 PRIVILEGING PROFESSIONAL INSIDER TRADING

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I. INTRODUCTION

When the Second Circuit Court of Appeals dismissed insider trading charges against two hedge fund managers in United States v. Newman, it shocked the securities enforcement community. Commentators perceived Newman as a new limitation on the reach of insider trading law, and expect its consequences to include a reduction in prosecutions. While this may be true, the debate has so far neglected the likely character of future enforcement actions because commentators and courts have failed to engage the true innovation in recent insider trading cases: that they have expanded the set of relationships subject to governmental regulation, and shifted focus from the professional to the personal. Beyond fiduciary obligations, beyond employers and employees, beyond principals and agents, modern insider trading enforcement is premised on the idea that personal relationships, such as friendship, can give rise to legally-enforceable duties of loyalty and confidentiality. This represents an immense expansion of the government’s regulatory power, effectively basing civil and criminal liability on “corruption” in purely personal relationships.

After Newman—which imposes limits on liability in the context of professional dealings—personal relationships are likely to be an increasing focus of insider trading enforcement. This is particularly true given the Supreme Court’s decision in Salman v. United States: in its most recent insider trading case, the Court affirmed liability for those who make a gift of confidential information to a trading relative or friend, but did not address

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1 773 F.3d 438, 455 (2d Cir. 2014), cert. denied, 136 S. Ct. 242 (2015) (vacating convictions of two defendants and holding that defendant-tippees must know that the tipper shared confidential information in exchange for some personal benefit).

Newman’s restrictions on liability in the context of professional relationships, or otherwise further clarify the law.3

This Article explores insider trading law’s focus on personal relationships and how the law has come to privilege professional insider trading—a problem that has so far escaped serious critique. To start, this Article explains how the Supreme Court’s decisions have constructed insider trading prohibitions as a means of protecting ownership interests in information. The law does this by enforcing duties of confidentiality and loyalty that employees and other fiduciaries owe to corporate owners of information, with the so-called classical and misappropriation theories as two means of accomplishing this aim. In this way, and contrary to popular perception, today’s insider trading law is not oriented around regulating market transactions; it instead regulates the flow and use of confidential information among parties.

In an effort to expand insider trading prohibitions and their own enforcement power, the Securities and Exchange Commission (SEC) and Department of Justice (DOJ) have taken this regulation in novel directions. Through its promulgation of Rule 10b5-2, the SEC purported to extend legal duties of confidentiality and loyalty under the misappropriation theory to purely personal relationships, such as friendships. This Article discusses how this expansion contravened court decisions that had developed the misappropriation theory, and precipitated increased governmental scrutiny of, and intrusion into, an array of personal relationships not previously regulated by the law.

This Article also shows why there is little reason to think that this increasing focus on personal relationships advances overall market fairness. Through cases such as Newman, the law has largely immunized trading by market professionals on insider tips received in the context of business relationships, leaving insider trading enforcement to focus primarily on personal relationships. The current legal framework thus advantages professional investors over others in the securities market, even in terms of their ability to trade based on insider tips. The result is a deeply

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3 See Salman v. United States, 137 S. Ct. 420, 427–28 (2017) (holding a tipper is liable for insider trading where he makes a gift of confidential information to a trading relative or friend, even if the tipper does not receive any further benefit).
irrational body of law that does not accomplish its proffered policy goals, including greater market fairness and integrity.

II. THE LAW OF INSIDER TRADING

There is no statute specifically defining and proscribing insider trading. Insider trading prosecutions are brought under Section 10(b) of the Exchange Act of 1934, which makes it unlawful for any person, either directly or indirectly:

To use or employ, in connection with the purchase or sale of any security... any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors.4

Pursuant to this statute, the SEC initially promulgated Rule 10b-5, prohibiting the direct or indirect use of any fraudulent scheme or statement in connection with the purchase or sale of any security.5 Regulators have employed this rule expansively to prohibit and punish various forms of fraud in connection with the securities markets.

But insider trading generally does not involve “fraud,” that is, a material misrepresentation. Instead, a person in possession of material nonpublic information trades securities without disclosing that information to his trading counterpart.

Market participants have no general obligation to reveal material information to one another before trading.6 Securities markets depend on informational inequality: there is a market for the exchange of securities precisely because different investors have different information, and therefore value the securities differently.7 In addition, investors must have some ability to profit

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5 17 C.F.R. § 240.10b-5 (2010).
7 See Jill E. Fisch, Start Making Sense: An Analysis and Proposal for Insider Trading Regulation, 26 Ga. L. Rev. 179, 221–22 (1991) (“[P]articipants in the market do not possess equivalent information. For example, the average analyst or other market professional has a great deal more information about the stocks he trades than the average small investor.”).
from information so that they are incentivized to seek it, which ultimately works to the benefit of the market as a whole.\(^8\) Some inequalities in information among market participants are thus both necessary and beneficial. The question is when inequalities of information are improper, illegitimate, or sufficiently counterproductive to the efficient operation of markets that they should be addressed by the government. The SEC and the courts have yet to find a satisfying answer to this question. But the lack of a coherent regulatory theory—or a more specific legislative directive aimed at insider trading—has not stopped the executive from promulgating rules and bringing cases.\(^9\)

A. THE CLASSICAL THEORY

The gravamen of any Section 10(b) violation is fraud, and today’s insider trading prohibitions depend on the theory that a fiduciary or agent who owes duties of loyalty and confidentiality perpetrates a fraud on his principal when he converts nonpublic information entrusted to him by the principal for his own benefit.\(^10\)

This started rationally enough in the context of insider trading law. Corporate insiders, such as directors and officers, owe a

\(^8\) See, e.g., Dirks v. SEC, 463 U.S. 646, 658 (1983) (explaining that the important function of investigating and analyzing market information would be inhibited if traders were required to disclose all nonpublic information gathered before making their own trades); Roberta S. Karmel, Outsider Trading on Confidential Information—A Breach in Search of a Duty, 20 CARDOZO L. REV. 83, 89 (1998) (recognizing that the parity of information theory was rejected because it became “apparent that security analysts and other market professionals whose job it was to ferret out information about securities should be given the opportunity to trade on such information because permitting such trading would provide an incentive for better disclosure about, and more efficient pricing of, securities”); Frank H. Easterbrook, Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information, 1981 SUP. CT. REV. 309, 323 (“[S]ometimes nondisclosure is necessary to enable people to capture the value of information; to permit use without disclosure is to encourage the creation of new information.”).

\(^9\) “Often, the prosecution of traders on inside information by the SEC has been pursued as an end in itself to rid Wall Street of such flamboyant and controversial personalities as Ray Dirks and Michael Milken.” Karmel, supra note 8, at 84.

\(^10\) For clear statements of the specific legal elements of criminal and civil insider trading, see United States v. Neuman, 773 F.3d 438, 445–47, 450 (2d Cir. 2014); United States v. Jiau, 734 F.3d 147, 152–53 (2d Cir. 2013); SEC v. Bauer, 723 F.3d 758, 768–69, 772, 775 (7th Cir. 2013); United States v. Smith, 155 F.3d 1051, 1063 (9th Cir. 1998); see also Stephen M. Bainbridge, Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition, 52 WASH. & LEE L. REV. 1189, 1190 (1995) (“Someone violates the federal insider trading prohibition only if his trading activity breached a fiduciary duty owed either to the investor with whom he trades or to the source of the information.”).
Fiduciary duty to their shareholders. This fiduciary relationship creates an obligation to disclose information impacting the stock price before entering a transaction with current or future shareholders, which the directors or officers would be violating if they traded the company’s stock based on material nonpublic information. Actual corporate insiders are engaging in transactions with individuals to whom they owe a direct fiduciary duty when they trade their company’s stock. Therefore, they need not make an affirmative misrepresentation to commit fraud: their fiduciary obligation to these shareholders gives rise to a duty to disclose information impacting the stock price before trading with them. Silence, coupled with a special duty, constitutes fraud. This “classical” theory of insider trading liability was endorsed by the Supreme Court in \textit{Chiarella v. United States}.\footnote{See \textit{Chiarella}, 445 U.S. at 230 (“[C]orporate insiders . . . have an obligation to place the shareholder’s welfare before their own . . . .”); \textit{see also In re Cady, Roberts & Co.}, 40 SEC 907 (1961) (“An affirmative duty to disclose material information has been traditionally imposed on corporate ‘insiders,’ particularly officers, directors, or controlling stockholders. We, and the courts have consistently held that insiders must disclose material facts which are known to them by virtue of their position but which are not known to persons with whom they deal and which, if known, would affect their investment judgment.”).}

\footnote{See \textit{Chiarella}, 445 U.S. at 228 (explaining a corporate insider’s duty to disclose information prior to the consummation of a transaction).}

\footnote{Id. (noting that corporate insiders have a special relationship of trust and confidence with shareholders when trading the corporation’s stock).}

\footnote{Id. (“[O]ne who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so.”).}

\footnote{Id. at 230. I say this began “rationally enough” because at the time the Supreme Court adopted this theory of insider trading, it was not clear that directors owed fiduciary duties to individual shareholders, as opposed to the corporation itself. The majority common law rule was that the fiduciary duty was owed to the corporation. \textit{See Barbara Bader Aldave, Misappropriation: A General Theory of Liability for Trading on Nonpublic Information}, 13 Hofstra L. Rev. 101, 104 (1984); \textit{cf. Douglas G. Baird & M. Todd Henderson, Other People’s Money}, 60 Stan. L. Rev. 1309, 1309 (2008) (characterizing “the oft-repeated maxim that directors of a corporation owe a fiduciary duty to the shareholders” as one “example of an almost-right principle that has distorted much of the thinking about corporate law”). Nor was it clear that all employees owed such duties. \textit{See Karmel, supra note 8, at 87 (noting that it was “directors [who] were deemed to owe fiduciary duties to their corporations”). Nor was the source or extent of any fiduciary duty clear; courts have not even been consistent as to whether state law determines the scope of fiduciary duties in the context of federal securities law. \textit{See Bainbridge, supra note 10, at 1197–1212 (discussing how courts have never precisely defined the fiduciary duties owed in the context of insider trading jurisprudence or clarified whether those duties derive from state or federal law). There was also the problem that prospective purchasers of shares were not yet in any sort of special relationship with a corporate insider selling shares. These were all issues that the Supreme Court glossed over in articulating this theory.}}
In retrospect, the most significant contribution of Chiarella is to say what insider trading law is not: the law is not about guaranteeing parity of information among market participants, or even equal access to information. The Supreme Court declined to endorse a blanket prohibition on trading while in possession of material nonpublic information. Unfortunately, the Court also did not explain what the proper focus of insider trading law should be, or articulate an animating principle for the law.

Nonetheless, Chiarella had its virtues. Chiarella preserved a link to the text of Section 10(b) by seeking a fraud or deception directly “in connection with” the purchase or sale of a security, as opposed to at some earlier point in time: the fiduciary had an obligation to disclose the information to his counterpart when making the trade, and the counterpart was deceived as to the correct price as a result of the fiduciary’s failure to disclose information. The rule looked to the relationship between the

While liability for corporate insiders who personally trade is one of the least controversial aspects of insider trading law, it falls short of universal acceptance. As a legal matter, the theory has the many difficulties mentioned above. Further, commentators have long maintained that insider trading should not be prohibited for a variety of reasons. See, e.g., Henry G. Manne, Insider Trading and the Stock Market (1966); Easterbrook, supra note 8, at 318–32 (noting that insider trading is not obviously “fraudulent,” that it has no clear victim, that its prohibition is difficult to support based on concepts of fairness, and that there is some argument it should be allowed so long as the firm that created certain information “desires (or tolerates) such trading”); Dennis W. Carlton & Daniel R. Fischel, The Regulation of Insider Trading, 35 STAN. L. REV. 857, 861 (1983) (arguing that permitting the practice of insider trading “may be an efficient way to compensate corporate managers”).

