Rule 10b-5.²⁵⁹ The Act also reflects Congress's recent judgment that interstitial lawmaking by federal courts continues to be an effective means of regulating the misuse of material nonpublic information in connection with securities trading—whether that information emanates from inside or outside of the government.

The momentum that fueled the STOCK Act's landslide votes of 96–3 in the Senate and 417–2 in the House²⁶⁰ grew out of a claim in a *60 Minutes* broadcast that congressional insider trading was “perfectly legal.”²⁶¹ To quell the public's outcry, Congress quickly held hearings on proposed bills seeking to ban the purported practice,²⁶² and in the span of a few short months, passed legislation that President Obama signed into law in April 2012. As the Senate Report reflects, although the STOCK Act's drafters recognized that a federal court could theoretically apply misappropriation theory analysis if it were presented with

256. S. 1380, 100th Cong. (“Reconciliation Draft,” dated November 19, 1987), reprinted in *Symposium: Defining Insider Trading*, 39 ALA. L. REV. 531 app. at 554 (1988). The statutory definition of “wrongful” extended to information that “‘has been obtained by, or its use would constitute, directly or indirectly, (A) theft, bribery, misrepresentation, espionage (through electronic or other means) or (B) conversion, misappropriation, a breach of any fiduciary duty, any personal or other relationship of trust and confidence, or any contractual or employment relationship.’” *Id.*

257. *Carpenter v. United States*, 484 U.S. 19, 24 (1987) (stating that “[t]he Court is evenly divided with respect to the convictions under the securities laws and for that reason affirms the judgment below on those counts”).

258. Pitt & Shapiro, *supra* note 255, at 236 (observing that “when there was no longer any compelling fear that the courts would require such legislation, the Proscriptions Act faded from public attention, and Congress turned to other legislative proposals more directly supportive of the Commission’s program”).

259. STOCK Act, Pub. L. No. 112-105 §§ 4(a), 9(b), 126 Stat. 291 (2012) (affirming that members of Congress and congressional employees, as well as all officers and employees in the executive and judicial branches of the federal government, “are not exempt from the insider trading prohibitions arising under the securities laws, including Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder”); *id.* at §§ 4(b), 9(b) (codified at 15 U.S.C. §§ 78u-1(g)(1) and (h)(1) (2012)).

260. Robert Pear, *Insider Trading Ban for Lawmakers Clears Congress*, N.Y. TIMES (Mar. 22, 2012), <http://www.nytimes.com/2012/03/23/us/politics/insider-trading-ban-for-lawmakers-clears-congress.html>.

261. See *Congress: Trading Stock on Inside Information*, 60 MINUTES (June 11, 2012), http://www.cbsnews.com/8301-18560_162-57323527/congress-trading-stock-on-inside-information/ (stating in the episode summary: “[f]or now, the practice is perfectly legal, but some say it’s time for the law to change”).

262. See *Insider Trading and Cong. Accountability: Hearing Before the S. Comm. on Homeland Sec. & Gov’t Affairs*, 112th Cong. (2011) [hereinafter Senate STOCK Act Hearings]; *The Stop Trading on Cong. Knowledge Act: Hearing on H.R. 1148 Before the H. Comm. on Fin. Servs.*, 112th Cong. (2011) [hereinafter House STOCK Act Hearings].

a prosecution involving congressional insider trading, they were uncertain as to whether “the unique nature of an elected office of Congress . . . [would] give[] rise to a fiduciary-like duty owed . . . to anybody.”²⁶³ The STOCK Act addressed this uncertainty by adding new provisions to the Exchange Act—Section 21A(g) and Section 21A(h)—which provide that “solely for the purposes of the insider trading prohibitions arising under this Act, including section 10(b) and Rule 10b-5 thereunder,” all federal officials, including members of Congress, owe “a duty arising from a relationship of trust and confidence” to the United States government and its citizens with respect to material nonpublic information obtained in connection with their government service.²⁶⁴ Prior to these amendments to the Exchange Act, the federal insider trading prohibitions arising under Section 10(b) and Rule 10b-5 had been rooted solely in a judicially implied claim. Thus, the STOCK Act made explicit what Congress had previously ratified through its enactment of ITSA and ITSFEA.

But the STOCK Act’s amendments to the Exchange Act are important for a second reason: they reinforce insider trading law’s collaborative nature by expressly “incorporat[ing] the fiduciary duty approach reflected” in *Chiarella*, *Dirks*, and *O’Hagan*.²⁶⁵ Prior bills leading up to the legislation had sought to resolve the controversy by amending the Exchange Act to include an outright statutory proscription against congressional insider trading.²⁶⁶ But the STOCK Act’s drafters ascribed to the “duty of trust and confidence” approach as a means of ensuring “that the insider trading prohibitions apply to Members of Congress in the same way that they apply to everyone else” and to leave unaltered “the construction of the antifraud provisions of the securities laws [and] the authority of the SEC or DOJ under those provisions.”²⁶⁷ Although Congress could have used the *60 Minutes*-generated controversy to enact an express statutory prohibition of insider trading and tipping that would apply to the entire investing public (including its own members),²⁶⁸ SEC officials once again cautioned against the adoption of a statutory proscription,²⁶⁹ and other witnesses proffered similar advice.²⁷⁰

263. See S. REP. NO. 112-244, S. 2038 114th Cong. (2012), at 5 (stating that “the Committee agrees with Professor Langevoort’s explanation of clarifying that the insider trading provisions apply to Members of Congress”).

264. 15 U.S.C. §§ 78u-1(g)(1) and (h)(1) (2012). Section 21A(g) further specifies that members of Congress and congressional employees owe that duty to Congress itself. 15 U.S.C. § 78u-1(g)(1).

265. See Fisch, *supra* note 202, at 480.

266. See Donna M. Nagy, *Insider Trading, Congressional Officials, and Duties of Entrustment*, 91 B.U. L. REV. 1105, 1130–37 (2011) (critiquing prior versions of the STOCK Act).

267. S. REP. NO. 112-244, at 9 (2011–2012).

268. See House STOCK Act Hearings, *supra* note 262, at 97 (prepared statement of Professor Donna Nagy highlighting the proposed Insider Trading Proscription Act of 1987 and emphasizing that “much could be gained from dusting off that proposal and reconsidering it in light of the insider trading jurisprudence that has developed over the last 25 years”); Senate STOCK Act Hearings, *supra* note 262, at 65.

269. House STOCK Act Hearings, *supra* note 262, at 25 (testimony of SEC Director of Enforcement Robert Khuzami) (expressing concern about “the dangers that would flow from a general statutory prohibition that attempted to cover the entire field of insider trading”).

270. Senate STOCK Act Hearings, *supra* note 262, at 15 (testimony of Professor John C. Coffee, Jr. expressing concern about “conflicts in the circuits” because “legislation with new terms” will prompt federal courts to “spend 10 to 15 years resolving what those new terms mean”); see also *id.* (“[I]f you try to adopt comprehensive legislation, I am afraid that every special interest group in the United States will want a safe harbor for what they do, and you will find that the statute will go from short to page after page of proposed safe harbors.”).

As the foregoing Sections demonstrate, in the 36 years since Justice Powell authored the decision in *Chiarella*, Congress has hardly been silent as to the scope of the federal prohibitions against insider trading and tipping. To the contrary, the legislative developments reflected in ITSA, ITSFEA, and the STOCK Act evidence concerted congressional judgments rendered only after repeated consultations with securities law scholars and practitioners, and more importantly, with the expert agency officials at the SEC. These judgments confirm Congress's multiple determinations that the fraud-based rubric—and the interstitial lawmaking that is a necessary function of that rubric—puts securities traders on sufficient notice that securities transactions based on misappropriated information will be subject to stiff monetary fines and harsh criminal penalties.²⁷¹ And notwithstanding several recent bills introduced by individual members of Congress,²⁷² and a plethora of prior suggestions from securities law scholars,²⁷³ Congress has not shown a willingness to reconsider its prior determinations that insider trading is best regulated as a species of securities fraud.

V. REGULATION FD

As publicly traded companies, both Dell and NVIDIA are subject to the requirements and prohibitions in Regulation FD.²⁷⁴ Yet remarkably, the *Newman* court never once mentioned this regulation nor the legal constraints that it placed on Dell's and NVIDIA's insider-tippers. This omission is all the more striking because Regulation FD, throughout the last 15 years, has regulated the very space that *Dirks* sought to create—and the Second Circuit sought to expand—for insider-analyst communications.²⁷⁵ This myopia substantially undermined *Newman*'s conclusion that gratuitous tipping, and trading on such

271. See *supra* note 189 (differentiating the misappropriation theory endorsed in *O'Hagan* from the due process concerns that prompted the holding in *Skilling*).

272. Since the decision in *Newman*, several members of Congress have introduced bills that would define the offense of insider trading and eliminate entirely the personal benefit requirement in tipper-tippee cases. See, e.g., The Stop Illegal Insider Act, S. 702, 114th Cong. (2015), <https://www.congress.gov/bill/114th-congress/senate-bill/702/text> (introduced by Senators Jack Reed (D-RI) and Robert Menendez (D-NJ)); The Ban Insider Trading Act of 2015, H.R. 1173, 114th Cong. (2015) (introduced by Rep. Steven Lynch (D-MA), <https://www.congress.gov/114/bills/hr1173/BILLS-114hr1173ih.pdf>; H.R. 1625, The Insider Trading Prohibition Act (2015) (introduced by Reps. Jim Himes (D-CT), Steve Womack (R-AR) and Emanuel Cleaver (D-MO)), <https://www.congress.gov/bill/114th-congress/house-bill/1625the>.

273. See *supra* note 268 and accompanying text (quoting STOCK Act testimony); see also Henning, *supra* note 54, at 773–76 (pointing out the benefits of an insider trading prohibition that would turn on the possession of material nonpublic information, akin to the abstain or disclose approach in Rule 14e-3); Jill E. Fisch, *Start Making Sense: An Analysis and Proposal for Insider Trading Regulation*, 26 GA. L. REV. 179, 236, 239 (1991) (suggesting that “regulation of insider trading would be improved by reclassifying such trading as a regulatory violation rather than a crime” and proposing a statute that focuses on insiders “who are in a position to control corporate disclosure”); Donald C. Langevoort, *Rereading Cady, Roberts: The Ideology and Practice of Insider Trading*, 99 COLUM. L. REV. 1319, 1339, 1338–39 (1991) (proposing statutory language “that eliminates the intellectual awkwardness of the prevailing fiduciary basis for the duty to disclose to marketplace traders, the *Dirks* ‘personal benefit’ test . . . and the cramped nature of the misappropriation theory”).