See Chiarella, 445 U.S. at 233 (“[N]either the Congress nor the Commission ever has adopted a parity-of-information rule.”); id. at 229 (“A purchaser of stock who has no duty to a prospective seller because he is neither an insider nor a fiduciary has been held to have no obligation to reveal material facts.”); id. at 232 (rejecting the lower court’s finding that the securities laws “created a system providing equal access to information necessary for reasoned and intelligent investment decisions”); see also Dirks v. SEC, 463 U.S. 646, 657 (1983) (Chiarella “repudiat[es] any notion that all traders must enjoy equal information before trading”).

See Chiarella, 445 U.S. at 229 (“A purchaser of stock who has no duty to a prospective seller because he is neither an insider nor a fiduciary has been held to have no obligation to reveal material facts.”). The Supreme Court did not reach the question of whether one could be penalized for converting to his own benefit information that had been entrusted to him by the corporate owner of information (the misappropriation theory of liability); the jury had not been instructed on this theory of liability. Id. at 236.

Id. at 228 (“One who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so. And the duty to disclose arises when one party has information ‘that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.’ ” (quoting Restatement (Second) of Torts § 551(2)(1) (AM. LAW. INST. 1976))); id. at 232
person who trades on information and his trading counterpart, as opposed to some other relationship, and examined whether there was actionable fraud or deception in this particular transaction. 19

It provided a relatively workable standard.

In subsequent cases, however, the Supreme Court struggled with the boundaries of this relatively limited insider trading prohibition. One open question was how the law should address insiders who shared nonpublic information by tipping others, but did not trade themselves. Another question was how to deal with individuals who were not corporate insiders, but who somehow acquired and then traded on nonpublic information.

The first question could have been easy. In cases where a corporate insider did not trade, but instead disclosed information to someone else who traded, courts could have determined liability based on conspiracy law. If the insider tipper and tippee agreed, either explicitly or implicitly, to trade securities based on the insider’s material nonpublic information, they would both be guilty of the crime of conspiracy to commit insider trading, regardless of which conspirator committed which specific act. 20

19 Id. at 230 (“[L]iability is premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction.”).

20 This would be akin to conspiracy charges of honest services fraud, in violation of 18 U.S.C. §§ 1343 and 1346: individuals can be prosecuted for conspiracy to commit the offense even if only one conspirator owes the requisite duty of honest services, so long as both agree to a scheme to violate that duty. See 18 U.S.C. §§ 1343, 1346 (2012) (defining and proscribing honest services fraud); id. § 1349 (providing for conspiracy liability for honest services fraud); United States v. Renzi, 769 F.3d 731, 736, 759 (9th Cir. 2014) (affirming the conviction of both public official and businessman for conspiracy to commit honest services wire fraud); United States v. McDonough, 727 F.3d 143, 147, 166 (1st Cir. 2013) (upholding convictions of state senator and lobbyist for conspiracy to commit honest services wire fraud); see also Ocasio v. United States, 136 S. Ct. 1423, 1429–30 (2016) (“Although conspirators must ‘pursue the same criminal objective,’ ‘a conspirator [need] not agree to commit or facilitate each and every part of the substantive offense.’ . . . A defendant must merely reach an agreement with the ‘specific intent that the underlying crime be committed’ by some member of the conspiracy. . . . [A]lso a conspirator may be convicted ‘even though he was incapable of committing the substantive offense’ himself.” (internal citations omitted)); id. at 1432 (“In other words, each conspirator must have specifically intended that some conspirator commit each element of the substantive offense.”).

A conspiracy framework for determining tipper and tippee insider trading liability would look to the knowledge and intent of each party in basically the same manner as insider trading law today. In addition, because conspiracies are often furtive, it would look to indirect evidence of the conspiratorial agreement including, for example, the relationship between the parties and any benefits conferred on the tipper by the person who trades.
Instead of this approach, however, in *Dirks v. SEC* the Supreme Court converted what might have been evidence of a conspiratorial agreement—the relationship between the tipper and tippee, and any benefit conferred on the tipper—into elements of a new insider trading offense.21

*Dirks v. SEC* is an example of how bad facts make bad law, though not always in the way one might predict. Ronald Secrist, a former officer of Equity Funding of America, decided to turn whistleblower and informed investment analyst Raymond Dirks that Equity Funding was overstating its assets through fraud.22 Secrist urged Dirks to investigate the matter and disclose it publicly.23 Dirks investigated; shared the allegations of fraud with a *Wall Street Journal* reporter; and informed some of his investor clients, who sold Equity Funding stock.24 The SEC censured Dirks for abetting insider trading.25 The Supreme Court overturned this finding of liability.26

The Supreme Court’s decision in *Dirks* mostly aligns with *Chiarella* and its rationale. In *Dirks*, the Court emphasized that liability must flow from some fraud based on a fiduciary relationship between the person who trades a corporation’s stock and that corporation’s shareholders.27 The Court affirmed that not every person who knowingly acquires material nonpublic information and trades will be in this sort of relationship, meaning that there is no general prohibition on trading on such information.28 The Court also saw that not every disclosure of confidential information by an insider will be an actionable violation of his fiduciary duty.29 But, the Court found that insiders

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21 See *Dirks v. SEC*, 463 U.S. 646, 663–64 (explaining that tipper and tippee are liable for insider trading when the tipper personally benefits from the disclosure of information and that such personal benefit may be shown from a relationship that suggests a quid pro quo or “when an insider makes a gift of confidential information to a trading relative or friend”).

22 Id. at 649.

23 Id.

24 Id. at 649–50.

25 The SEC found Dirks liable in an administrative hearing but elected only to censure him, since he “played an important role” in bringing a “massive” fraud to light. *Id.* at 650–52.

26 Id. at 667.

27 Id. at 654–55 (reaffirming “there is no general duty to disclose before trading on material nonpublic information, . . . [s]uch a duty arises rather from the existence of a fiduciary relationship” (citing *Chiarella v. United States*, 445 U.S. 222, 227–35 (1980))).

28 Id. at 654, 658–59.

29 Id. at 661–62 (“All disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders.”).
who exploit information for personal gain in violation of their fiduciary duties (and those who knowingly participate in this exploitation with them) should be liable for an offense.  

Finally, the Court rejected liability for Dirks.  

The Court reached its decision by an unusual route, however. It created a novel legal fiction that one person can inherit another’s fiduciary duties by receiving improperly disclosed confidential information. This framework was more recently endorsed by the Court again in *Salman v. United States*, where the Court professed its continued adherence to *Dirks’s rationale*.  

According to the Supreme Court, a tippee assumes an insider-tipper’s fiduciary duty to shareholders when information has been made available to the tippee “improperly,” which means “when the insider has breached his fiduciary duty to the shareholders by disclosing the information” and “the tippee knows or should know that there has been a breach.” The Court stated that the propriety of an insider’s disclosure of information—the question of whether the tipper has breached his fiduciary duty—should be judged by whether the disclosure was personally beneficial to the tipper.  

This framework did several things to alter the course of insider trading law. First, it created an amorphous test for liability of insider tippers and their tippees that was an additional step removed from the statutory language: the question of whether there was a legally-cognizable fraud was replaced by the question of whether someone received a meaningful “personal benefit” from

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30 *Id.* at 659. It is this exploitation of information for some personal benefit that renders use of the information deceptive or manipulative towards shareholders, and therefore fraudulent. *See id.* at 663 (noting that a disclosure to a tippee deceives, manipulates, or defrauds shareholders if the insider receives a “direct or indirect personal benefit”).  

31 *Id.* at 667.  

32 *See id.* at 664 (explaining that a tippee can inherit the duty to disclose or abstain when the insider breaches a fiduciary duty); see also Aldave, *supra* note 15, at 109 (criticizing *Chiarella* and *Dirks*, stating “[p]recisely how a breach by the insider creates the requisite fiduciary duty on the part of the tippee is unclear”).  

33 *See Salman v. United States*, 137 S. Ct. 420, 423 (2016) (stating a “tippee acquires the tipper’s duty to disclose or abstain from trading if the tippee knows the information was disclosed in breach of the tipper’s duty”).  

34 *Dirks*, 463 U.S. at 660 (emphasis omitted).  

35 *Id.* at 662. The Court opined that there should be “objective criteria” to measure such benefit, “such as a pecuniary gain or a reputational benefit that will translate into future earnings,” and that such benefit also exists when “an insider makes a gift of confidential information to a trading relative or friend.” *Id.* at 663–64.
disclosing information. This test has created ongoing confusion for lower courts.36

Second, and more importantly, Dirks moved the locus of fraud or improper conduct away from the security transaction itself to the acquisition of the nonpublic information. Dirks was liable for insider trading if the person who gave him the information breached a fiduciary duty, regardless of Dirks’s or any subsequent trader’s relationship to the trading counterpart.37 This shift in the locus of the requisite fraud laid the groundwork for later expansions of insider trading liability.38

This shift also signaled what would become the guiding principle of insider trading law: namely, protecting a corporate owner’s right to control the use of its own nonpublic information. As in Chiarella, the Dirks Court rejected any notion that there

36 In Salman, a number of amici argued that the personal benefit test is improperly ambiguous and should be modified. See generally Brief for NYU Center on the Administration of Criminal Law as Amicus Curiae in Support of Neither Party, Salman v. United States, 137 S. Ct. 420 (2016) (No. 15-628) (arguing the Court should reject the personal benefit test and instead require the government to prove that the tipper disclosed information for reason other than to benefit the corporation or shareholders, and that the tipper knew his tippee would trade); Brief for Securities Industry and Financial Markets Association as Amicus Curiae in Support of Neither Party, Salman v. United States at 20, 137 S. Ct. 420 (2016) (No. 15-628) (opining that the current personal benefit test has “produced inconsistent results across cases” and advocating for the more limited standard endorsed by the Second Circuit); Brief for Cato Institute as Amicus Curiae in Support of Petitioner, Salman v. United States, 137 S. Ct. 420 (2016) (No. 15-628) (criticizing the personal benefit standards employed by the Ninth Circuit). Unfortunately, the Supreme Court did not meaningfully engage these critiques and declined to clarify the personal benefit test. See supra notes 32–35 and accompanying text.

37 See supra notes 32–35 and accompanying text.

38 This is the critical shift that precipitated adoption of the misappropriation theory and other expansions of insider trading liability, such as liability for trading after the theft or “hacking” of confidential information. See SEC v. Dorozhko, 574 F.3d 42, 49 (2d Cir. 2009) (holding that hacking information to use for trading is actionable as insider trading securities fraud); see also Sung Hui Kim, Insider Trading as Private Corruption, 61 UCLA L. Rev. 928, 998 (2014) (arguing that such hacking is not conventional insider trading). It also created an avenue to liability for remote tippees, who courts claim inherit the fiduciary obligations of the original insider, but who may have been exempted from liability under a conspiracy analysis. See Kathleen Coles, The Dilemma of the Remote Tippee, 41 Gonz. L. Rev. 181, 211–16 (2005–2006) (discussing the Dirks decision’s impact on the remote tippee and the extension of liability to individuals who have weak links to the co-venture).
must be equal access to information among all traders.\textsuperscript{39} But in describing \textit{Chiarella}, the \textit{Dirks} court recast the holding: \textit{Chiarella} was not about the fraud perpetrated on the insider’s trading counterpart, but about the “inherent unfairness” involved when an insider gains some personal advantage from “information intended to be available only for a corporate purpose”—in other words, when the insider misuses information entrusted to him by its corporate owner.\textsuperscript{40} In \textit{Chiarella}, the insider breaches his fiduciary duty by trading with someone to whom he owes a special duty of care; in \textit{Dirks}, the insider breaches his fiduciary duty by using corporate information for his personal benefit. The Court shifted the victim of the offense from the specific trading counterpart to the corporation and shareholders, collectively, whose proprietary information is being misused.

This focus of insider trading law on protecting a corporate owner’s right to control the use of its nonpublic information explains why the Court affirmed that insiders could continue to share nonpublic information with particular analysts, provided they were doing this for professional reasons, and not personal gain.\textsuperscript{41}

This also helps explain the outcome of the case. While a company generally has the right to direct the use of its own nonpublic information, this right would not extend to information regarding fraud perpetrated by the company. As the Solicitor General argued in his brief opposing liability for \textit{Dirks},

\begin{footnotesize}
\textsuperscript{39} See \textit{Dirks}, 463 U.S. at 656–57 (rejecting SEC argument that appears to require “equal information among all traders”).

\textsuperscript{40} Id. at 654 (quoting \textit{In re Merrill Lynch, Pierce, Fenner & Smith, Inc.}, 43 SEC 933, 936 (1968)); id. at 659 (“[I]nsiders [are] forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage.”). This shift is evidenced in Justice Powell’s recorded deliberations in crafting the opinion. It is clear that he was focused on the corporate insider’s disloyalty to the corporation itself, not to the particular corporate shareholders involved in the securities transaction. See Adam C. Pritchard, \textit{Dirks and the Genesis of Personal Benefit}, 68 SMU L. Rev. 857 (2015) (tracing the evolution in Justice Powell’s deliberations to a focus on the personal benefit to a tipper and the fiduciary duty to the shareholders).

\textsuperscript{41} See \textit{Dirks}, 463 U.S. at 662 (explaining that there may not be a breach of fiduciary duty “when insiders disclose information to analysts” because “the test is whether the insider personally will benefit” and “[a]bsent some personal gain, there has been no breach of duty”); see also \textit{SEC v. Payton}, 97 F. Supp. 3d 558, 561 (S.D.N.Y. 2015) (stating that the law allows an executive to “prim[e] the market” by making early disclosure of nonpublic information to certain analysts, provided the corporate owner of the information authorizes this disclosure).
\end{footnotesize}
information about an ongoing crime is not the private property of anyone and is not amenable to “conversion”; to the contrary, agents are not required to hold confidential such information and its secrecy is antithetical to the public interest.\footnote{See Brief for the United States as Amicus Curiae in Support of Reversal at 38, Dirks v. SEC, 463 U.S. 646 (1983) (No. 82-276) (opining the decision should be reversed because Dirks’s tipper acted lawfully in disclosing information of an “ongoing criminal scheme,” evidence of which is “not the private property of anyone”; asserting that finding liability “threatens to impair private initiative in uncovering violations of federal law”).} Although the Supreme Court disclaimed basing its decision on the nature of the information,\footnote{See Dirks, 463 U.S. at 665 n.25 (“We need not decide . . . whether information concerning corporate crime is properly characterized as ‘inside information.’ ”).} the Court was unlikely to find that Dirks or any insider had a duty to hold confidential information regarding corporate fraud.\footnote{See, e.g., Jonathan R. Macey, From Fairness to Contract: The New Direction of the Rules Against Insider Trading, 13 Hofstra L. Rev. 9, 33 (1984) (“Dirks provides an archetypal example of corporate information in which the corporation had no legitimate property right.”).}

B. THE MISAPPROPRIATION THEORY

The final important Supreme Court case addressing the bounds of insider trading liability dealt with the open question of how to treat those who were not corporate insiders, or the tippees of such insiders, but who nevertheless acquired and then traded on material nonpublic information.

A footnote in \textit{Dirks} addressed certain such groups. Some parties to whom corporate information was legitimately revealed for business purposes—underwriters, accountants, and lawyers—could become temporary corporate insiders, bound by the same trading rules as traditional insiders.\footnote{See Dirks, 463 U.S. at 655 n.14 (“The basis for recognizing this fiduciary duty is not simply that such persons acquired nonpublic corporate information, but rather that they have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes.”); see also United States v. O’Hagan, 521 U.S. 642, 652 (1997) (“The classical theory applies not only to officers, directors, and other permanent insiders of a corporation, but also to attorneys, accountants, consultants, and others who temporarily become fiduciaries of a corporation.”).} Like traditional insiders, these parties owed a fiduciary obligation directly to the corporation and its shareholders, which they would be violating if they used nonpublic information to trade the corporation’s stock. But what about others who acquired inside information?
In *United States v. O'Hagan*, the Supreme Court considered the legality of trading on material nonpublic information “misappropriated in breach of a fiduciary duty to the source of the information.”46 James O’Hagan was a lawyer representing Grand Metropolitan PLC (Grand Met) in connection with a potential tender offer for the stock of Pillsbury Company.47 O’Hagan purchased call options for Pillsbury stock before the tender offer was announced.48 He used his trading profits to conceal a previous embezzlement of unrelated client funds.49 While arguably a temporary insider of Grand Met (and a fiduciary, as that company’s lawyer), he had no direct fiduciary relationship to Pillsbury. He was plainly guilty of several crimes;50 the specific question was whether he was also guilty of insider trading in violation of Section 10(b).51

The Supreme Court said yes, for the first time explicitly endorsing the misappropriation theory. According to the Court,

> a fiduciary’s undisclosed, self-serving use of a principal’s information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information. In lieu of premising liability on a fiduciary relationship between company insider and purchaser or seller of the company’s stock, the misappropriation theory premises liability on a fiduciary-turned-trader’s deception of those who entrusted him with access to confidential information.52

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46 521 U.S. at 647. Ten years earlier, in *Carpenter v. United States*, the Supreme Court split 4–4 over an insider trading conviction based on the misappropriation theory, thus affirming the conviction. 484 U.S. 19, 23–24 (1987).

47 *O'Hagan*, 521 U.S. at 647.

48 Id.

49 Id. at 648.

50 In addition to insider trading, O’Hagan was convicted of mail fraud and money laundering. Id. at 648–49.

51 Id. at 647.

52 Id. at 652.
Following the path carved by Dirks, the Court’s focus shifted from fraud in the securities transaction to fraud in connection with the acquisition of information.53

One hurdle for the Court in adopting the misappropriation theory was an apparent conflict with its earlier statement in Santa Fe Industries, Inc. v. Green that not every breach of a fiduciary duty constituted a violation of Section 10(b), because not every breach was deceptive.54 In O’Hagan, the Court addressed this problem by stating that actionable breaches must involve both a violation of a fiduciary duty and deception, meaning that a person will not be liable if he “discloses to the source [of information] that he plans to trade on the nonpublic information.”55

The effect of this caveat is to reaffirm insider trading law’s focus on protecting an owner’s right to control the use of its nonpublic information. If the fiduciary or corporate owner of information says that a party can trade, then the party can trade—regardless of fairness to other market participants.56 The Supreme Court effectively adopted a business property rationale for prohibiting insider trading, which precludes disclosures or uses of information that “reduce [the information’s] value to the rightful owner,” and suggests “that insider trading should be permitted to the extent the firm that created the information desires (or tolerates) such trading.”57

As Justice Thomas recognized in his dissent, this limitation on liability undermines various policy considerations mentioned in

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53 Three justices dissented from this holding because they believed this shift to be improper. Considering the language of the statute and the rule of lenity, Justice Scalia opined that Section 10(b) “must be construed to require the manipulation or deception of a party to a securities transaction.” Id. at 679 (Scalia, J., concurring in part and dissenting in part). Justice Thomas, joined by Chief Justice Rehnquist, detailed how the majority departed from the statutory language requiring fraud “in connection with” a securities transaction. Id. at 680–81 (Thomas, J., concurring in part and dissenting in part).

54 See 430 U.S. 462, 474–76 (1977) (concluding that a breach of fiduciary duty, without any deception, representation, or nondisclosure, does not constitute a violation of Section 10(b) or Rule 10b-5); see also United States v. George, 477 F.2d 508, 512 (7th Cir. 1973) (“Not every breach of every fiduciary duty works a criminal fraud.”).

55 O’Hagan, 521 U.S. at 655; accord Salman, 137 S. Ct. at 423 (stating liability flows from “undisclosed” trading and that individuals face liability if they trade without making “appropriate disclosures ahead of time”).

56 See O’Hagan, 521 U.S. at 655 (“[F]ull disclosure forecloses liability under the misappropriation theory . . . 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. . . .”).

57 Easterbrook, supra note 8, at 331.
passing by the O'Hagan majority to justify adoption of the misappropriation theory, including fairness and the general public interest.\textsuperscript{58} The misappropriation theory does not prevent insider trading based on tips or informational advantages derived from position or relationships; it merely requires that such trading be disclosed to the trader's principal. In other words, the Supreme Court sanctioned "trading based on nonpublic information that the average investor has no hope of obtaining through his own diligence," so long as the principal who shared the information does not object.\textsuperscript{59}

\section*{C. EXPLAINING INSIDER TRADING PROHIBITIONS}

Two key themes emerge from these Supreme Court cases. The most obvious, said repeatedly by the Court, is that insider trading prohibitions are not intended to prevent all trading on material nonpublic information; they are not intended to guarantee parity of information for all market participants.\textsuperscript{60} They do not prevent selective disclosure of information to preferred investors or trading by those investors.

Instead, insider trading prohibitions are fundamentally about protecting an owner's right to direct the use of its nonpublic information, generally through the mechanisms of contract and agency law. Individuals entrusted with nonpublic information by

\textsuperscript{58} See O'Hagan, 521 U.S. at 655, 659 (stating that someone who trades on misappropriated information "harms members of the investing public" because he trades with others at an informational disadvantage stemming "from contrivance, not luck; it is a disadvantage that cannot be overcome with research or skill"); id. at 689 (Thomas, J., concurring in part and dissenting in part) (arguing that the majority's reliance on these policy considerations is "misleading in the context of the misappropriation theory"). The fact that a person can trade with his principal's permission equally undermines some academics' claims that market fairness and integrity were the animating principles of O'Hagan. See, e.g., Nagy, supra note 2, at 18 (explaining that the O'Hagan decision was grounded in the "important policy objectives" of ensuring "honest securities markets" and "investor confidence").

\textsuperscript{59} O'Hagan, 521 U.S. at 690 (Thomas, J., concurring in part and dissenting in part).

\textsuperscript{60} See Dirks v. SEC, 463 U.S. 646, 657 (1983) (explaining Chiarella's principle that "only some persons, under some circumstances, will be barred from trading while in possession of material nonpublic information" and confirming that Chiarella "repudiat[es] any notion that all traders must enjoy equal information in trading"); Chiarella v. United States, 445 U.S. 222, 233 (1980) ("[N]either the Congress nor the Commission ever has adopted a parity-of-information rule."); see also United States v. Newman, 773 F.3d 438, 449 (2d Cir. 2014) ("[N]othing in the law requires a symmetry of information in the nation's securities markets.").
some principal have an obligation to use that information as directed by the principal. Without explicitly so stating, the Supreme Court has adopted a version of the business property theory of insider trading prohibitions. In this way, current insider trading law is not about fairness or really even fraud—it is about conversion and theft.