274. 17 C.F.R. § 243.100 (2011).

275. See Robert B. Thompson & Ronald King, *Credibility and Information in Securities Markets after Regulation FD*, 79 WASH. U. L. Q. 615, 634 (2001) (concluding that “the effect of Regulation FD is to redraw the line regarding what transfers of information are permissible”).

tips, does not amount to a violation of Rule 10b-5.

A. Regulation FD's Purpose and Scope

As other securities law scholars have recounted, the SEC adopted Regulation FD to navigate around the personal benefit hurdle that *Dirks* had erected in tipper-tippee insider trading cases.²⁷⁶ Over the decade prior, the SEC became increasingly concerned that corporate executives were routinely providing securities analysts and professional investors with material nonpublic information pertaining to their companies, including advance notice of earnings announcements, product developments, and corporate reorganizations.²⁷⁷ The agency found this practice of selective disclosure blatantly unfair because “those who were privy to the information beforehand were able to make a profit or avoid a loss at the expense of those kept in the dark.”²⁷⁸ The SEC also emphasized the “close resemblance” between issuer selective disclosure and insider tipping and trading.²⁷⁹ As the SEC explained:

In both cases, a privileged few 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. Likewise, selective disclosure has an adverse impact on market integrity that is similar to the adverse impact from illegal insider trading: investors lose confidence in the fairness of the markets when they know that other participants may exploit “unerodable informational advantages” derived not from hard work or insights, but from their access to corporate insiders.²⁸⁰

But as the SEC rather grudgingly came to recognize,²⁸¹ absent the receipt of a personal benefit by a corporate executive, the *Dirks* decision allowed valuable corporate information to be legally dribbled out to securities analysts, who could legally trade securities on the basis of those selective disclosures or advise their clients to do so.²⁸² Until the SEC acted

276. See Jill E. Fisch & Hillary A. Sale, *The Securities Analyst As Agent: Rethinking the Regulation of Analysts*, 88 IOWA L. REV. 1035, 1061 (2003) (observing that “the Supreme Court’s decisions in *Chiarella* and *Dirks* created a privileged status for analysts with respect to insider trading regulation”).

277. See *Selective Disclosure and Insider Trading*, Release Nos. 33-7881, 34-43154, [2000 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 86,319, at 83,692, 83,677 (Aug. 15, 2000) [hereinafter *Regulation FD Adopting Release*]; see also Fisch & Sale, *supra* note 276, at 1062 (observing that the problem of selective disclosure “took on increased urgency as market volatility increased in the late 1990s” and as evidence mounted that “a substantial number of issuers apparently made selective disclosure a regular practice”).

278. *Regulation FD Adopting Release*, *supra* note 277, at 83,677.

279. *Id.*

280. *Id.* (quoting *United States v. O’Hagan*, 521 U.S. 642, 658 (1997) (citing Victor Brudney, *Insiders, Outsiders and Informational Advantages under the Federal Securities Laws*, 93 HARV. L. REV. 322, 360 (1979))).

281. See Donna M. Nagy & Richard W. Painter, *Selective Disclosure by Federal Officials and the Case for an FGD (Fairer Government Disclosure) Regime*, 2012 WIS. L. REV. 1285, 1341–43 (discussing the securities industry’s reaction to the SEC settlement in Phillip J. Stevens, Litigation Release No. 12,813, 48 S.E.C. Docket 739, 739 (Mar. 19, 1991)). The SEC claimed that selective disclosure to a securities analyst satisfied the *Dirks* test because the CEO’s motivation in making the disclosure was “to protect and enhance his reputation.” *Id.* at 1342 (quoting Phillip J. Stevens, Litigation Release, No. 12,813, 48 S.E.C. Docket 739, 739 (Mar. 19, 1991)). The SEC’s position was never tested in court and the settlement sparked an outcry from securities law scholars and practitioners. The SEC thereafter opted against initiating subsequent Rule 10b-5 litigation to get at the problem of selective disclosure. *Id.* at 1343.

282. See Nagy & Painter, *supra* note 281, at 1292; Stephen J. Choi, *A Framework for the Regulation of*

to change that practice, corporate executives could almost always come up with a corporate purpose for sharing material nonpublic information with securities analysts and other securities professionals.²⁸³

Regulation FD, which took effect in October 2000, sought to level the playing field for ordinary investors by effectively banning the practice of selective disclosure and thereby thwarting the privileged securities trading that came with it. The SEC did so by exercising its rulemaking authority under Section 13(a) of the Exchange Act, which empowers the agency to mandate ongoing disclosure by SEC reporting issuers.²⁸⁴ The regulation applies only to disclosures made in the name of the issuer or by “person[s] acting on [its] behalf,” a term that includes senior executives as well as any “investor relations or public relations officer” or any employee “who regularly communicates” with securities industry professionals or institutional investors.²⁸⁵ However, it extends to disclosures made by those persons only to four categories of recipients:

(1) broker-dealers and their associated persons [including sell-side securities analysts], (2) investment advisers, certain institutional investment managers and their associated persons, and (3) investment companies, hedge funds, and affiliated persons [including buy-side analysts and (4)] . . . any holder of the issuer’s securities, under circumstances in which it is reasonably foreseeable that such person would purchase or sell securities on the basis of the information.²⁸⁶

Regulation FD also explicitly exempts disclosures made to temporary agents who owe a duty of loyalty to the issuer (such as attorneys, accountants or other advisers),²⁸⁷ as well as to other persons who have “expressly agree[d] to maintain the disclosed information in confidence.”²⁸⁸ In addition, the regulation specifies that an “officer, director, employee, or agent of an issuer who discloses material nonpublic information in breach of a duty of trust or confidence to the issuer shall not be considered to be acting on behalf of the issuer.”²⁸⁹ But for this latter qualification, an insider’s illegal tipping in violation of Rule 10b-5 would likewise trigger a Regulation FD violation on the part of the issuer.

Regulation FD’s effective ban on “unfair selective disclosure” follows from a consequence of its rules rather than from an explicit prohibition in its text.²⁹⁰ Its basic mandate requires that whenever an issuer or a person acting on its behalf discloses material

Securities Market Intermediaries, 1 BERKELEY BUS. L.J. 45, 57 (2004) (contending that the Court in *Dirks* “was particularly concerned with giving corporate officers the ability to pass inside information freely to analysts”).

283. See Donald C. Langevoort, *Investment Analysts and the Law of Insider Trading*, 76 VA. L. REV. 1023, 1024 (1990) (observing that selective disclosures to analysts served a variety of corporate ends, “such as to enhance the company’s standing with the investor community or to strengthen pre-existing lines of communication”).

284. 15 U.S.C. § 78m(a) (2010). In addition to issuers with a class of securities registered under Exchange Act Section 12, Regulation FD applies to issuers required to file reports under Exchange Act Section 15(d) and to closed-end investment companies, but it does not apply to any other investment companies or any foreign government or foreign private issuer. 17 C.F.R. § 243.101(b) (2016).

285. 17 C.F.R. § 243.101(c), (f).

286. Regulation FD Adopting Release, *supra* note 277, at 83,681 (quoting FD Rule 100(b)(1)).

287. 17 C.F.R. § 243.100(b)(2)(i).

288. *Id.* at § 243.100(b)(2)(ii).

289. *Id.* at § 243.101(c).

290. See Regulation FD Adopting Release, *supra* note 277, at 83,681 (stating that “Regulation FD . . . establishes a clear rule prohibiting unfair selective disclosure”).

nonpublic information to any of the four enumerated categories of recipients, the issuer must make public disclosure of that same information “simultaneously” for “intentional” (i.e., knowing or reckless) disclosures,²⁹¹ or “promptly” for non-intentional disclosures.²⁹² The clear intent behind the SEC’s “simultaneous” disclosure requirement is to prohibit issuers and their officials from intentionally making selective disclosures to those persons who are most likely to trade on that information. In other words, Regulation FD puts issuers and their officials to an “all or nothing choice: they are not required to disclose any more information than before, but if they tell someone, they must tell everyone.”²⁹³ If the issuer fails to “tell everyone,” the issuer’s antifraud liability for material omissions liability is not affected,²⁹⁴ but the SEC can bring an enforcement action for the issuer’s violations of Regulation FD and Section 13(a) as well as against the issuer official who caused, or aided and abetted, those violations.²⁹⁵ Securities analysts may likewise be liable for causing or aiding and abetting an issuer’s Regulation FD violations, in certain instances.²⁹⁶

Although Regulation FD reflects the SEC’s concerted effort to regulate issuers and their disclosure practices rather than securities investors and their trading, the regulation was clearly constructed with the troubling practices of securities analysts in mind. The Final Rule Release made a particularly pointed reference to the “practice of securities analysts seeking ‘guidance’ from issuers regarding earnings forecasts,” and it cautioned corporate officials that private discussions with analysts who are seeking guidance about earnings estimates presents a “high degree of risk under Regulation FD.”²⁹⁷ Favoring directness to subtlety, the SEC explicitly warned that “[i]f the issuer official communicates selectively to the analyst nonpublic information that the company’s anticipated earnings will be higher than, lower than, or even the same as what analysts have been forecasting, the issuer likely will have violated Regulation FD.”²⁹⁸

Thus, as Professors Robert Thompson and Ronald King have aptly summarized,

291. 17 C.F.R. § 243.101(a). An “intentional” disclosure occurs when “the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic.” *Id.*

292. *Id.* at § 243.101(d). “Promptly means as soon as reasonably practicable (but in no event after the later of 24 hours or the commencement of the next day’s trading on the New York Stock Exchange) after a senior official of the issuer . . . learns that there has been a non-intentional disclosure by the issuer or person acting on behalf of the issuer of information that the senior official knows, or is reckless in not knowing, is both material and nonpublic.” *Id.*

293. Thompson & King, *supra* note 275, at 615.

294. See 17 C.F.R. § 243.102 (stating that “[n]o failure to make a public disclosure required solely by § 243.100 shall be deemed to be a violation of Rule 10b-5 under the Securities Exchange Act”).