Relatedly, although somewhat counterintuitively, today’s insider trading law is not focused on regulating market transactions. The law instead regulates the use and flow of information among individuals and companies, enforcing ownership interests in information and the promises of loyalty and confidentiality that parties make to one another. Framed from the perspective of criminal law, although trading is traditionally perceived as the actus reus of an insider trading offense, Dirks, O’Hagan, and Salman show that the criminal act is not the market transaction itself—it is the fraudulent breach of duty. In

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61 See, e.g., United States v. Chestman, 947 F.2d 551, 576–78 (2d Cir. 1991) (Winter, J., dissenting in part and concurring in part) (explaining the business property rationale for banning insider trading and how the misappropriation theory fits this rationale; noting further that “any obvious relationship to Section 10(b) is presently missing because theft rather than fraud or deceit, seems the gravamen of the prohibition”); Easterbrook, supra note 8, at 312 (opining that Chiarella was fundamentally about an agent who attempted to use information in a way not approved by his principal); Macey, supra note 44, at 11 (“The Court’s present 10b-5 analysis evinces a new understanding of the fact that privileged corporate information is a valuable asset in the nature of a property interest.”); id. at 29 (“By emphasizing the defendants’ fiduciary relationship to the owner of privileged information, the Supreme Court has begun to finally recognize that concerns about insider trading are really concerns about the proper use of valuable privately owned information.”); Bainbridge, supra note 10, at 1192 (explaining that insider trading liability is premised on violation of the “duty to refrain from self-dealing in confidential information owned by another party”); Stephen M. Bainbridge, Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud, 52 SMU L. REV. 1589, 1606–08 (1999) (discussing the “growing consensus that the federal insider trading prohibition is more easily justified as a means of protecting property rights in information” and explaining how O’Hagan is consistent with this rationale). The Supreme Court has long acknowledged that confidential information acquired or compiled by a corporation in the course of its business is a species of corporate property. See Carpenter v. United States, 484 U.S. 19, 26 (1987) (“Confidential business information has long been recognized as property.”).

In claiming the Court adopted this theory, I do not contend that the Court always faithfully applies property law to insider trading cases. It does not—just as it does not always faithfully apply other common law doctrines in its opinions. Instead, I mean that the animating principle of the Court’s decisions is protecting corporate owners’ right to direct the use of their nonpublic information.

62 See Macey, supra note 44, at 29 (“[T]he Supreme Court has begun to finally recognize that concerns about the insider trading are really concerns about the proper use of valuable privately owned information.”).
this way, these decisions render insider trading law under Section 10(b) closely analogous to other general federal fraud statutes. Court(s) have regularly referenced the federal wire fraud statute to interpret Section 10(b). See, e.g., SEC v. Clark, 915 F.2d 439, 448 (9th Cir. 1990) (“For guidance in determining whether the misappropriation theory sits within the concept of ‘fraud’ in § 10(b) and Rule 10b-5, we look to the mail and wire fraud statutes, which contain similar language.”).

63 Title 18, Sections 1341, 1343, and 1346 criminalize schemes to defraud another of money or property, including the intangible right to honest services. See, e.g., 18 U.S.C. §§ 1341, 1343 (2012).

64 The culpable act is the fraudulent scheme to deprive another of property or honest services, and the jurisdictional hook for federal criminalization of this act is the use of interstate mail or wires. Similarly, in today’s insider trading law, the culpable act is a fiduciary’s fraudulent scheme to deprive some principal of intangible property rights and honest services (by using the principal’s nonpublic information for personal gain, either by tipping or trading), while trading in securities is the jurisdictional hook for the federal criminalization of this act.

When we understand this, one immediate question is why should federal law engage in such widespread regulation of a fiduciary’s use of his principal’s information? And to the extent that this regulation may seem desirable, or at least justifiable, in the context of employer-employee and similar relationships (which have a commercial nexus and are already subject to legal oversight), how can it be justified in the context of purely personal relationships such as friendship (which have no commercial nexus and are not otherwise subject to legal obligations of loyalty and confidentiality)?

The next Section considers how insider trading law ventured into the realm of personal relationships. This too can be traced to Dirks, both in the Supreme Court’s focus on how information is acquired and in dictum suggesting that the government may show an improper personal benefit from the use of information whenever a tipper gratuitously tips a relative or friend. It was
then significantly advanced by the SEC’s expansion of misappropriation liability in the context of information shared among family members and friends—a move the Commission made even as it declined to actively limit the flow of information between companies and market professionals.

III. THE SEC’S EXPANSION OF MISAPPROPRIATION LIABILITY

The misappropriation theory represented a way to prohibit and punish misuse of information when a person was not a permanent or temporary corporate insider, but had gained access to nonpublic corporate information through some business relationship. Misappropriation was a tenable means of establishing a violation of Section 10(b) because certain breaches of fiduciary duties could be characterized as state or common law violations.67 The theory was endorsed by the Supreme Court in the context of a lawyer who had a well-established duty of confidentiality and loyalty to his corporate client.68 The certiorari question in O’Hagan specifically addressed misappropriation predicated on a violation of a fiduciary duty.69 The cases relied upon by the Supreme Court in adopting the theory all limited misappropriation liability to information obtained in the context of a professional relationship or business dealings.70

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68 See supra notes 46–52 and accompanying text.


70 See United States v. Chestman, 947 F.2d 551, 568, 571 (2d Cir. 1991) (rejecting liability for misappropriating spouse); United States v. Newman, 664 F.2d 12, 15–16, 18 (2d Cir. 1981) (finding liability based on employees’ “deceitful misappropriation” of information from investment banking firm, which defrauded employers and corporate clients); SEC v. Cherif, 933 F.2d 403, 408–10 (7th Cir. 1991) (endorsing misappropriation theory where an individual “misappropriat[es] and trad[es] upon material information entrusted to him by virtue of a fiduciary relationship such as employment,” and collecting cases from the
Nonetheless, in 2000, in what it characterized as a response to confusion in the courts, the SEC promulgated a rule creating liability for an entire new class of individuals who traded on nonpublic information: those who broke the confidences of their family members and friends.\textsuperscript{71} This expansion of liability had virtually no basis in prior court decisions or the statutory text of Section 10(b).

A. THE LAW BEFORE RULE 10B5-2

Both before and after the Supreme Court endorsed the misappropriation theory, the executive was working to extend its bounds.\textsuperscript{72} As the theory developed in lower courts, federal authorities sought to apply the theory to a myriad of relationships, including employer and employee; psychiatrist and patient; husband and wife; and father and son.\textsuperscript{73} Despite these efforts, circuit courts uniformly limited the misappropriation theory to

\textsuperscript{71} See infra notes 91–92 and accompanying text.

\textsuperscript{72} See Nagy, supra note 70, at 1236 (noting that “the SEC and the Justice Department soon began to embrace a misappropriation theory of insider trading liability” in the context of new sets of relationships).

\textsuperscript{73} See, e.g., SEC v. Cherif, 933 F.2d 403, 411 (7th Cir. 1991) (employer and employee context); United States v. Willis, 737 F. Supp. 269 (S.D.N.Y. 1990) (psychiatrist and patient context). Prior to 1997, the misappropriation theory had been adopted by the Second, Third, Seventh and Ninth Circuits. Jason Anthony et al., Securities Fraud, 36 AM. CRIM. L. REV. 1095, 1109 n.88 (1999). Rather than strictly adhering to state fiduciary rules, courts appeared to be developing a common law of fiduciary duties. See Richard W. Painter et al., Don't Ask, Just Tell: Insider Trading After United States v. O'Hagan, 84 VA. L. REV. 153, 205 n.215 (1998) (“Courts adopting the misappropriation theory seemed to be creating a federal common law of confidential relationships without explicitly addressing the choice-of-law issue.”). The Fourth and Eighth Circuits rejected the misappropriation theory. See United States v. O'Hagan, 92 F.3d 612, 617 (8th Cir. 1996), rev'd, 521 U.S. 642 (1997) (“[W]e hold that § 10(b) liability cannot be based on the misappropriation theory.”); United States v. Bryan, 58 F.3d 933, 944 (4th Cir. 1995) (concluding that “neither the language of section 10(b), Rule 10b-5, the Supreme Court authority interpreting these provisions, nor the purposes of these securities fraud prohibitions, will support convictions” based upon the misappropriation theory). The Fourth Circuit's reasons for rejecting this theory remain compelling, particularly in light of how the theory has developed since its adoption by the Supreme Court. See Bryan, 58 F.3d at 950 (discussing how “[i]t would be difficult to overstate the uncertainty that has been introduced into the already uncertain law governing fraudulent securities transactions through adoption of the misappropriation theory" and that “although fifteen years have passed since the theory's inception, no court adopting the misappropriation theory has offered a principled basis for distinguishing which types of fiduciary or similar relationships of trust and confidence can give rise to Rule 10b-5 liability and which cannot”).
legally-recognized relationships of trust and confidence—fiduciary and a circumscribed group of functionally-equivalent relationships—and disclosures made in the context of professional dealings.74

United States v. Chestman, the leading pre-O’Hagan case, is instructive. In Chestman, the Second Circuit sitting en banc held that “misappropriation” of information from a spouse could not give rise to insider trading liability.75 Defendant Robert Chestman was a stockbroker who worked for Keith Loeb. Keith Loeb was married to Susan Loeb, who was related to the president, directors, and controlling shareholders of Waldbaum, Inc.76 President Ira Waldbaum agreed to sell the company; he informed several family members, whom he told to keep the information secret.77 His sister told Susan Loeb, and asked her not to tell anyone “except her husband.”78 Susan told Keith Loeb, and asked him to keep it secret. Keith Loeb shared the information with Chestman, who purchased Walbaum stock for both of them.79 Chestman was found liable for insider trading as a tippee and as an abettor of Loeb’s misappropriation of information.80

A majority of the Second Circuit held that Chestman could not be guilty of insider trading because Loeb did not owe the required fiduciary or fiduciary-like duty to his wife or her family.81 The court recognized that it “heretofore never applied the misappropriation theory—and its predicate requirement of a fiduciary breach—in the context of family relationships.”82 It

74 Before 2000, no circuit affirmed liability for a defendant who misappropriated information shared in a purely personal relationship. See, e.g., supra note 70 (collecting cases); see also SEC v. Sargent, 229 F.3d 68, 71, 73 (1st Cir. 2000) (permitting suit against defendant charged with misappropriating information from business partner in closely-held corporation, with whom he shared an office; requiring proof that misappropriator breached a fiduciary duty owed to person who shared the information); Anthony et al., supra note 73, at 1110 (collecting cases and noting that a “fiduciary relationship most frequently exists between an employer and employee, although it has also been found between an attorney and client and a psychiatrist and patient. So far, the courts have declined to impose liability between family members.” (footnotes omitted)).

75 See United States v. Chestman, 947 F.2d 551, 568 (2d Cir. 1991) (“Marriage does not, without more, create a fiduciary relationship.”).

76 Id. at 555.

77 Id.

78 Id.

79 Id.

80 Id. at 564.

81 Id. at 570.

82 Id. at 564.
expressed concern about extending Section 10(b) liability to even all breaches of fiduciary duties because of the potential scope and ambiguity of this expansion: “Tethered to the field of shareholder relations, fiduciary obligations arise within a narrow, principled sphere. The existence of fiduciary duties in other common law settings, however, is anything but clear.” The court further concluded that nothing in the relationship between Loeb and his wife’s family, or Loeb and his wife, demonstrated that Loeb acted in a fiduciary capacity in these relationships. As a result, Chestman’s conviction could not stand.

The Second Circuit’s rejection of liability based solely on kinship or some other intimate personal relationship is consistent with other circuit court decisions prior to 2000. No circuit held that an intimate personal relationship by itself could give rise to fiduciary-like duties sufficient for liability under the misappropriation theory. Courts also rejected the idea that one could create the requisite fiduciary-like relationship merely by entrusting another with confidential information.