295. See Regulation FD Adopting Release, *supra* note 277, at 83,691. As Professor John Coffee points out, the “willful” violation of an SEC rule is a criminal offense under both the Exchange Act and the Securities Act. Thus, a corporate executive who willfully violates Regulation FD by engaging in warehousing in advance of a merger announcement “is seemingly subject to criminal prosecution.” John C. Coffee, Jr., *Introduction: Mapping the Future of Insider Trading Law: Of Boundaries, Gaps, and Strategies*, 2013 COLUM. BUS. L. REV. 281, 311 (2013).

296. See Richard W. Walker, Director of Enforcement, Sec. Exch. Comm’n, Speech before the Compliance & Legal Division of the Securities Industry Association: Regulation FD – An Enforcement Perspective (Nov. 1, 2000) (transcript available at <http://www.sec.gov/news/speech/spch415.htm>) (advising that while it would not be a common occurrence for the SEC to charge an analyst, “comments by an analyst to an issuer along the lines of ‘you can tell me, the SEC will never find out’ . . . [would] raise red flags and convey an intention by the analyst to induce the issuer’s violation of FD”).

297. Regulation FD Adopting Release, *supra* note 277, at 83,684.

298. *Id.*

through its adoption of Regulation FD “the SEC has reversed the legal consequences of the analyst’s conduct discussed in *Dirks*.”²⁹⁹ Regardless of any possibly positive effect on pricing efficiency, selective disclosures about earnings results—or any other intentional transfers of material nonpublic information to securities analysts—are now *unlawful*, even if the issuer official is not tipping that information for a personal benefit.

B. The Interplay Between Regulation FD and Gratuitous Tipping

The Second Circuit’s failure to consider the post-*Dirks* development brought about by the SEC’s adoption of Regulation FD substantially undermines *Newman*’s conclusion that gratuitous tipping and trading on such tips does not constitute a violation of Rule 10b-5. Regulation FD radically changed the legal landscape for private, one-on-one discussions between issuer officials (such as the Dell insider, who worked in its investor relations department) and securities industry professionals (such as his friend/acquaintance, the Neuberger Berman analyst).³⁰⁰ Thus, if the insider at Dell did not intentionally tip the analyst so that he could trade securities (or advise others to trade), that insider likely caused, or aided and abetted, Dell’s violation of Regulation FD. Moreover, virtually all publicly traded companies now have stringent policies and procedures in place to guard against Regulation FD violations.³⁰¹ Such internal policies have sensitized all employees to the perils of disclosing material nonpublic information (especially earnings-related), even if an employee (such as the NVIDIA insider, who worked in the finance unit) is not a “senior executive” or otherwise covered by the prohibitions in Regulation FD.³⁰²

The Court’s decision to consider *Newman*’s personal benefit standard in the context of the *Salman* petition opens the door for a new interpretation of Rule 10b-5’s insider trading prohibition that takes full account of Regulation FD. The consequences for the precedent in *Dirks* and the controversy over gratuitous tipping are two-fold.

First, against the backdrop of Regulation FD, it now makes little sense to narrowly interpret the personal benefit element to facilitate what *Dirks* had viewed as the analyst’s role in “ferret[ing]” out material nonpublic information from an issuer’s officials.³⁰³ For as long as Regulation FD remains on the books—and notwithstanding the studied views of several distinguished securities law scholars³⁰⁴—that type of ferreting by securities

299. Thompson & King, *supra* note 275, at 635.

300. See *supra* text accompanying notes 60–63. In view of *Newman*’s ruling that the tipplers did not breach a duty of trust and confidence owed to their employers, the Dell insider would have been a “person acting on behalf of an issuer” because he was a person who “regularly communicate[d] with securities industry professionals,” even if he was not an “investor relations officer.” 17 C.F.R. § 243.101 (2016).

301. See Jill E. Fisch, *Regulation FD: An Alternative Approach to Addressing Information Asymmetry*, in RESEARCH HANDBOOK ON INSIDER TRADING 129 (Stephen M. Bainbridge ed. 2013) (observing that issuers “have taken seriously the applicable regulatory restrictions in engaging in private communications with investors and analysts and have structured compliance and education systems to reduce both intentional and unintentional selective disclosures”).

302. See *supra* text accompanying notes 64–65. Depending on the scope of his duties and the regularity of his contacts with securities industry professionals or holders of the company’s securities, the NVIDIA insider may have been a “person acting on behalf of an issuer” under Regulation FD, Rule 101(c).

303. See *supra* note 84 and accompanying text (quoting *Dirks*).

304. See *supra* text accompanying notes 32–33 (discussing amicus brief filed in the Second Circuit by Professors Bainbridge, Henderson and Macey); see also Epstein, *supra* note 188, at 1485 (contending that “Regulation FD places an unfortunate straightjacket on how various firms do business with analysts of their stock” and arguing that firms “should be allowed to authorize their employees to make selective disclosures of inside

analysts is no longer revered by the SEC as “necessary to the preservation of a healthy market.”³⁰⁵ Thus, Regulation FD has sucked out most of the air from the very space that *Dirks* created for insider-analyst communications.³⁰⁶ *Newman*’s narrow reading of *Dirks* plainly encourages activity that constitutes a violation of Regulation FD and, in the SEC’s expert judgment, leads to a loss of investor confidence in the fairness and integrity of the securities markets.³⁰⁷ The notion that courts should interpret Rule 10b-5 narrowly to facilitate an activity that is currently unlawful is both strange and unsettling.

Second, Regulation FD leaves corporate insiders, particularly those in investor relations or finance departments, with little room for a credible claim that selective disclosures about earnings information were prompted by a mistaken belief about whether it “already has been disclosed or that it is not material enough to affect the market.”³⁰⁸ Publicly traded companies have been highly proactive in forbidding communications that could be construed as a leak of material nonpublic information. Such companies likewise issue frequent and unambiguous warnings pertaining to the confidentiality of pre-announcement earnings. These admonishments are likely prompted by the SEC’s depiction of these communications as involving a “high degree of risk.”³⁰⁹

Thus, before concluding that the circumstantial evidence surrounding the multiple instances of tipping “was simply too thin” to support the jury’s finding of a personal benefit

information so long as [their] officers and directors have concluded in good faith that the release of that information will increase overall firm value”); Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes–Oxley Act of 2002*, 28 J. CORP. L. 1, 51 (2002) (contending that “Regulation FD can be seen as part of a misguided SEC strategy of insider trading regulation that has hobbled markets’ ability to scrutinize corporate misconduct” and concluding that “forcing sharing of information necessarily weakens incentives to gather and create the information”).

305. *Dirks v. SEC*, 463 U.S. 646, 658 (1983). In addition to the SEC’s growing concern about the unfair use of selectively disclosed information by analysts and their client, see *supra* notes 278–80 and accompanying text, technological changes also prompted the SEC to reassess the value of encouraging private conversations between insiders and analysts. See Michael D. Guttentag, *Selective Disclosure and Insider Trading: Tipper Wrongdoing in the 21st Century*, 69 FLA. L. REV. (forthcoming 2016) (SSRN draft at 12), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2830735 (quoting *Dirks*, 463 U.S. at 659) (pointing out that *Dirks*’s favorable view toward selective disclosure in 1983 was in part a function of the then-nature of “‘this type of information, and indeed of markets themselves, [whereby] such information [could not] be made simultaneously available to all of the corporation’s stockholders or the public generally’”).

306. See Pritchard, *supra* note 34, at 861 (“Powell wanted to leave space for securities professionals to uncover nonpublic information, even if it came from corporate insiders.”).

307. See Donald C. Langevoort, *Newman and Selective Disclosure*, CLS BLUE SKY BLOG (Jan. 28, 2015), <http://clsbluesky.law.columbia.edu/2015/01/28/newman-and-selective-disclosure/> (expressing concern that *Newman* “read[s] almost as a roadmap for selective disclosure”). The panel in *Newman* drew attention to other investor relations officials at Dell and NVIDIA who “routinely ‘leaked’ earnings data in advance of quarterly earnings.” *United States v. Newman*, 773 F.3d 438, 455 (2d Cir. 2014). In the one specific example provided, Dell’s Head of Investor Relations selectively disclosed nonpublic earnings-related information to “establish relationships with financial firms who might be in a position to buy Dell’s stock.” *Id.* The fact that other Dell and NVIDIA officials may have caused their companies to violate Regulation FD should have heightened the court’s scrutiny of the tips provided by the defendants’ original tippers. *Newman*’s view that other instances of selective disclosure at Dell and NVIDIA somehow mitigate that conduct is troubling, to say the least. Cf. Langevoort, *supra* (observing that *Newman* “takes as exculpatory how willing senior types at Dell and NVIDIA were to leak earnings information” and noting that the court failed to mention “that (if the information was material) that conduct was a gross violation of Regulation FD”).

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

309. Regulation FD Adopting Release, *supra* note 277, at 83,684.

by the Dell and NVIDIA insiders,³¹⁰ the Second Circuit should have drilled down more deeply into the question of motivation. As the Seventh Circuit recognized in *Maio*, absent some “legitimate reason” for the insider’s disclosure, the inference that information was “improper[ly] gift[ed]” may be “unassailable.”³¹¹ Given the jury’s finding of personal benefits, and Regulation FD’s clear prohibition of selective disclosure, gratuitous tipping for the “ephemeral benefit of the ‘value of . . . friendship,’”³¹² may well have been the explanation that convinced the jury beyond a reasonable doubt that the tippers had violated the fiduciary duties that they owed to Dell and NVIDIA and that the defendants knew, or consciously avoided knowing, about their breaches.³¹³

VI. LACK OF GOOD FAITH AND THE DUTY OF LOYALTY

Along with the *O’Hagan* decision, the Exchange Act amendments (in ITSA, ITSFEA, and the STOCK Act), and Regulation FD, the Delaware judiciary’s expanded notion of the fiduciary duty of loyalty has an important bearing on insider trading cases involving gratuitous tipping. Although the insider trading and tipping prohibitions arising under Rule 10b-5 implicate federal common law, federal courts often look to state law in determining whether a fiduciary has breached a duty of trust and confidence by trading securities on the basis of material nonpublic information, or by disclosing such information to someone else who used it to trade. As the court observed in *United States v. Whitman*,³¹⁴ “general principles of state fiduciary law . . . [can provide] helpful guidance for determining the parameters of the applicable federal common law to be applied.”³¹⁵

State fiduciary law can offer particularly valuable guidance on two questions that lie at the core of Rule 10b-5’s prohibition of tipping: 1) [h]ow should a court regard the careless disclosure of material nonpublic information when a fiduciary does not intend for securities trading to result and 2) how should a court regard a fiduciary’s deliberate action to disclose entrusted information so that it can be used to provide one or more persons with a securities trading advantage? The Delaware Supreme Court’s decision in *The Walt Disney Company Derivative Litigation*³¹⁶ has direct relevance to the first question and

310. *Newman*, 773 F.3d at 451–52.