Moreover, while courts struggled to define the bounds of fiduciary and fiduciary-like relationships for purposes of the misappropriation theory, they largely agreed on the essential characteristics. The sine qua non of a fiduciary relationship is

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83 Id. at 567; see also id. at 583 (Miner, J., concurring) (expressing concern about uncertainty that would be created by implying familial duties of confidentiality and cautioning, “[i]t would give the wrong signal to prosecutors in their continuing efforts to push against existing boundaries in the prosecution of securities fraud cases. [P]rosecutors can often claim that some confidential relationship was abused—whether between lovers, family members, longtime friends, or simply that well-known confidential relationship between bartender and drunk. Such a test inherently creates legal uncertainty and invites selective prosecutions.” (quoting John C. Coffee, Outsider Trading, That New Crime, WALL ST. J., Nov. 14, 1990, at 16)).

84 Id. at 570–71.

85 Id.

86 See id. at 568 (stating that kinship does not create a fiduciary relationship); United States v. Reed, 601 F. Supp. 685, 706 (S.D.N.Y. 1985) (“[M]ore kinship does not of itself establish a confidential relation.” (internal quotations omitted)), rev’d on other grounds, 773 F.3d 477 (2d Cir. 1985).

87 See Chestman, 947 F.2d at 567 (“[A] fiduciary duty cannot be imposed unilaterally by entrusting a person with confidential information.”); Walton v. Morgan Stanley & Co., 623 F.2d 796, 799 (2d Cir. 1980) (“Appellants contend that Morgan Stanley became a fiduciary of Olinkraft by virtue of the receipt of the confidential information. However, the fact that the information was confidential did nothing, in and of itself, to change the relationship between Morgan Stanley and Olinkraft’s management. Put bluntly, although, according to the complaint, Olinkraft’s management placed its confidence in Morgan Stanley not to disclose the information, Morgan Stanley owed no duty to observe that confidence.”).
agency: one party relies on the other party to act in her interest.88 As then-Judge Sotomayor explained, “Qualifying relationships are marked by the fact that the party in whom confidence is reposed has entered into a relationship in which he or she acts to serve the interests of the party entrusting him or her with such information.”89 The relationship is characterized by dominance, reliance, and control. It is not a relationship between peers or equals.90

B. AFTER RULE 10B5-2

Despite this law, in 2000 the SEC promulgated a rule to define relationships that could give rise to a duty to refrain from trading

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88 See, e.g., Chestman, 947 F.2d at 68–69 (“[A]t the heart of the fiduciary relationship lies reliance, and de facto control and dominance.... A fiduciary relationship involves discretionary authority and dependency: One person depends on another—the fiduciary—to serve his interests. In relying on a fiduciary to act for his benefit, the beneficiary of the relation may entrust the fiduciary with custody over property of one sort or another. Because the fiduciary obtains access to this property to serve the ends of the fiduciary relationship, he becomes duty-bound not to appropriate the property for his own use.”) (internal citations omitted) (internal quotes omitted)); United States v. Skelly, 442 F.3d 94, 98–99 (2d Cir. 2006) (requiring proof of de facto control and dominance to infer a fiduciary relationship); United States v. Willis, 737 F. Supp. 269, 272, 274 (S.D.N.Y. 1990) (permitting charge of misappropriation against psychiatrist who traded on information disclosed by patient; noting the Hippocratic oath and stating it is “difficult to imagine a relationship that requires a higher degree of trust and confidence than... physician and patient”); see also Brief for the United States as Amicus Curiae in Support of Reversal at 33, Dirks v. SEC, 463 U.S. 646 (1983) (No. 82-276) (explaining that “[a] fiduciary is a person who undertakes to act in the interest of another person” (quoting Austin W. Scott, The Fiduciary Principle, 37 CAL. L. REV. 539, 540 (1949))); Donald C. Langevoort, Fraud and Deception by Securities Professionals, 61 TEX. L. REV. 1247, 1249 (1983) (“The functional justification for law governing fiduciary relationships is the notion of agency costs.”); Ethan J. Leib, Friends as Fiduciaries, 86 WASH. U. L. REV. 665, 672 (2009) (summarizing cases where a fiduciary-like relationship is implied as those where “one party dominates, is superior to, or is especially vulnerable to another party”); id. at 721 (“[A]ll courts require something more than trust—sometimes termed ascendancy, dominance, superiority, expertise, or information asymmetry—to find a fiduciary relationship.”).


90 See, e.g., United States v. Kim, 184 F. Supp. 2d 1006, 1010–11 (N.D. Cal. 2002) (rejecting argument that the ability to be influential, as one is with colleagues or peers, is sufficient to infer a fiduciary-like relationship and declining to find such relationship among fellow club members). In Kim, the court noted three characteristics of fiduciary and quasi-fiduciary relationships: (1) disparate knowledge and expertise; (2) a persuasive need to share confidential information; and (3) a legal duty to render competent aid. Id. at 1011. The case addressed trading that occurred prior to the enactment of Rule 10b5-2, which the court characterized as establishing new law. Id. at 1014.
on nonpublic information under the misappropriation theory. The SEC claimed that its rule was necessary to address the “unsettled issue” of when “certain non-business relationships, such as family and personal relationships, may provide the duty of trust or confidence required under the misappropriation theory.”

The SEC also set forth a general definition of insider trading incorporating the misappropriation theory, purportedly based on the “existing case law” of Chiarella, Dirks, and O’Hagan.

The SEC began by defining the test for misappropriation as a breach of “trust or confidence”—as opposed to the “trust and confidence” required by the Supreme Court—and opened up the possibility of owing such a duty to any “source” of information. In Rule 10b5-2, the SEC then enumerated a non-exhaustive list of situations in which such a relationship would be presumed, meaning a trader would owe a legal duty to the source of the information:

1. Whenever a person agrees to maintain information in confidence;
2. Whenever the person communicating the material nonpublic information and the person to whom it is communicated have a history, pattern, or practice of sharing confidences, such that the recipient of the information knows or reasonably should know that the

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93 See Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,601 n.86 (Dec. 28, 1999); see also 17 C.F.R. § 240.10b5-1(a) (2016) (“The ‘manipulative and deceptive devices’ prohibited by Section 10(b) of the Act (15 U.S.C. 78j) and § 240.10b-5 thereunder include, among other things, the purchase or sale of a security of any issuer, on the basis of material nonpublic information about that security or issuer, in breach of a duty of trust or confidence that is owed directly, indirectly, or derivatively, 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.”).

person communicating . . . expects that the recipient will maintain its confidentiality; or
(3) Whenever a person receives . . . information from his or her spouse, parent, child, or sibling . . . .95

In describing the need for this rule, the SEC repeatedly referenced interactions between family members, and did not discuss other personal relationships.96 But the rule goes beyond familial relationships to target communications made in the context of friendships and social acquaintances.

“Friendship” is not a word used by the SEC. But that is the nature of the relationship described in Rule 10b5-2(b)(2): friends are people who, over the course of time, voluntarily associate, sharing interests, activities, and confidences, with certain reciprocal expectations.97

To confirm that the SEC’s rule targets communications between friends, one need look no further than recent insider trading cases. In the last several years, the government has pursued insider trading charges against individuals who “misappropriate” information from social acquaintances. The allegations narrate a story where two people meet and their relationship grows over time through shared interests, experiences, or life events, culminating in a relationship of trust and confidence—or what non-lawyers might call friendship. When one friend discloses or trades on information shared by the other friend, he will be liable for insider trading. Here is an example from a 2014 Third Circuit case:

[Timothy] McGee first met [Christopher] Maguire between 1999 and 2001 while attending Alcoholics Anonymous (“AA”) meetings. AA is a fellowship of recovering alcoholics . . . . As a newcomer to AA,

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95 17 C.F.R. § 240.10b5-2(b) (2016).
97 There is no uniform definition of friendship, but these are some of its key characteristics. See Ethan J. Leib, Friendship & the Law, 54 UCLA L. REV. 631, 642–45 (2007) (explaining that friends, among other things, associate together regularly over time; pursue intimacy, or “mutual knowledge and discovery of one another through conversation and activities”; provide mutual assistance; and develop trust through, among other things, private disclosures). Rule 10b5-2(b)(2) may not define every factor necessary for a friendship, but the rule’s factors will virtually always be present in a friendship.
Maguire sought support from McGee, who shared similar interests and had successfully achieved sobriety for many years.

For the better part of a decade, McGee informally mentored Maguire in AA. Though the two biked and competed in triathlons together, sobriety was “the primary purpose” of their relationship. . . . [T]hey shared intimate details about their lives to alleviate stress and prevent relapses.98

Here are allegations from a 2014 New York case:

[Trent] Martin and Attorney-1 sought advice from each other and shared common interests, a common cultural background, and the common experience of being single men who worked in demanding industries and lived far from their home countries of, respectively, Australia and New Zealand . . . .99

Martin confided details of a family illness . . . and also sought legal advice on behalf of another friend, in both instances revealing sensitive information about the underlying facts and circumstances.100

In other recent cases, the government pursued charges against an individual who allegedly misappropriated information from a former coworker with whom he exchanged confidences “relating to, among other things, . . . careers, families, relationships, and plans for the future,”101 and against a man who allegedly misappropriated information from a “social acquaintance” with whom he shared “a love of golfing.”102

99 Indictment ¶¶ 14, 18, United States v. Durant, No. 12 Cr. 887 (S.D.N.Y. Nov. 19, 2014). This and the following quote refer to the same relationship, first in a criminal case and then in the SEC civil enforcement action. The tipping attorney is referred to as “Attorney-1” or the “Associate.” The author represented defendant Benjamin Durant in the criminal case, which ended in a dismissal.
101 Indictment ¶ 13, United States v. Valvani, No. 16 Cr. 412 (S.D.N.Y. June 14, 2016) (describing the relationship between insider and initial tippee, who then allegedly passed information to others, including the named defendant).
In each of these cases, the defendant charged with insider trading had no direct relationship with the owner of nonpublic information. Instead, the defendant reportedly received nonpublic information from some social acquaintance, whom the government did not charge with wrongdoing. The government’s theory was that the trading defendant committed a civil violation or crime by “misappropriating” information shared by the social acquaintance—in other words, the defendant committed a legal violation by using for personal gain information shared by a friend.

C. ENFORCING THE RIGHT TO HONEST FAMILY AND FRIENDS

Rule 10b5-2 was a striking expansion of insider trading liability.103 First, it shifted focus from business communications and relationships to personal communications and relationships.104 As discussed, no court had previously found liability for using information “misappropriated” in the context of a purely personal relationship.105 While courts had recognized the possibility of misappropriation from personal relationships where the parties also had extensive prior business dealings,106 the SEC obliterated this requirement.107

practice of sharing confidences, it is alleged that McPhail owed Person A a duty of trust and confidence and that he reasonably should have known that Person A’s communications about AMSC should be kept in confidence.“).  

103 This Article discusses the second two prongs, Sections 10b5-2(b)(2)–(3). Commentators have also criticized the manner in which Section 10b5-2(b)(1) expanded liability. See, e.g., Jonathan R. Macey, The Distorting Incentives Facing the U.S. Securities and Exchange Commission, 33 HARV. J.L. & PUB. POL’Y 639, 659–61 (2010) (criticizing the manner in which the SEC promulgates and enforces rules, such as with Rule 10b5-2(b)(1)).

104 See supra Section III.B.

105 See supra Section III.A.

106 See SEC v. Yun, 327 F.3d 1263, 1272–73 (2003) (finding that misappropriation among spouses might be possible where they had a “history or practice of sharing business confidences”); United States v. Reed, 601 F. Supp. 685, 705 (S.D.N.Y. 1985) (permitting misappropriation charge to proceed where father and son shared repeated confidences regarding “affairs of business and commerce”), rev’d on other grounds, 773 F.2d 477 (2d Cir. 1985). In United States v. Chestman the Second Circuit accepted Reed for the narrow proposition that “repeated disclosure of business secrets between family members may substitute for a factual finding of dependence and influence and thereby sustain a finding of the functional equivalent of a fiduciary relationship,” 947 F.2d 551, 569 (2d Cir. 1991). Yun was decided after the SEC’s adoption of Rule 10b5-2, but concerned trades predating the rule; the rule nonetheless clearly influenced the court’s decision. See Yun, 327 F.3d at 1273 n.23 (noting SEC rule “bolstered” court’s conclusion).

107 In their comments to the proposed regulation, the American and New York City Bar Associations suggested maintaining this requirement of the sharing of prior business confidences in order to infer a fiduciary-like duty; the SEC rejected this recommendation.
Second, the rule was untethered from even the messy bounds of existing fiduciary or fiduciary-like relationships, extending legal obligations of loyalty and confidentiality to familial relations and friendships. The relationships listed in Rule 10b5-2(b)(2)–(3) do not evince the critical qualities that would render them even quasi-fiduciary. Family members such as siblings are not generally considered legal fiduciaries of one another. Nor are friends and social acquaintances; these are not relationships where one party is considered the agent of the other, or where one exerts de facto dominance and control in exchange for the other's reliance. These are not relationships that courts had previously recognized as imparting fiduciary-like obligations.108

Why does this break from recognized fiduciary relationships matter? Under the theory of insider trading liability articulated in Dirks and O'Hagan, the essential culpable act is the unauthorized acquisition and use of another's nonpublic information (not simply the act of trading securities based on this information).109 This is a tenable theory of civil or criminal liability under the statute because a fiduciary's use of his principal's information for personal gain—whether characterized as theft, conversion, or breach of trust—had consistently been deemed unlawful and could plausibly be characterized as deceitful or fraudulent based on the representations inherent in one's acceptance of a fiduciary position.110

See Selective Disclosure and Insider Trading, Exchange Act Release Nos. 33-7881, 34-43154, 65 Fed. Reg. 51,716, 51,729 (Aug. 24, 2000) (summarizing comments). The ABA lodged several other criticisms, including that the proposed rule risked eroding personal privacy and employed unduly vague and subjective terms. Letter from the American Bar Association Ad Hoc Task Force to Jonathan G. Katz, Secretary of the Securities and Exchange commission regarding Proposed Rule 10b5-1 and 10b5-2, at 13–21 (May 8, 2000). 108 See, e.g., Bennett v. Allstate Ins. Co., 753 F. Supp. 299, 303 (N.D. Cal. 1990) (rejecting argument that longtime friendship created fiduciary duties); Leib, supra note 97, at 633 ("[W]e appear not to furnish the status of friend with any clear legal recognition of consequence."); Painter et al., supra note 73, at 215 ("[C]ertain categories of persons are not fiduciaries...for example, family members (who do not also have a business relationship with each other), friends, participants in discussion groups (Alcoholics Anonymous, Bible studies), and hairdressers."); see also Sanford Levinson, Testimonial Privileges and the Preferences of Friendship, 1984 DUKE L.J. 631, 641 (stating friendship and similar relationships exhibit an "obvious reciprocity...that distinguishes [them] from the hierarchy typified in the agency relationship").

109 See supra notes 27–35 and accompanying text.

110 See, e.g., SEC v. Cherif, 933 F.2d 403, 410 n.5 (7th Cir. 1991) (accepting misappropriation theory, citing House Report that “deceitful misappropriation of confidential information by a fiduciary” has consistently been held unlawful); SEC v. Clark,
But there are no analogous underlying legal requirements governing the use of information shared among friends and family members: the SEC creates these duties of loyalty and confidentiality out of whole cloth.\textsuperscript{111} By abandoning the requirement of a preexisting legal duty, Rule 10b5-2 premises insider trading liability on conduct—essentially, betraying the confidence of a family member or friend—that is not criminal, tortious, or fraudulent.\textsuperscript{112}

To see the absurdity of recent insider trading cases, one might consider whether the conduct alleged as “fraudulent” under Section 10(b)—using information confided by an AA sponsor, friend, or golf buddy for some personal benefit—could plausibly

\textsuperscript{111} There is no obvious reason that the SEC has the power to create these obligations. Administrative agencies are empowered to make rules to clarify the law; “[t]he rulemaking power . . . is not the power to make law.” \textit{Ernst & Ernst v. Hochfelder}, 425 U.S. 185, 213 (1976). For the SEC, such power would traditionally extend only to regulated entities and market participants in their actions vis à vis markets—not in purely private relationships. \textit{cf.} United States v. Bryan, 58 F.3d 933, 952–53 (4th Cir. 1995) (contending Section 10(b) is “unconcerned with the fairness of conduct toward persons such as family members, employers, medical patients, or other parties to the infinite number of similar trust relationships who are not in any way connected with or even interested in a purchase or sale of securities”), abrogated by United States v. O’Hagan, 521 U.S. 642 (1997). Moreover, the rule is addressing purportedly-ambiguous language in a Supreme Court decision, not in the statute itself.

For a discussion of why courts should not defer to SEC interpretations of statutes in the context of criminal law specifically, see generally \textit{Whitman v. United States}, 135 S. Ct. 352 (2014) (Scalia, J., respecting the denial of certiorari).

\textsuperscript{112} This raises additional constitutional questions. In \textit{United States v. O’Hagan}, the Supreme Court rejected a constitutional challenge to the misappropriation theory in part because liability was narrowly circumscribed to “those who breach a recognized duty.” 521 U.S. 642, 666 (1997). Without this limitation, there are potential constitutional due process issues related to lack of notice and improper vagueness. A full examination of the potential constitutional infirmities of the current misappropriation theory is beyond the scope of this Article.
constitute fraud under the federal wire and mail fraud statutes. The answer is clearly no.

In this expansion of insider trading liability, there are apparent parallels with past developments in honest services fraud, where the government sought to impose federal liability for a variety of unethical actions, and courts struggled to articulate both the source and content of the “intangible . . . honest services” owed under law.113 However, with Rule 10b5-2, insider trading law has expanded even beyond pre-*Skilling v. United States* honest services fraud’s outer reaches: in the context of honest services fraud, the government at least limited itself to policing workplace and public corruption; with insider trading enforcement, the government has moved beyond the public sphere to target corruption in purely personal relationships, such as friendship. We are thus even further down the road of developing, in Justice Scalia’s phrasing, the federal crime of “unethical conduct.”114

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113 See 18 U.S.C. §§ 1343, 1346 (2012) (proscribing “any scheme or artifice to defraud” by wire, radio, or television, including a scheme or artifice “to deprive another of the intangible right of honest services”); *Skilling v. United States*, 561 U.S. 358, 400–08 (2010) (discussing the history of honest services fraud and construing the statute to require kickbacks or bribes to avoid unconstitutional vagueness); id. at 417 (Scalia, J., concurring in part and concurring in the judgment) (“None of the ‘honest services’ cases, neither those pertaining to public officials nor those pertaining to private employees, defined the nature and content of the fiduciary duty central to the ‘fraud’ offense. There was not even universal agreement concerning the source of the fiduciary obligation . . . .”); see also *Sorich v. United States*, 555 U.S. 1204, 1205–06 (2009) (Scalia, J., dissenting from denial of certiorari) (collecting cases involving honest services fraud); *Karmel*, supra note 8, at 109 (“The most perplexing aspect of the misappropriation theory is the way it transforms a breach of duty to an employer or client under state law into a fraud under the federal securities laws.”).

114 *Sorich*, 555 U.S. at 1207 (Scalia, J., dissenting from denial of certiorari). At least one commentator apparently supports this route and has posited a theory of insider trading law as prohibiting “private corruption,” defined as the use of an entrusted position for self-regarding gain. See generally *Kim*, supra note 38. This formulation seems practically indistinguishable from broadly-construed—and unconstitutionally vague—honest services fraud. As a means of understanding insider trading law, it is both too broad and too narrow. It uncritically accepts that federal securities law should reach “corruption” in purely personal relationships—a dubious contention in light of Supreme Court precedent and our commonsense understanding that not every form of private corruption is or should be a crime, federal or otherwise. See id. at 1005 (arguing that wife who used information from her husband should be liable for insider trading because “she violated the trust of her husband in a way that seemed deeply inconsistent with the communal norms of their relationship”). At the same time, the theory excludes cases like *SEC v. Dorozhko*, 574 F.3d 42 (2d Cir. 2009), which are arguably more in line with Section 10(b)’s statutory language, since individuals obtain information via something closer to a deceptive device or scheme. See *Kim*, supra note 38, at 998 (determining that “[i]nder the corruption theory, Dorozhko would not be liable for insider trading”).
IV. BUSINESS PROPERTY, MARKET FAIRNESS, AND THE GROWING DIVERGENCE BETWEEN PROFESSIONAL VERSUS NONPROFESSIONAL INSIDER TRADING

Rule 10b5-2 is an obvious effort by the SEC to expand liability to additional classes of individuals who trade while in possession of nonpublic information. This expansion makes sense in light of the SEC’s prior efforts to hold liable any person who trades while in possession of nonpublic information and the agency’s increasing focus on insider trading enforcement. The SEC itself has never embraced the business property theory of insider trading prohibitions. In promulgating Rule 10b5-2, it largely disregarded issues of ownership of information, instead opining that trading on nonpublic information “has the same impact on the market and investor confidence” regardless of how traders acquire the information. Nor are the SEC’s motives mysterious. With courts consistently rejecting blanket liability for everyone who trades while in possession of nonpublic information, but endorsing the misappropriation theory, the way forward for the SEC to expand enforcement is to increase the situations in which “misappropriation” can occur.

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115 See, e.g., Dirks v. SEC, 463 U.S. 646, 651 (1983) (repeating SEC finding that tippees like Dirks who “come into possession of material ‘corporate information that they know is confidential and know or should know came from a corporate insider,’ . . . must either publicly disclose that information or refrain from trading” (internal citation omitted)); Bainbridge, supra note 10, at 1198 (“The misappropriation theory and Rule 14e-3 are best viewed as part of a SEC effort to revive the TGS equal access to information rule while nominally remaining faithful to the fiduciary duty requirement.”).


117 See Selective Disclosure and Insider Trading, Exchange Act Release Nos. 33-7787, 34-42259, 64 Fed. Reg. 72,590, 72,603 (Dec. 28, 1999) (comparing trading by a family member who receives information from an insider in breach of that insider’s fiduciary duty; family member who trades in breach of express promise of confidentiality to a family member; and a family member who trades in breach of another’s expectation of confidentiality, and opining that all three scenarios should be treated the same).

118 In proposing Rule 10b5-2, the SEC made clear that it was seeking the means to prosecute individuals who could not be reached under existing law. See id. (explaining that for many trading family members and friends “a classical tipper-tippee theory of liability
The particular expansions in Rule 10b5-2 also make sense in terms of the overarching narrative offered by enforcement agencies pursuing insider trading cases: insider trading is cast as a form of cheating or personal corruption that prevents securities markets from being a level playing field.\textsuperscript{119} Nepotism feels like a particularly indefensible form of special advantage. And what could be more personally corrupt on the part of a trader than betraying the secret of a family member or friend? Perhaps for these reasons, this regulation has faced very little court scrutiny.\textsuperscript{120}

But the fact that cases under Rule 10b5-2 fit within one pro-enforcement narrative of insider trading does not mean that they actually align with the policy rationale behind insider trading prohibitions as articulated by courts. To the contrary, when viewed in light of the actual purpose of insider trading law as endorsed by the Supreme Court—protecting legitimate ownership interests in information\textsuperscript{121}—the regulation is problematic.