311. *See supra* text accompanying note 176 (quoting *SEC v. Maio*, 51 F.3d 623, 632 (1995)).

312. *Newman*, 773 F.3d at 452 (quoting *United States v. Jiau*, 734 F.3d 147, 153 (2d Cir. 2013)).

313. *See infra* notes 375–79 and accompanying text (discussing Regulation FD’s relevance to a tippee’s awareness of an insider-tipper’s lack of good faith). The question of which policy preferences—the SEC’s or the *Dirks* majority’s—should be accorded greater weight in deciding the legality of gratuitous tipping also implicates core principles of administrative law from decisions including *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984). *See Whitman v. United States*, 135 S. Ct. 352 (2014) (statement by Scalia & Thomas, JJ) (agreeing with the Court’s denial of certiorari, but suggesting that *Chevron* does not obligate courts to defer “to an executive agency’s interpretation of a law that contemplates both criminal and administrative enforcement”). Because it is beyond the scope of this (already lengthy) Article, analysis of *Chevron* deference issues will be left for another day.

314. *United States v. Whitman*, 904 F. Supp. 2d 363 (S.D.N.Y. 2012).

315. *Id.* at 370. Some securities law scholars have advocated for a role for state law that would entail much more than simply guidance. *See* Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition*, 52 WASH. & LEE L. REV. 1189, 1193 (1995) (arguing that such incorporation “would advance the federalism policies of the federal securities laws, without frustrating any of the other policies thereof”).

316. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27 (Del. 2006).

*Stone v. Ritter*³¹⁷ offers an important perspective on the second.

Taken together, both *Disney* and *Stone* will provide the Supreme Court in *Salman* with a compelling justification for rejecting *Newman*'s restrictive view that tipping violates Rule 10b-5 only when a fiduciary shares entrusted information in the context of "a meaningfully close personal relationship" when information is exchanged for "a personal benefit of . . . some consequence."³¹⁸ Moreover, because *Stone* construes breaches of the duty of loyalty to include not only self-dealing but also other deliberate actions evidencing a lack of good faith, the standards from that decision can also provide federal courts with "objective criteria" in making determinations about whether a tippee "knows or should know that there has been a breach."³¹⁹ Indeed, when Justices Powell and Ginsburg referenced the "duty of trust and confidence" in their respective opinions in *Dirks* and *O'Hagan*, they could not possibly have had in mind the more expansive notion of loyalty that the Delaware Supreme Court developed in 2006.

A. The Duty of Loyalty under Delaware Law

State fiduciary law has long distinguished between the duty of care and the duty of loyalty.³²⁰ In the realm of corporate law, the consequences of this distinction are particularly important because a fiduciary's violation of the duty of care can be excused and/or indemnified by the corporation, whereas violations of the duty of loyalty cannot. Delaware law, for example, permits a corporation to eliminate or limit a director's personal liability for monetary damages "for breach of fiduciary duty as a director," but the provision will not allow exculpation involving "any breach of the director's duty of loyalty to the corporation or its stockholders" or "for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law."³²¹ Delaware's indemnification statute likewise permits a corporation to indemnify its officers and directors for actions taken "in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation."³²² Although the precise wording of such exculpation and indemnification provisions vary from state to state, Delaware's provisions and the case law that interprets them have tremendous significance not only because most publicly traded companies are incorporated in Delaware, but also because many states use Delaware as a guide for developing their own statutes and case law.

The *Disney* litigation involved a derivative suit by shareholders against the company's directors and officers for damages arising out of the hiring and firing of the company's President, Michael Ovitz.³²³ The shareholders claimed that members of the board of directors had violated their fiduciary duties by first approving an out-sized compensation package in Ovitz's employment contract and then, less than a year later, by allowing a no-fault termination payment that cost the company approximately \$130 million. If the

317. *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362 (Del. 2006).

318. *United States v. Newman*, 773 F.3d 438, 452 (2d Cir. 2014).

319. *Dirks v. SEC*, 463 U.S. 646, 660 (1983).

320. Cf. Pritchard, *supra* note 197, at 942 (recognizing that under *Dirks*, "the federal common law of insider trading was brought into line with the traditional distinction in state corporate law between breaches of care and loyalty").

321. DEL. CODE ANN. tit. 8, § 102(b)(7) (2015).

322. DEL. CODE ANN. tit. 8, § 145 (2011).

323. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 36–46 (Del. 2006).

shareholders were successful in proving that these actions by the board were the result of a lack of good faith, then the damages sought by the shareholders could neither be exculpated nor indemnified.

Recognizing that the parameters of the duty to act in good faith had been “relatively uncharted,” the Delaware Justices set out in *Disney* to remedy that deficiency.³²⁴ The court noted in particular that to adopt “a definition that conflates the duty of care with the duty to act in good faith by making a violation of the former an automatic violation of the latter, would nullify those legislative protections and defeat the General Assembly’s intent.”³²⁵ It thus held explicitly that “[t]here is no basis in policy, precedent or common sense that would justify dismantling the distinction between gross negligence and bad faith.”³²⁶ But the court then provided some much needed guidance as to what a duty to act in good faith entails:

[T]he universe of fiduciary misconduct is not limited to either disloyalty in the classic sense (i.e., preferring the adverse self-interest of the fiduciary or of a related person to the interest of the corporation) or gross negligence. Cases have arisen where corporate directors have no conflicting self-interest in a decision, yet engage in misconduct that is more culpable than simple inattention . . . [F]iduciary conduct of this kind, which does not involve disloyalty (as traditionally defined) but is qualitatively more culpable than gross negligence, should be proscribed. A vehicle is needed to address such violations doctrinally, and that doctrinal vehicle is the duty to act in good faith.³²⁷

The court also provided three examples of deliberate conduct that indisputably evidences a fiduciary’s failure to act in good faith:

A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.³²⁸

Thus, *Disney* held not only that “grossly negligent conduct, without more, does not and cannot constitute a breach of the fiduciary duty to act in good faith.”³²⁹ It also made clear that shareholders could pursue a claim for lack of good faith outside of the standard self-dealing and conflicts of interest scenarios that are ordinarily implicated by the duty of loyalty.³³⁰

Less than five months later, in *Stone v. Ritter*,³³¹ the Delaware Supreme Court clarified an important doctrinal consequence that follows from a fiduciary’s failure to act in good faith. After reiterating the three examples from *Disney* of deliberate conduct evidencing a lack of good faith (one of which was “where the fiduciary acts with the intent

324. *Id.* at 64.

325. *Id.* at 66.

326. *Id.*

327. *Id.*

328. *Disney*, 906 A.2d at 67.

329. *Id.* at 65.

330. Gold, *supra* note 192, at 469.

331. *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362 (Del. 2006).

to violate applicable positive law”),³³² the court held explicitly that the obligation to act in good faith was not a separate stand-alone fiduciary duty.³³³ Instead, the fiduciary obligation to act in good faith is a core component of the duty of loyalty.³³⁴ As the Justices explained:

[T]he fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith. As the Court of Chancery aptly put it in *Guttman*, “[a] director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation’s best interest.”³³⁵

Thus, the incorporation of a good faith obligation into the duty of loyalty substantially expanded the circumstances under which successful claims for a breach of the duty of loyalty might be brought.³³⁶

As the above passage from *Stone* makes clear, the Delaware Supreme Court’s determination that the duty of loyalty encompasses an obligation to act in good faith echoed the observation made years before by then-Vice Chancellor (now Delaware Chief Justice) Leo Strine:

It does no service to our law’s clarity to continue to separate the duty of loyalty from its own essence; nor does the recognition that good faith is essential to loyalty demean or subordinate that essential requirement The reason for the disloyalty (the faithlessness) is irrelevant, the underlying motive (be it venal, familial, collegial, or nihilistic) for conscious action not in the corporation’s best interest does not make it faithful, as opposed to faithless.³³⁷

In *Guttman*, the court stated plainly that “one cannot act loyally as a corporate director by causing the corporation to violate the positive laws it is obligated to obey.”³³⁸ Of course, after *Disney* and *Stone*, the law is clear that negligent conduct—or even grossly negligent conduct—that results in the corporation’s violation of a federal or state law would not constitute a deliberate failure to act in good faith. But a fiduciary’s intentional violation of positive law, at least under Delaware law, now violates the duty of loyalty.³³⁹

332. *Id.* at 369 (quoting *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006)).

333. *Id.* at 369 (“[A] failure to act in good faith is not conduct that results, ipso facto, in the direct imposition of fiduciary liability.”).

334. *Id.* at 370.

335. *Id.* (quoting *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003)).

336. See Gold, *supra* note 192, at 471. But see Leo E. Strine, Jr. et al., *Loyalty’s Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L.J. 629, 695 (2010) (viewing *Stone*’s principal contribution as one of “doctrinal clarity” that prompts courts to inquire into good faith as “an instrumental way of determining whether an act of disloyalty was committed”).

337. *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003).

338. *Id.*

339. See *Desimone v. Barrows*, 924 A.2d 908, 934–35 (Del. Ch. 2007) (observing that “*Stone* clarified one of the most difficult questions in corporate law—when directors with no motivation to injure the firm can be held responsible if the corporation incurs serious harm as a result of its failure to obey the law” and emphasizing that a “knowing use of illegal means to pursue profit for the corporation is director misconduct”). For an argument that a fiduciary’s intentional violation of positive law should be treated separately from the duty of loyalty, see Stephen M. Bainbridge et al., *The Convergence of Good Faith and Oversight*, 55 UCLA L. REV. 559, 590–94 (2008).