The regulation is also part of the growing divergence between the law’s treatment of the use of nonpublic information acquired by market professionals versus other traders. It is one component of an overarching legal framework that seeks to intrusively scrutinize and manage information sharing in personal

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\textsuperscript{120} Courts have overwhelmingly deferred to this SEC rule with little discussion. See, e.g., SEC v. Cuban, 620 F.3d 551, 555–56 (5th Cir. 2010) (vacating dismissal of insider trading complaint predicated on Rule 10b5-2); SEC v. Rocklage, 470 F.3d 1, 7–12 (1st Cir. 2006) (affirming denial of motion to dismiss insider trading charges against wife who allegedly misappropriated information from husband, despite wife’s disclosure to husband of trading); SEC v. Yang, 999 F. Supp. 2d 1007, 1017 (N.D. Ill. 2013) (stating that friendship gave rise to a fiduciary duty under SEC rule); SEC v. Conradt, 947 F. Supp. 2d 406, 411 (S.D.N.Y. 2013) (stating that the SEC promulgated rule to “[a]ttempt[ ] to clarify the circumstances that may give rise to such a confidential relationship”); United States v. Corbin, 729 F. Supp. 2d 607, 615–17 (S.D.N.Y. 2010) (declining to dismiss charges and rejecting constitutional challenges to the rule); United States v. Gansman, 657 F.3d 85, 89–93 (2d Cir. 2011) (discussing rule).

\textsuperscript{121} See supra Section II.C.
relationships, while permitting tipping in the context of professional relationships. As a result, this framework does little to further overall market integrity or fairness.

A. THE BUSINESS PROPERTY RATIONALE

Insider trading prohibitions protect a corporate owner’s right to direct the use of its own nonpublic information.122 The clearest rationale for modern insider trading law may be that companies and shareholders need this form of governmental assistance to prevent the misuse of proprietary information by employees and others who must be given access to that information for business purposes.123 Yet Rule 10b5-2 is inconsonant with this aim.

First, the rule diminishes the liability of insiders and others who betray well-defined duties of confidentiality to the corporate owner of information: a fiduciary who violates his obligations by sharing corporate secrets with a brunch buddy or golf partner can avoid liability by claiming that he thought the other person would keep the information secret. The government has employed this rule to decline to charge individuals who breach clear obligations of confidentiality by sharing nonpublic information with social acquaintances, opting instead to charge only the insider’s friend.124 In the words of one prosecutor who complained when a tipping defendant tried to invoke the rule for his benefit, this “create[s] a dangerous permission structure . . . [whereby] ‘if two people repeatedly share confidences that they have no legal right to

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122 See supra Section II.C.
123 See, e.g., Macey, supra note 44, at 59–60 (recognizing, though doubting, that “[r]elying exclusively on corporations to police the insider trading abuses of its agents may result in a suboptimal level of enforcement”); Fisch, supra note 7, at 232 (contending that current insider trading rules benefit shareholders by sparing them the need to monitor and litigate insiders’ breaches of fiduciary duties).
124 In both the McGee and Conradt cases, for example, the individuals who initially shared nonpublic information with friends (in clear violation of their fiduciary duties to the corporate owners of the information) were not charged with wrongdoing, based on their claim that they thought the friend would hold information in confidence. See supra notes 98–100; see also Gansman, 657 F.3d at 89–90, 93 (finding that attorney-defendant alleged to have tipped his mistress could raise defense under Rule 10b5-2 that they had a history of sharing confidences, and thereby avoid liability for insider trading). One practical effect of this regulation is that it facilitates prosecutions by permitting insider tippers to cooperate with the government without having to admit their own culpability. So long as a tipper can plausibly claim that he did not think or intend for his friend to trade on shared information, the tipper can cooperate with the government without having to admit liability himself, which likely helps incentivize such cooperation.
share . . . eventually that means that they have a legal right to share.’ Such a result would be absurd.”

But, as the Second Circuit noted in response, that is precisely the effect of the SEC regulation.

This relates to another reason the Supreme Court’s limitation in O’Hagan to a fiduciary or other well-established duty was important. When a duty of confidentiality in a particular relationship is long-established in law, this represents a societal judgment of the imperative for the exchange of truthful information in the context of that relationship.

Agency, confidentiality, and privilege are linked: if one person requires an agent, he must be able to communicate with that agent fully and candidly.

There is no analogous imperative for truthful disclosure of information in other contexts, particularly where the disclosure is of detailed, sensitive, or proprietary business information, shared in a non-business relationship for a non-business purpose. In fact, traditional privileges of confidentiality are often disregarded.

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125 Brief for the United States of America at 26, United States v. Gansman, 657 F.3d 85 (2d Cir. 2011) 2010 WL 5167418 (No. 10-731-cr) (quoting the district court).

126 See Gansman, 657 F.3d at 92–93 (confirming that defendant could validly argue that he was not guilty of insider trading if he had a relationship of trust and confidence with tippee and that he expected her to keep shared information confidential).

127 See, e.g., Upjohn Co. v. United States, 449 U.S. 383, 389 (1981) (explaining that attorney-client privilege “encourage[s] full and frank communication between attorneys and their clients and thereby promote[s] broader public interests” and collecting cases confirming that privilege is intended to promote full and candid communication); Trammel v. United States, 445 U.S. 40, 51 (1980) (opining that traditional privileges, including lawyer-client, priest-penitent and doctor-patient are based on “imperative need for confidence and trust” to facilitate complete disclosure). In United States v. Kim, 184 F. Supp. 2d 1006, 1011 (N.D. Cal. 2002), the court identified a persuasive need to share confidential information as one of the key factors marking a fiduciary or quasi-fiduciary relationship.

128 See Levinson, supra note 108, at 638 (“We realize that the shoals and eddies of modern life cannot be navigated without the employment of agents . . . . In talking to one’s lawyer or psychiatrist, one is, in some sense, communicating with ‘oneself.’ . . . This emphasis on agency also helps to explain the specific nature of most of the testimonial privileges. We are entitled to confidentiality when talking to our doctor qua medical agent or our lawyer qua legal advisor. There is no notion at all that our relationships with these agents are ‘intimate’ in any important sense, only that they are necessary to effective protection of our selves, whether defined physically or legally.”); Leib, supra note 88, at 691 (“[P]arties in a fiduciary relationship require high degrees of trust and must freely share confidences, secrets, and information for that relationship to serve its purposes well.”).
where two people are consulting as friends, and not in some other capacity recognized under the law.\textsuperscript{129}

This distinction helps illuminate why \textit{Chestman} and other circuit decisions limited the misappropriation doctrine to business-related communications.\textsuperscript{130} When a person shares proprietary corporate information with another party for a legitimate business reason, then the confidentiality of the information must be protected to facilitate this necessary sharing. But, a corporate insider who shares proprietary business information with a brunch buddy or golf partner is misusing that information. As a society, we may want to foster greater trust and candor in personal relationships. But, we do not actually want to foster the sharing of information that other, more specific legal obligations require individuals to keep secret. By creating a new sphere of confidentiality, the SEC regulation effectively encourages this sharing, even though there is no agreed-upon societal benefit to it, and the sharing is a misuse of the information. Claiming, as Rule 10b5-2 does, that the tipper himself can create confidential relationships encourages disclosures that may not be sanctioned by the corporate owner of the information, and which undermine the owner’s exclusive control over the use of information.

Nor can there be any serious argument that the SEC’s creation of this limited confidentiality requirement protects the information from further disclosure. Because the duty of loyalty and confidentiality imposed by Rule 10b5-2 on siblings and friends does not otherwise exist in law, the person who learns the information can disseminate, publish, or sell the information without legal penalty, so long as he does not trade or directly benefit from trading the relevant securities.

There are additional disconnects between this regulation and the animating principle of insider trading law. In misappropriation cases under Rule 10b5-2, the person who discloses business information to a friend may not be the rightful

\textsuperscript{129} See, e.g., Modern Woodmen of Am. v. Watkins, 132 F.2d 352, 354 (5th Cir. 1942) (attorney-client privilege not available when lawyer was consulted “as a personal friend”); Burger v. State, 231 S.E.2d 769, 771 (Ga. 1977) (statements made to a minister not protected where made as “conversational statements to [one who was a] friend”).

\textsuperscript{130} This also explains why \textit{Chestman} was such a difficult case. There is, of course, a marital privilege and a longstanding recognition of the need for protection of marital communications. See, e.g., Blan v. United States, 340 U.S. 332, 333 (1951) (recognizing that a confidential communication between husband and wife is privileged).
owner of the information and may be misusing it. It is strange to legitimate this misuse and, in effect, punish conversion of information from someone who has already improperly converted the same. Typically, the law does not recognize the offense of converting or misappropriating from one who lacked a lawful interest in the property himself.\textsuperscript{131} Put another way: one way to theorize insider trading prohibitions under existing law is to determine when a party can legitimately expect to have a legally-cognizable property right in information, and to enforce that right by punishing conversion.\textsuperscript{132} In cases under Rule 10b5-2, the person sharing the information may not have this legally-cognizable property interest.

Relatedly, it is misguided to focus enforcement efforts on individuals who may be several levels removed from the corporate owners of information, as Rule 10b5-2 does. If the orientation of insider trading law is protecting business property, then enforcement is ideally aimed at individuals who have direct access to information via their relationship to the owner, and not at those who are one or more steps removed from the owner or rightful user of the information. The business property rationale for prohibiting insider trading supports targeting individuals who misappropriate information directly from the owner or rightful user of the information—corporate insiders who trade the company stock, or defendants like the lawyer in \textit{O'Hagan}, with whom the owner

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\textsuperscript{131} See, e.g., Caesars Entm't Operating Co. v. Johnson, No. 13-CV-00629-CRS, 2015 WL 5020695, at *3–4 (W.D. Ky. Aug. 24, 2015) (stating conversion claim depends on proof that plaintiff has legal title to property); AM Gen. Corp. v. DaimlerChrysler Corp., 246 F. Supp. 2d 1030, 1036 (N.D. Ind. 2003) (finding company must own intellectual property to assert claim of misappropriation); Duralastic Lamp Prods., Inc. v. Meyerowitz, No. 63 C 614, 1963 WL 8075, at *1 (N.D. Ill. Aug. 21, 1963) (“There cannot be any misappropriation unless there is a property right to begin with.”). The Second Circuit touched on this problem in a footnote, suggesting that one can only misappropriate information from a person who is authorized to have the information in the first place. See \textit{Gansman}, 657 F.3d at 93 n.10 (noting that this duty can only be owed to a person authorized to have the information and that it “question[s] whether that duty of trust of confidence can ever be relevant . . . to a person who was never authorized in the first place to have such information”). This is not entirely consistent with the Supreme Court’s opinion in \textit{O'Hagan}, which speaks to the principal’s exclusive right to the “use” of information. See \textit{United States v. O'Hagan}, 521 U.S. 624, 654 (1997) (“A company’s confidential information, we recognized in \textit{Carpenter}, qualifies as property to which the company has a right of exclusive use.”). Thus, a better rule would be that one cannot misappropriate from a person who is misusing information.

\textsuperscript{132} Cf. Macey, supra note 44, at 37 (arguing that courts considering insider trading liability should determine when a party can legitimately expect to have a legally cognizable property right in information).
must share information for some business reason. The law is less concerned with distant, downstream tippees: if people who trade on particular information did not participate or assist in the initial conversion of that information, and are not in direct contact with the insider who committed the conversion, there is less reason to penalize them. Rule 10b5-2 takes the opposite tack: it insulates the person who directly misappropriates information from the corporate owner and instead penalizes downstream tippees.