B. *The Interplay between State Fiduciary Law and Rule 10b-5*

When the *Salman* Court considers the legality of gratuitous tipping, the landmark decisions in *Disney* and *Stone* will, in the words of *Whitman*, provide “helpful guidance for determining the parameters” of Rule 10b-5’s insider trading and tipping prohibitions.³⁴⁰ *Disney*’s holding that gross negligence by itself cannot evidence a lack of good faith is coextensive with *Dirks*’s view as to when the disclosure of material nonpublic information to a person outside the corporation constitutes an unlawful tip. Talking indiscreetly about confidential information in a crowded train car,³⁴¹ or even sharing confidential information with others (including a securities analyst) in a mistaken belief that the information is either immaterial or already public,³⁴² implicates actions that are negligent or at most grossly negligent. Whistleblowing to expose fraud or corruption at a company likewise does not evidence a deliberate failure to act in good faith and thus does not constitute a violation of a fiduciary’s duty of loyalty.³⁴³

In sharp contrast, a fiduciary who “acts with a purpose other than that of advancing the best interests” of his employer³⁴⁴—such as disclosing entrusted M&A information to provide one’s brother with trading advantage over others in the market—is consciously failing to act in good faith and is thus violating his duty of loyalty. Likewise, the insiders at Dell and NVIDIA would have failed to act in good faith, and thereby violated their duties of loyalty, if they intentionally leaked unreleased earnings information to their friends (or acquaintances) knowingly or recklessly disregarding the procedures put in place by their companies to guard against violations of Regulation FD.

Thus, had the *Newman* court considered the state fiduciary law reflected in *Disney* and *Stone*, it might have reached different results on the tipper’s personal benefit issue as well as the defendants’ knowledge issue. The evidence in *Newman* did not suggest that the insiders at Dell and NVIDIA had any legitimate reason for repeatedly disclosing confidential earnings-related information. Nor can it be claimed that the repeated patterns of disclosures were mere slips of the tongue or that the insiders were unaware of the market-sensitive nature of their regularized leaks of confidential information. Thus, assuming the tips by the insiders had been for the “ephemeral benefit of the ‘value of [the tippee’s] friendship,’”³⁴⁵ those tips would have been deliberate actions not in good faith and thereby an undisclosed breach of their loyalty duties owed to Dell and NVIDIA as well as the companies’ shareholders. And if the defendants knew or consciously avoided knowing that the disclosures constituted violations of Regulation FD, and/or flagrantly contravened compliance procedures at Dell and NVIDIA, then their knowledge of those breaches of loyalty would support their Rule 10b-5 liability, regardless of the defendants’ knowledge of a personal benefit on the part of the insiders. In short, the *Newman* jury could have reasonably concluded that experienced professionals in the securities industry must either have known or consciously avoided knowing that a public company’s quarterly-earnings

340. *United States v. Whitman*, 904 F. Supp. 2d 363, 370 (S.D.N.Y. 2012).

341. *See SEC v. Obus*, 693 F.3d 276, 287 (2d Cir. 2012) (hypothesizing careless cellphone user and eavesdropping passenger).

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

343. *See id.* Cf. RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. c (Am. Law. Inst. 2006) (“[A]n agent may reveal to law-enforcement authorities that the principal is committing or is about to commit a crime.”).

344. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006).

345. *United States v. Newman*, 773 F.3d 438, 452 (2d Cir. 2014) (quoting *United States v. Jiau*, 734 F.3d 147, 153 (2d Cir. 2013)).

cannot be regularly made available other than through deliberate actions not taken in good faith by corporate insiders who had been entrusted with that information.³⁴⁶

VII. ALTERNATE PATHS FORWARD

In view of *Salman*'s uncontroverted facts, which involved gratuitous tips passed from an investment banker to his older brother, the Supreme Court could affirm the Ninth Circuit and disavow the *Newman* ruling, without any need to look beyond its prior statements in the *Dirks* decision. Indeed, as the first part of this Article demonstrated, the Second Circuit's decision to overturn the jury's finding on the personal benefit issue was based on ostensible constraints that appear nowhere in *Dirks* itself. Specifically, *Dirks* did not limit its "gifting" theory to disclosures that were made only in the context of a "meaningfully close personal relationship."³⁴⁷ And *Dirks* never conditioned application of its gifting theory on a showing that the tipper must have sought or expected some form of pecuniary exchange or other tangible benefit from the recipient. Instead, as the Ninth Circuit emphasized, *Dirks* was explicit in recognizing that "[t]he elements of fiduciary duty and exploitation of nonpublic information [] exist when an insider makes a gift of confidential information to a trading relative or friend."³⁴⁸ Accordingly, under *Dirks*, it is irrelevant whether the tippee is a beloved older brother, a best friend from college, a former business school classmate and colleague, or a family friend from church. If the "purpose of the disclosure"³⁴⁹ was to enable the recipient to benefit from the principal's information, the fiduciary's purpose was indisputably "improper,"³⁵⁰ and the fiduciary's disclosure would have constituted a breach of duty under *Dirks*. And as a co-participant in the tipper's breach of duty, the beneficiaries of those tips would have inherited the insider's Rule 10b-5 disclosure obligation to shareholders if "the tippee knows or should know that there has been a breach."³⁵¹

However, the Court in *Salman* now has before it the very same type of choice that the Court confronted more than 33 years ago. That is, Justice Powell viewed *Dirks* to be an "'easy'" case.³⁵² Justice Powell, however, wanted to do more than simply vacate the censure of the investment analyst who had advised clients to trade securities on the basis

346. Although Professor Epstein disagrees with *Newman*'s reasoning on the issue of tipper personal benefits, he supports the decision's outcome in view of the court's conclusion that "there was no evidence in the record to establish that the defendants knew they were trading on unauthorized information released in violation of the fiduciary duties of insiders." Epstein, *supra* note 188, at 1482. However, under common law principles, the defendants' awareness of Regulation FD would seemingly warrant the imposition of a constructive trust on the profits generated from the use of Dell and NVIDIA's confidential information: the hedge fund managers could not have reasonably believed that officers and directors of those companies had authorized their employees to repeatedly and selectively disclose unreleased earnings and other market-sensitive information to securities analysts.

347. *Id.*

348. *United States v. Salman*, 792 F.3d 1087, 1092 (9th Cir. 2015) (quoting *Dirks v. SEC*, 463 U.S. 646, 664 (1983)).

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

350. *Id.* at 659.

351. *Id.* at 660.

352. See Pritchard, *supra* note 34, at 862 n.25 (quoting handwritten notes of Justice Lewis F. Powell, Jr.).

of nonpublic information provided by a corporate whistleblower.³⁵³ As Justice Powell explained to his colleagues on the Court, “[d]eciding this case without identifying a general principle would accomplish very little.”³⁵⁴ The Justices in *Salman* could likewise limit themselves to a narrow ruling on *Salman*’s easy facts.³⁵⁵ But the Court could accomplish so much more by identifying “a general principle” that would govern in subsequent insider trading cases, perhaps for decades to come.

For the reasons discussed below, the *Salman* Court should seize this opportunity to make insider trading law substantially more coherent and legitimate. The first Section raises tipping scenarios that are motivated by something other than a tipper’s desire to enrich either himself, a friend, or a relative. In such scenarios, the spirit of *Dirks* and the letter of *O’Hagan* would be satisfied with a liability test that turns on a tipper’s deceptive breach of a fiduciary duty of loyalty, whether or not the tipper received a personal benefit in exchange for the information. Thus, were the Court to follow this path, it could act modestly in clarifying joint tipper-tippee liability by focusing on breaches of loyalty in both classical and misappropriation theory contexts. The second Section explores how the Court can use the *Salman* case to re-conceptualize insider trading law more generally. Although fiduciary principles should have a substantial role in Rule 10b-5’s insider trading and tipping prohibitions, the crux of the offenses involve defrauding investors by trading on information that was obtained wrongfully, regardless of whether the trader or the tipper violated a fiduciary duty owed to the issuer or the source of the information.

A. Joint Tipper-Tippee Liability Premised on Deceptive Breaches of Loyalty

The Court in *Salman* could clarify insider trading law considerably by delineating the specific duty that a tipper must breach in order for a tippee to owe a disclosure obligation under Rule 10b-5, either to the issuer’s shareholders (in classical cases involving corporate insiders) or to the source of the information (in misappropriation cases involving fiduciary outsiders). *Dirks* makes a host of general references to “fiduciary” duties or breaches.³⁵⁶ But these open-ended phrases, in conjunction with the Court’s more explicit references to “personal gain,”³⁵⁷ have left some scholars convinced that *Dirks* was focused entirely on a fiduciary’s duty to refrain from direct or indirect self-dealing.³⁵⁸ And under such a reading

353. See *id.* at 863.

354. See *id.* (quoting Justice Lewis F. Powell, Jr. Memorandum for Conference, *Dirks v. SEC*).

355. There was never a dispute in *Salman* as to whether the two brothers had a “meaningfully close personal relationship.” Thus, that part of the *Newman* holding is not, at least theoretically, presented to the Court for review. See Brief for Petitioner, *supra* note 134 (quoting question presented in *Salman*’s petition for certiorari). A short opinion by the Court simply affirming the Ninth Circuit, therefore, would not necessarily undercut the “meaningful relationship” part of *Newman*’s heightened standard. Although the “tangible benefit” part of *Newman*’s holding has proven to be the more difficult hurdle for the government to scale, the “meaningfully close personal relationship” prong has presented some difficulty as well. See In the Matter of Joseph C. Ruggieri, Admin. Proceedings Ruling Release No. 3-16178 (Sept. 14, 2015), <https://www.sec.gov/alj/aljdec/2015/id877jsp.pdf> (applying *Newman* and concluding that while the tipper was “friends” with the tippee, “the evidence fails to establish that Bolan and Ruggieri’s ‘friendship’ was meaningful, close, or personal”).

356. See, e.g., *Dirks v. SEC*, 463 U.S. 646, 654–56, 659–660, 662, 664–67 (1983).

357. *Id.* at 659, 662, 666 n.27.

358. See Bainbridge, *supra* note 315, at 1200 (concluding that *Dirks* should be read as imposing a “duty to refrain from self-dealing in nonpublic information”); *id.* at 1201 (“[A] duty to disclose before trading arises only if trading would violate a duty to refrain from self-dealing in confidential information owed by the trader to the

of *Dirks*, many indisputably deceptive breaches of the duty of loyalty would not amount to illegal tipping—even when a tipper knew full well that the information he disclosed would be used to advantage some traders over others in the securities markets.

It is precisely here that *O'Hagan's* depiction of the Rule 10b-5 disclosure duty holds more promise. Because *O'Hagan* views a fiduciary's misappropriation as a betrayal that deprives the principal "of the exclusive use of [its] information,"³⁵⁹ under either the classical or the misappropriation theory, the insider trading prohibition could extend to *any* deceptive breach of the fiduciary's duty of loyalty, insofar as the breach involves a secret disclosure of information that is shared with others for securities trading purposes.³⁶⁰ Moreover, reading *O'Hagan* to encompass such secret and disloyal breaches gives effect to important changes in state corporate law: breaches of loyalty are no longer limited to instances of self-dealing or other conflicting interests; they can also be shown when a fiduciary deliberately fails to act in good faith.³⁶¹

Consider, for example, an imaginative scenario posited by Professor James Cox that involves an employee who, "like a modern day Paul Revere," rides through a town sharing highly confidential good news in advance of a major press conference planned by his corporate employer.³⁶² There should be no doubt that a fiduciary who deliberately makes such disclosures would be failing to act in good faith and would be breaching his duty of loyalty;³⁶³ and if he feigned fidelity to his employer after his ride was complete, he would be doing so deceptively (at least until the employer learned of his antics). If this employee were acting to facilitate securities trading by the townspeople, or if the townspeople's securities trading was clearly foreseeable, he would have engaged in conduct that constituted tipping—even if those tips were being disseminated to complete strangers with absolutely nothing sought or expected by the employee in return.³⁶⁴ In view of his deceptive lack of good faith, and in light of *O'Hagan's* concerns about market integrity and investor confidence,³⁶⁵ that employee could be held liable for illegal tipping under Rule 10b-5. As Delaware Chief Justice Strine has emphasized, "the reason for the disloyalty (the faithlessness) is irrelevant, the underlying motive (be it venal, familial, collegial, or nihilistic) for conscious action not in the corporation's best interest does not

owner of that information."); see also Pritchard, *supra* note 34, at 874 ("Giving away corporate information to strangers might make you feel like a big shot, but the standard is self-dealing: the gift needs to be an indirect personal benefit, which suggests a close relationship, not a casual one.").

359. United States v. *O'Hagan*, 521 U.S. 642, 643, 652 (1997).

360. Cf. James J. Park, *Rule 10b-5 and the Rise of the Unjust Enrichment Principle*, 60 DUKE L.J. 345, 409 (2010) ("[T]he Supreme Court's decision in *O'Hagan* suggests a doctrinal foundation that can be modified so that a workable Rule 10b-5 unjust enrichment principle can continue to develop.").

361. *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 369 (Del. 2006).

362. Cox, *supra* note 38.

363. See *id.* (contending that this modern day Revere would have breached "his state law fiduciary relationship" and that his corporate employer "would be able to hold him financially accountable under orthodox agency principles").

364. In his critique of the *Newman* opinion, Professor Prichard contends that for a gift of information to constitute illegal tipping, "the gift needs to be exploitation, not waste (the corporate law term for a hypothetical gift to a stranger)." Pritchard, *supra* note 34, at 874. But if the Court in *Salman* were to make it explicit that breaches of the duty of loyalty in connection with securities trading create a disclosure obligation for purposes of Rule 10b-5, then the employee's tips to strangers would violate Rule 10b-5. Cf. *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 749 (Del. Ch. 2005), *aff'd*, 906 A.2d 27, 75 (Del. 2006) ("The Delaware Supreme Court has implicitly held that committing waste is an act of bad faith.").

365. See *supra* note 145 and accompanying text (quoting *O'Hagan*).

make it faithful, as opposed to faithless.”³⁶⁶ Justices Blackmun and Marshall made essentially that same point in *Dirks* when they criticized the majority for engrafting “a special motivational requirement on the fiduciary duty doctrine.”³⁶⁷

Moreover, under a test for joint tipper-tippee liability that turned on the tipper’s deceptive breach of loyalty, some of the townspeople who traded securities based on the employee’s disclosures could be liable under Rule 10b-5 as well. As the Court outlined in *Dirks*, their liability would depend on “what they knew or should have known” regarding the employee’s breach of loyalty. If they knew or should have known that the employee deliberately failed to act in good faith in violation of a loyalty obligation owed to his employer to keep corporate secrets, then a claim under Rule 10b-5 could be stated against the townspeople for their illegal trading, assuming the SEC could prove scienter. Placing the test for liability on a tippee’s knowledge of the tipper’s breach of loyalty, rather than on knowledge of the tipper’s personal benefit, provides the “objective criteria” that the Court had been seeking in *Dirks*.³⁶⁸

A less imaginative scenario, but a far more realistic one, would involve an investor-relations official at a publicly traded company. Assume that the official causes the company to violate Regulation FD by intentionally or recklessly disclosing material nonpublic information to the investment manager of a holder of the company’s securities, “under circumstances in which it is reasonably foreseeable that the person will [trade] the issuer’s securities on the basis of the information.”³⁶⁹ Suppose, for instance, the official was operating under a misguided view that such selective disclosure was in the company’s best interest—perhaps because the holder was a valued institutional investor that owned a substantial amount of the company’s shares. Under the *Stone* decision, the official’s “intent[ion] to violate applicable positive law” would constitute a deliberate failure to act in good faith and thus a breach of her duty of loyalty.³⁷⁰ And under *O’Hagan*, if the official kept her violations of Regulation FD secret from the company, she would be “feign[ing] fidelity.”³⁷¹ The official’s selective disclosures to the investment manager could therefore constitute illegal tipping under Rule 10b-5, even if the investment manager had been a mere casual acquaintance or a complete stranger.³⁷² Once again, the personal motivation behind the investor-relations official’s deliberate actions in violation of Regulation FD would be irrelevant to the question of whether her intentional leaks of confidential information constituted a breach of her duty of loyalty.³⁷³

366. Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003).

367. Dirks v. SEC, 463 U.S. 646, 668 (1983) (Blackmun, J., dissenting).

368. *Id.* at 670; see Pritchard, *supra* note 34, at 865 (contending that it was Justice O’Connor who convinced Justice Powell to incorporate the requirement of a tipper’s personal benefit, which alleviated the need for a “‘tippee to ‘predict’ what is going on in the mind of his tipper”).

369. 17 C.F.R. § 243.100(b)(1)(iv) (2011).

370. *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 369 (Del. 2006) (quoting *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 76 (Del. 2006)).

371. *United States v. O’Hagan*, 521 U.S. 642, 655 (1997).

372. Moreover, even if some supervising officials at a publicly traded company were to condone selective disclosures notwithstanding the firm’s compliance policies and the firm’s regulatory obligations under Regulation FD, the firm itself is still deserving of a loyalty obligation from its agent—and to foreclose a finding of deception, full disclosure would have to be made to the firm. See Guttentag, *supra* note 305, at 49 (concluding that even if an insider’s tips do not deceive an immediate principal who may have sanctioned selective disclosures, such tips would deceive “the firm which has adopted a policy prohibiting such behavior”).

373. If the *Salman* Court were to reformulate the test for joint tipper-tippee liability to focus explicitly on a

A remaining question concerns the investment manager-tippee, who clearly traded on material nonpublic information that “ha[d] been made available to [the manager] improperly.”³⁷⁴ As the beneficiary of the official’s intentional selective disclosures in violation of Regulation FD, the manager’s investment funds could reap tremendous gains, as did the hedge funds managed by the defendants in *Newman*.³⁷⁵ Because all investment managers are well aware of the prohibition of selective disclosure under Regulation FD, that manager either knew or recklessly disregarded that the investor-relations official had breached a duty of loyalty that she owed to the company to comply with “applicable positive law.”³⁷⁶ Here again, the manager’s awareness (or willful ignorance) that the tip emanated from a violation of federal securities law provides a court with “objective criteria” similar to the type that *Dirks* sought with its personal benefit test.³⁷⁷ Thus, consistent with *O’Hagan*’s policy objectives, and in view of the clarity of the Regulation FD violation at issue, the government would be justified in pursuing a Rule 10b-5 claim against the manager for illegally trading on the basis of selectively disclosed information. As a co-participant in the official’s deceptive breach of a loyalty duty owed to the shareholders of the company, the manager would likewise be violating Rule 10b-5 in connection with the purchase or sale of securities.³⁷⁸

In short, *O’Hagan* advanced insider trading law considerably by stating explicitly that a loyalty duty is breached when fiduciaries misappropriate material nonpublic information and deprive their principals of the exclusive use and control over such information. The *Salman* Court now has the opportunity to advance the law even further by holding explicitly that breaches of loyalty in connection with securities trading trigger for tippers a Rule 10b-5 disclosure obligation, and that tippees inherit that obligation when they know or should know that the tipper has deliberately failed to act in good faith by conveying entrusted information. A desire for personal gain—or for a gain by one’s friend or relative—may well be the most common explanation for tipping, whether by corporate insiders or fiduciary outsiders. But other conscious failures to act in good faith can facilitate stock trading tips, and to paraphrase *O’Hagan* again, it would make “scant sense to hold [a tipper] a § 10(b) violator if he” engaged in a quid pro quo or gratuitous tipping, but not if

tipper’s deceptive breach of the duty of loyalty, then the SEC would almost certainly be prompted to reconsider—and to retract—prior positions taken with respect to the effect of Regulation FD violations. Indeed, when it initially proposed Regulation FD, the SEC expressly disclaimed any intent to “treat selective disclosure as a type of fraudulent conduct or revisit the insider trading issues addressed in *Dirks*.” See Selective Disclosure and Insider Trading, Exchange Act Release No. 34-42259 [1999–2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,228, at 82,860 (Dec. 20, 1999). The SEC’s position, however, was predicated on the view that *Dirks* required a personal benefit on the part of the tipper for a selective disclosure to be illegal, *id.*, which was itself a function of a pre-*Stone*, pre-*Disney* notion that the duty of loyalty encompassed little more than an obligation to avoid self-dealing. See *supra* text accompanying notes 325–40.

374. *Dirks v. SEC*, 463 U.S. 646, 660 (1983).

375. See *supra* text accompanying note 58 (observing that Newman’s stock trading generated more than \$4 million in profits for the funds he managed and Chiasson’s funds reaped profits exceeding \$68 million).

376. *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 369 (Del. 2006) (quoting *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 76 (Del. 2006)).

377. *Dirks v. SEC*, 463 U.S. 646, 664 (1983); see *supra* text accompanying note 188 (comparing awareness about misappropriated information to awareness about other types of stolen property).

378. Professor Guttentag takes this conclusion even farther and argues that, in view of Regulation FD and the internal compliance policies adopted by publicly traded firms to protect the confidentiality of market-sensitive information, courts should “create a rebuttable presumption that repeated selective access to material nonpublic information indicates that deceptive conduct is occurring.” See Guttentag, *supra* note 305, at 32.

he consciously failed to act in good faith by providing a trading advantage to a third-party acquaintance or even a complete stranger.³⁷⁹

B. Insider Trading Based on a “Fraud on Contemporaneous Traders”

As the foregoing has demonstrated, *O’Hagan’s* “fraud on the source” misappropriation theory plugged most of the insider trading gaps left open by *Chiarella* and *Dirks’s* classical theory, and a clear statement from the *Salman* Court that joint tipper-tippee liability turns on deceptive breaches of loyalty (irrespective of a personal benefit) would plug other troubling gaps, including the gap that now exists for many instances of trading on selective disclosures that were deliberately leaked in violation of Regulation FD. But the insider trading and tipping prohibitions arising under Rule 10b-5 have not yet been construed broadly enough to encompass a number of additional instances of securities trading on the basis of material nonpublic information that has been obtained wrongfully. Securities trading on the basis of stolen information, for instance, may involve neither a fiduciary breach nor active deception, and thus only some computer hackers who trade securities and/or tip others to trade will be found liable under Rule 10b-5.³⁸⁰ Moreover, as the Court itself acknowledged in *O’Hagan*, its misappropriation theory does not extend to a fiduciary who brazenly discloses to the source that he plans to trade on the nonpublic information, or where the source is otherwise aware that a breach of loyalty is occurring.³⁸¹ Securities trading by non-fiduciary thieves (such as computer hackers) or brazen fiduciaries (such as an employee who discloses an intention to trade, and then quits) undermines investor confidence and compromises market integrity to the same extent as the self-serving use of the source’s information by its agents or other fiduciaries.³⁸² To be sure, the “fraud on the source” theory was entirely adequate for the purpose of reinstating *O’Hagan’s* Rule 10b-5 conviction, and the government “[did] not propose . . . a theory of that breadth.”³⁸³ But the Court’s observation that “§ 10(b) is only a partial antidote to the problems it was designed to alleviate”³⁸⁴ need not come to pass if the text of Section 10(b) and Rule 10b-5 support a broader insider trading theory that encompasses other instances

379. *United States v. O’Hagan*, 521 U.S. 642, 659 (1997).

380. *See SEC v. Dorozhko*, 574 F.3d 42, 51 (2d Cir. 2009). The court in *Dorozhko* was of the view that no breach of duty was necessary because “misrepresenting one’s identity in order to gain access to information that is otherwise off limits, and then stealing that information is plainly ‘deceptive.’” *Id.* But the court raised a question as to whether exploiting a weakness in an electronic code to gain unauthorized access would involve active deception or “mere[ly] theft.” *Id.*; *see also* Noeleen Walder et al., *Hackers stole secrets for up to \$100 million insider-trading profit: U.S.*, REUTERS (Aug. 12, 2015, 5:05 AM), <http://www.reuters.com/article/us-cybercybersecurity-hacking-stocks-arr-idUSKCN0QG1EY20150812>; Andrew N. Vollmer, *Computer Hacking and Securities Fraud*, 47 SEC. REG. & L. REP. 1985 (Oct. 19, 2015) (contending that the ring of traders “engaged in no deceit at all” and that the actions by the hacker-tippers “were steps away from a deception coinciding with a securities trade”).

381. *O’Hagan*, 521 U.S. at 655–56.

382. *See* Nagy, *Fiduciary Principles*, *supra* note 47, at 1336 (contending that the Court in *O’Hagan* would have served its “policy goals far better had it not endorsed a theory predicated entirely on a fiduciary relationship between the source and the trader”); Nagy, *Reframing Misappropriation*, *supra* note 47, at 1274 (contending that *O’Hagan’s* fraud-on-the-source version of the misappropriation theory is “under-inclusive in that it fails to prohibit a whole variety of securities transactions based on misappropriated information that, under the majority’s rationale, would be as unfair to investors and as harmful to securities markets as the particular trading accomplished by *O’Hagan*”).

383. *O’Hagan*, 521 U.S. at 655 n.6.

384. *Id.* at 661 n.9.

of securities trading on wrongfully obtained information that fall outside of the Court's "deception by a fiduciary" paradigm.

In his dissenting opinion in *Chiarella v. United States*,³⁸⁵ Chief Justice Burger articulated a workable "fraud on contemporaneous traders" theory of insider trading liability that would extend Rule 10b-5 to a litany of instances involving tips and trades that currently fit into neither the classical nor the misappropriation theory. The Chief Justice's theory, which was rooted in the Government's brief,³⁸⁶ focused the Rule 10b-5 analysis on the propriety of a trader's silence about material nonpublic information in a securities transaction. Although he agreed with the majority that generally "neither party to an arm's-length business transaction has an obligation to disclose information to the other unless the parties stand in some confidential or fiduciary relation,"³⁸⁷ the Chief Justice believed that the policies that underlie that general rule "should limit its scope" and that the common law rule of caveat emptor should in particular "give way when an informational advantage is obtained, not by superior experience, foresight, or industry, but by some unlawful means."³⁸⁸

Accordingly, the Chief Justice would have read "§ 10(b) and Rule 10b-5 to encompass and build from this principle: a person who has misappropriated nonpublic information has an absolute duty to disclose that information or to refrain from trading."³⁸⁹ The key support from the common law was the precedent in the British case of *Phillips v. Homfray*,³⁹⁰ involving a real estate transaction in which the buyer obtained an informational advantage through an illegal trespass on the seller's property. The *Homfray* court refused to order specific performance of the contract, reasoning that the trespassing buyer's non-disclosure of material information pertaining to valuable mineral deposits amounted to a misrepresentation. In other words, the general rule of caveat emptor/vendor "gave way" when the informationally advantaged party employed an illegitimate "mode of acquiring knowledge."³⁹¹

Although Chief Justice Burger did not explicitly describe his theory as such, because he had postulated a disclosure duty that ran to the shareholders on the opposite side of the securities transaction, the Rule 10b-5 violation that he contemplated would have resulted in a "fraud on contemporaneous traders."³⁹² Corporate insiders or other persons who

385. *Chiarella v. United States*, 445 U.S. 222, 240 (1980) (Burger, C.J., dissenting).

386. See Brief of Respondent United States at 39-43, *Chiarella v. United States*, 445 U.S. 222 (1979) (No. 78-1202), 1979 WL 199454.

387. *Chiarella*, 445 U.S. at 239-40 (Burger, C.J., dissenting).

388. *Id.* at 240 (quoting Page W. Keeton, *Fraud—Concealment and Non-Disclosure*, 15 TEX. L. REV. 1, 25-26 (1936)) (observing that "[a]ny time information is acquired by an illegal act it would seem that there should be a duty to disclose that information.").

389. *Id.*; see Donald C. Langevoort, *Words from on High about Rule 10b-5: Chiarella's History*, Central Bank's Future, 20 DEL. J. CORP. L. 865, 883-84 (1995) (favorably critiquing Chief Justice Burger's dissent in *Chiarella* and advocating judicial recognition of a misappropriation theory premised on the fraud that is perpetrated on other marketplace traders).

390. *Phillips v. Homfray* (1871), 6 Ch. App. 770 (Eng.) (discussed in Brief of Respondent United States, *supra* note 387, at 41).

391. *Homfray*, 6 Ch. App at 780; see also *Mallon Oil Co. v. Bowen/Edwards Assoc.*, 965 P.2d 105, 112 (Colo. 1998) (recognizing an exception to the rule of nondisclosure "when the buyer acquires [information about oil and gas reserves] . . . through improper means, such as trespass" (citing RESTATEMENT (SECOND) OF CONTRACTS § 161 illus. 11 (Am. Law Inst. 1981))).

392. *Chiarella v. United States*, 445 U.S. 222, 240-45 (1980) (Burger, C.J., dissenting). Along with the Chief Justice, Justices Brennan, Blackmun and Marshall supported the recognition of an exception to the general

communicate misappropriated or otherwise wrongfully obtained information to facilitate securities trading would likewise be violating Rule 10b-5 as a co-participant in the trader's fraud. The notion that contemporaneous traders are wronged by persons trading on misappropriated information is also what prompted Congress to provide the express private right of action in Section 20A of the Exchange Act.³⁹³

Support for the consolidation of the classical and misappropriation approaches into a unified and expanded theory can also be drawn from *O'Hagan* itself, as well as from the Court's more recent decision in *Chadbourne & Parke LLP v. Troice*.³⁹⁴ As Justice Ginsburg underscored in *O'Hagan*, the federal insider trading prohibition arising under Section 10(b) and Rule 10b-5 is directed at conduct that "undermines the integrity of, and investor confidence in, the securities markets."³⁹⁵ And while under the Court's view it was a breach of loyalty that triggered that particular defendant's Rule 10b-5 disclosure obligation to the source of the information, Justice Ginsburg also emphasized that *O'Hagan's* fraud on the source "simultaneously harm[ed] members of the investing public."³⁹⁶ In *Troice*, Justice Breyer not only reiterated *O'Hagan's* view that an insider trader's "victims [are] 'members of the investing public' harmed by the defendant's gaining of an 'advantageous market position' through insider trading."³⁹⁷ But he also went further to categorize *O'Hagan* as a decision involving deception "that was 'material' to another individual's decision to 'purchase or sell' a statutorily defined 'security'" and in which "the relevant statements or omissions were material to a transaction in the relevant securities by or on behalf of someone other than the fraudster."³⁹⁸ Justice Breyer's placement of *O'Hagan* within this line of "in connection with" cases may have foreshadowed a recognition on the part of the Court that investors trading opposite to a misappropriator are not only "harmed" and "victimized" but also deceived and defrauded in violation of Rule 10b-5.

My purpose in restating this "fraud on contemporaneous traders" theory is not to once again set out the research and arguments that I have discussed extensively elsewhere;³⁹⁹ it

principle of caveat emptor. See *id.* 238–39 (Brennan, J., concurring in the judgment) (endorsing a broad misappropriation theory, but agreeing with the majority that misappropriation instructions had not been presented to the jury); *id.* at 245–46 (Blackmun, J. joined by Marshall, J., dissenting) (endorsing a more expansive parity of information approach, but observing that Chiarella's trading on misappropriated confidential information "is the most dramatic evidence that [he] was guilty of fraud").

393. See *supra* text accompanying notes 246–250 (discussing ITSFEA).

394. *Chadbourne & Parke LLP v. Troice*, 134 S. Ct. 1058 (2014).

395. *United States v. O'Hagan*, 521 U.S. 641, 658 (1997).

396. *Id.* at 656.

397. *Chadbourne & Park LLP v Troice*, 134 S. Ct. 1058, 1067 (2014) (quoting *O'Hagan*, 521 U.S. at 656). At issue in *Troice* was whether state law claims brought by the plaintiffs in state court were preempted by a provision in the Securities Litigation Uniform Standards Act, which limited the provision to cases in which plaintiffs allege a "misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security." *Id.* at 1064 (quoting 15 U.S.C. § 78bb(f)(1)). The Court looked to Rule 10b-5's "in connection with" requirement to assist its task of interpreting the identical language in SLUSA. *Id.* at 1066.

398. *Id.* at 1069 (internal citations omitted) (emphasis added). But see *id.* at 1077 (Kennedy, J., dissenting) (quoting *O'Hagan* and questioning the view that the securities fraud at issue in *O'Hagan* related to an investment decision, and highlighting *O'Hagan's* holding that the attorney-defendant's securities transactions deceived and defrauded his law firm and their client, notwithstanding that neither had the status of an "identifiable purchaser or seller" of securities).

399. See Nagy, *Reframing Misappropriation*, *supra* note 47, at 1287–1310; Nagy, *Fiduciary Principles*, *supra* note 47, at 1373–78.

is rather to underscore the advantages of a path that would consolidate the classical and misappropriation approaches into a unified and expanded insider trading theory. This “fraud on contemporaneous traders” theory would turn on whether a securities trader, with scienter, used wrongfully obtained information in a securities transaction. A reconceptualization such as this would be warranted now—even if it were not in *O’Hagan*—because in the 19 years since that decision, the complementary liability theories for classical insiders and misappropriating outsiders have resulted in an insider trading jurisprudence that is unnecessarily complex.⁴⁰⁰ Thus, a choice by the *Salman* Court to narrowly address the central issue of gratuitous tipping or to follow a path that merely clarifies joint tipper-tippee liability would be a lost opportunity.

A unified and expanded theory of insider trading that incorporates *Chiarella*, *Dirks*, and *O’Hagan*’s fiduciary principles—but would not be cabined by them—would have much to commend it. Lower courts would no longer feel obliged to stretch fiduciary principles beyond recognition, as courts have done in dozens of cases that fall outside of fiduciary parameters but nonetheless involved securities trading on wrongfully obtained information.⁴⁰¹ A “fraud on contemporaneous traders” theory would, for example, be a better fit for securities trading by information thieves (such as computer hackers) who are strangers to the source of the stolen information⁴⁰² as well as to brazen fiduciaries (and their tippees) who trade with disclosure, but not with permission from the source.⁴⁰³ In addition, the theory would extend to securities traders who knowingly or recklessly trade securities on the basis of material nonpublic information that has been selectively disclosed by corporate insiders in violation of Regulation FD, even if some of the issuer’s executives had condoned those disclosures.⁴⁰⁴ However, because a “fraud on contemporaneous traders” theory is triggered only by wrongful conduct that results in informational asymmetries, securities traders would still be able to capitalize on informational advantages obtained through legitimate searches for information and diligent research.

If the *Salman* Court were to embark down this path, its starting place, of course, would be with Section 10(b) and Rule 10b-5’s text. That is, the Court would explain why *Salman*’s conduct constituted deception in connection with the purchase or sale of securities: *Salman* defrauded the investors with whom he was trading when he remained silent about material nonpublic information that he knew or was reckless in not knowing had been misappropriated from an investment bank and its clients by his brother-in-law, *Maher*.⁴⁰⁵ And *Maher*’s guilty plea for securities fraud was clearly warranted because, as the original tipper who improperly disclosed his employer’s and its client’s confidential information,⁴⁰⁶ *Maher* was a co-participant in *Salman*’s fraud on contemporaneous traders. In addition, the

400. See *supra* note 54 and accompanying text (quoting observations by Professors Henning and Hazen).

401. See Nagy, *Fiduciary Principles*, *supra* note 47, at 1361–62 (charting the gradual demise of fiduciary principles in insider trading decisions by lower federal courts, settled enforcement proceedings, and rules adopted by the SEC).

402. See *SEC v. Dorozhko*, 574 F.3d 42, 51 (2d Cir. 2009) (remanding case to determine whether computer hacking involved active deception).

403. See *SEC v. Rocklage*, 470 F.3d 1, 7 (1st Cir. 2006) (observing that a corporate executive’s wife’s disclosure that she intended to give her brother a “gift of information” negated a finding that her tipping was deceitful; but holding that the SEC stated a claim because the wife deceived her husband in her acquisition of that information).

404. See *supra* note 372 (quoting Professor Guttentag).

405. See *United States v. Salman*, 792 F.3d 1087, 1089 (9th Cir. 2015).

406. *Id.*

Salman Court could explain that in framing the deception at issue as a “fraud on contemporaneous traders,” the theory prohibits precisely the type of fraudulent conduct vis-a-vis investors that Congress intended Section 10(b) to reach.⁴⁰⁷ The Court could likewise relate this unified and expanded theory of insider trading to its recent decision in *Troice*, and specifically to its recognition that a fraud occurs “in connection with” a securities transaction only if that fraud is “‘material’ to another individual’s decision to ‘purchase or s[ell]’ a statutorily defined ‘security.’”⁴⁰⁸

To assist lower courts in applying a Rule 10b-5 insider trading prohibition based on a fraud on contemporaneous traders, the *Salman* Court could also provide “guiding principles.” The Court’s greatest challenge would be in defining the scope of the wrongful conduct that would trigger the disclosure duty in a securities transaction. But the Court could seize upon general categories of wrongful conduct such as illegal acts (e.g., theft and bribery), tortious acts (e.g., deceit, conversion, trespass, or invasions of privacy), fiduciary breaches of loyalty, and breaches of confidentiality agreements.⁴⁰⁹ Ultimately, however, the “fraud on contemporaneous traders” path would continue to develop through DOJ and SEC enforcement actions and in decisions by lower federal courts, but the greater uniformity and legitimacy from a unified and expanded theory would facilitate that development considerably.

VIII. CONCLUSION

The Supreme Court did not have insider trading especially in mind when it famously observed that a “peculiar blend of legislative, administrative, and judicial history . . . surrounds Rule 10b-5.”⁴¹⁰ Nevertheless, that observation fits the development of insider trading jurisprudence to a T. The federal insider trading and tipping prohibitions that arise under Section 10(b) and Rule 10b-5 reflect a unique collaboration dating back to the SEC’s 1961 administrative order in *Cady, Roberts*, and continuing to the present with the Supreme Court’s imminent decision in *Salman v. United States*.

As this Article recounts, the federal prohibitions of insider trading and tipping extended their farthest with the parity of information approach developed in *Cady, Roberts* and *Texas Gulf Sulphur*. But in the early 1980s, *Chiarella* and *Dirks* refused to recognize such a broad-based duty to forgo trading on material nonpublic information and narrowly premised the necessary disclosure obligation on a fiduciary relationship between the parties to the securities transaction. Then, in 1997, *O’Hagan* substantially expanded the insider trading prohibition to include undisclosed misappropriations of material nonpublic information by securities traders who owe duties of loyalty to an information’s source. And in 2000, the SEC’s concerns with informational asymmetries carried the day once again through Regulation FD’s ban on selective disclosure, which unmoors certain types of tipping from the construct of fraud by imposing regulatory constraints on publicly traded securities issuers and their officials. Keenly aware of its own essential role in the collaboration, Congress passed insider trading legislation on two occasions soon after

407. See Nagy, *Fiduciary Principles*, *supra* note 47, at 1361; Nagy, *Reframing Misappropriation*, *supra* note 47, at 1301–03.

408. *Chadbourne & Park LLP v. Troice*, 134 S. Ct. 1058, 1069 (2014); see also *supra* text accompanying note 398.

409. Nagy, *Fiduciary Principles*, *supra* note 47, at 1377–78.

410. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 749 (1975).

Dirks, and again more recently, with the STOCK Act. At each legislative juncture, Congress's support for insider trading and tipping prohibitions arising under Section 10(b) and Rule 10b-5 has been constant and unequivocal.

The Court's decision in *Salman* constitutes the next chapter in this peculiar blend of history. Looking beyond *Dirks* in tipper-tippee insider trading cases appropriately credits the profound changes effectuated by all three branches of the federal government and recognizes important changes in state law that bear on federal disclosure duties under Rule 10b-5. These post-*Dirks* developments have paved the way for a clearer doctrine of joint tipper-tippee liability that turns on whether a tipper has breached a duty of loyalty to the source of material nonpublic information, whether or not the tipper conveyed the information for personal gain.

But the *Salman* case presents an opportunity for the Court to re-conceptualize insider trading jurisprudence more generally—to render it more coherent and legitimate as well as better aligned with Congress's and the SEC's policy goals of promoting market integrity and investor confidence. The Court should clarify the law and better serve these objectives by consolidating its prior classical and misappropriation approaches into a new “fraud on contemporaneous traders” theory. Under this unified and expanded framework, a Rule 10b-5 violation would occur when a person knowingly or recklessly uses wrongfully obtained material nonpublic information in connection with a securities transaction, or wrongfully communicates such information, regardless of whether the trader or tipper violated a fiduciary duty that was owed to the shareholders of the issuer or the source of the information.