Finally, although this certainly is not the focus of insider trading law, there can be no serious argument that the regulation has any salutary effect on friendship or familial relations. The supposed duty of confidentiality among certain family members and friends is not otherwise recognized in law, so their conversations are in no way shielded from public discovery. In fact, whenever Rule 10b5-2(b)(2) is invoked, all aspects of the friendship come under governmental scrutiny. It is ironic that the SEC justified its blanket prohibition on trading by certain family members, in part, to limit the “intrusive examination” of familial relationships that would result from a case-by-case analysis, while at the same time promulgating a rule

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133 Cf. Easterbrook, supra note 8, at 338 (stating that the business property rationale suggests that “[w]hen the firm is entitled to secrecy, the person who passes out a tip is the wrongdoer” and “that there is little point in penalizing the trading of tippees of information”). In theory, downstream tippees might be punished for the same reason as those who sell stolen goods—their use of the information helps create the market for the information and encourages theft. Liability would thus depend on any trader knowing that information was stolen. At the very least, this confirms the correctness of the Second Circuit’s decision in Newman that to incur liability a tippee must know that information was stolen (and not merely that the information was confidential or disclosed by an insider). See United States v. Newman, 773 F.3d 438, 442 (2d Cir. 2014) (“[I]n order to sustain a conviction for insider trading, the Government must prove beyond a reasonable doubt that the tippee knew that an insider disclosed confidential information and that he did so in exchange for a personal benefit.”).

134 Most communications among family members and friends are not privileged. See, e.g., Levinson, supra note 108, at 645, 648 (“[I]t is not only the lover who is unprotected in American law. Family relationships other than the spousal are generally not recognized as conferring testimonial privilege, although several courts have recently recognized a parent-child privilege. There is no doubt, though, that American law does not recognize a sibling privilege, let alone other kinship privileges. Friendship per se goes wholly unprotected.” (footnotes omitted)); see also Leib, supra note 97, at 633 (arguing that communications among friends should enjoy such privilege).

135 See, e.g., United States v. McGee, 763 F.3d 304, 308–09, 317 (3d Cir. 2014) (detailing the friendship between tipper and tippee and the application of Rule 10b5-2(b)(2)).

necessitating intrusive examination of a large swath of other personal relationships. Because there is no broader legal protection or privilege granted to most family members and social acquaintances who exchange confidences, there can be no real argument that this limited duty enhances the quality of these relationships.

B. MARKET FAIRNESS AND THE GROWING DIVIDE BETWEEN PROFESSIONAL AND NONPROFESSIONAL INSIDER TRADERS

For its part, the SEC opined without much elaboration that Rule 10b5-2 defines duties of trust and confidence in a manner that “appropriately serves the purposes of insider trading law.” But, the rule does not comport with the business property rationale. And even if one looks past the actual purpose of insider trading law to the more amorphous notions sometimes referenced—fairness and market integrity—it is difficult to justify this regulation, particularly when viewed in light of the current overarching legal framework, which increasingly penalizes insider trading by some, but not others.

Proponents of expanded insider trading restrictions often reference ideas of market integrity and fairness in support of liability. But, it is a little difficult to tease out the meaning of the words here. As Judge Easterbrook observed, one suspects that “few people who invoke arguments based on fairness have in mind any particular content for the term.” Fairness is not a level playing field, or even equal access to information material to trading. In O'Hagan, Justice Ginsburg cryptically complained that a misappropriator’s advantage is improper because it “stems

distinguish between” different cases of trading by family members would “require an unduly intrusive examination of the details of particular family relationships”).

138 See, e.g., id. at 51,727 (“We have long recognized that the fundamental unfairness of insider trading harms not only individual investors but also the very foundations of our markets, by undermining investor confidence in the integrity of the markets.”); Charles C. Cox & Kevin S. Fogarty, Bases of Insider Trading Law, 49 OHIO ST. L.J. 353, 353 (1988) (“The more important argument against insider trading is that it is unfair, either in the sense that it is dishonest or in the sense that it simply does not allow everyone an equal opportunity to profit.”).
139 Easterbrook, supra note 8, at 324.
from contrivance, not luck” and “cannot be overcome with research or skill.”

Picking up on this theme, one proponent of the misappropriation theory explains: “We think that those who have special access to information, because of employment or other relationships, should be barred from using that information to gain an advantage over the rest of us.”

But under the current legal regime, corporate insiders in possession of nonpublic information can share this information with select investors, giving those investors an advantage in the market based purely on their relationships or position. Typically, the information is shared with professional analysts or favored shareholders—either inadvertently, in the course of conversations intended to maintain investor relations, or purposefully, to “prime” the market or otherwise educate preferred investors in some fashion.

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141 United States v. O’Hagan, 521 U.S. 642, 659 (1997). This is a strange sentence. There are myriad forms of special advantage enjoyed by some participants in the market that others cannot overcome by research or skill. As one commentator noted in discussing the problem of attempting to guarantee market fairness, “It will almost always be the case that one party has an ‘advantage’ over the other in a given securities trade. One side is likely to have greater knowledge about the relevant supply and demand for a particular stock. One party will inevitably have greater sophistication, knowledge, intelligence or expertise.” Macey, supra note 44, at 16–17 (footnotes omitted); see also United States v. Carpenter, 791 F.2d 1024, 1031 (2d Cir. 1986) (“There are disparities in knowledge and the availability thereof at many levels of market functioning that the law does not presume to address.”); Cary Martin Shelby, Privileged Access to Financial Innovation, 47 LOY. U. CHI. L.J. 315, 315–17 (2015) (discussing greater investment options enjoyed by elite investors, such as wealthy individuals and large institutions, versus retail investors); Fisch, supra note 7, at 221–23 (discussing various legal informational advantages enjoyed by professional investors). Some liken insider trading to cheating. See, e.g., Alan Strudler & Eric W. Otis, Moral Principle in the Law of Insider Trading, 78 TEX. L. REV. 375, 412 (1999) (arguing that trading on stolen nonpublic information cheats the victim). But prohibiting insider trading because it is “cheating” is an unhelpful tautology. Cheating means doing something in violation of the rules of the game. To say that something “should be illegal because it is cheating” is to say that it “should violate the rules because it violates the rules.”

142 Aldave, supra note 15, at 123; see also SEC v. Payton, 97 F. Supp. 3d 558, 559 (S.D.N.Y. 2015) (characterizing insider trading as a “form of cheating, of using purloined or embezzled information to gain an unfair trading advantage”); Kim, supra note 38, at 966 (complaining that insider trading is unfair because “traders accrue such profits not through effort, ingenuity, risk-taking or even random luck, but through special, privileged access”); Donald C. Langevoort, Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement, 70 CAL. L. REV. 1, 2 (1982) (noting the intuition that insider trading is unfair because those “in a position to have special access to confidential information bearing on the value of a security are perceived as being unjustly enriched when they trade with others who are unable to discover that information”).

143 The ability of companies to share information with certain investors, and for these privileged investors to trade on that information, has been repeatedly sanctioned by courts.
This flow of nonpublic information from companies to select investors is more expansive and institutionalized than occasional phone calls. Roughly 97% of CEOs of publicly traded companies meet with the company’s investors. Companies host private meetings for select investors, including investment advisory firms, pension managers, and hedge-funds. They meet at venues including conferences, investors’ offices (referred to as “road shows”), and firms’ headquarters. Even apart from these meetings, firms have investor relations departments that are specifically tasked with communicating with select investors.

For example, in Chiarella, even while endorsing an expansive misappropriation theory, Justice Burger clarified that such a theory “would not threaten legitimate business practices”—to wit, “market specialists would not be subject to a disclose-or-refrain requirement in the performance of their everyday market functions.” Chiarella, 445 U.S. at 242–43 (Burger, C.J., dissenting); see also Dirks v. SEC, 463 U.S. 646, 658–59 (1983) (“Imposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market. It is commonplace for analysts to ‘ferret out and analyze information,’... and this often is done by meeting with and questioning corporate officers... And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation’s securities.” (footnotes and citations omitted)); United States v. Salman, 792 F.3d 1087, 1091 (9th Cir. 2015) (“[C]orporate insiders, in the many conversations they typically have with stock analysts, often accidentally or mistakenly disclose material information that is not immediately available to the public.”), aff’d, 137 S. Ct. 420 (2016); Payton, 97 F. Supp. 3d at 561 (recognizing that corporate executives may disclose nonpublic information by “priming the market” before a public announcement); Brief for Securities Industry and Financial Markets Association as Amicus Curiae in Support of Neither Party at 8, Salman v. United States, 137 S. Ct. 420 (2016) (No. 15-628) (“SIFMA’s members and employees frequently learn information through communications with company officers and employees. [The Supreme Court] went to considerable length in Dirks to acknowledge the general legitimacy of informational exchanges between professionals, emphasizing that information obtained in this way, even if non-public, ‘normally may be the basis for judgments as to the market worth of a corporation’s securities.’” (citation omitted)).

See David Solomon & Eugene Soltes, What Are We Meeting For? The Consequences of Private Meetings with Investors, 58 J.L. & ECON. 325, 326–27, 330 (2015) (describing how company managers “spend a large amount of time meeting privately with investors at public conferences, investors’ offices, and the headquarters of firms”; finding that investors who enjoy such private meetings exhibit correlated trading activity—implying that they receive information in these meetings—and that they tend to outperform investors who do not attend such meetings).

Id. at 330–31.

See, e.g., In re Charles P. Grom, Exchange Act Release No. 34-7150, ¶¶ 13–17, 2016 WL 683595 (Feb. 17, 2016) (describing investors’ and analysts’ receipt of information during private meetings and a “non-deal roadshow” meeting with company executives); Solomon & Soltes, supra note 144, at 331 (describing these meeting formats).

See Solomon & Soltes, supra note 144, at 333 (discussing meetings with investor relations officers).
And in the course of these many communications, the companies regularly share nonpublic—clearly valuable—information, to which only select investors have access. Yet none of this apparently violates insider trading prohibitions.

See id. at 326–28 (concluding that meetings with management help investors make more informed trading decisions).

In theory, Regulation Fair Disclosure (Reg FD), promulgated at the same time as Rule 10b5-2, might limit a corporation’s ability to selectively distribute nonpublic information, a practice which the SEC recognizes “bears a close resemblance to ordinary ‘tipping’ and insider trading.” Selective Disclosure and Insider Trading, Exchange Act Release Nos. 33-7881, 34-43154, 65 Fed. Reg. 51,716, 51,731 (Aug. 24, 2000). The SEC claims that Reg FD is designed to limit such “selective disclosure.” Id. at 51,717. However, there are several reasons that Reg FD has not been effective.

First, the SEC virtually never pursues cases under the regulation. The SEC pointedly refused to endorse a private right of action for violations, and emphasized that this was not an antifraud provision. See id. at 51,726 (“It is not an antifraud rule, and it is not designed to create new duties under the antifraud provisions of the federal securities laws or in private rights of action.”). In the fifteen years since enactment, the SEC appears to have brought only five enforcement actions under Reg FD, the last of which was in 2010. Solomon & Soltes, supra note 144, at 330 n.5. Second, the SEC made the regulation narrowly applicable to only certain knowing or recklessly-made communications, by and to specific personnel. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,718. Third, the regulation permits giving seemingly valuable information to professional investors under the theory that the information is not “material.” Id. at 51,722. In promulgating the regulation, the SEC gave a convoluted explanation as to how certain information might be material only to professional investors (and not the market as a whole), meaning it could be disclosed to those investors without running afoul of the regulation. As the SEC wrote, an issuer is not prohibited from disclosing a non-material piece of information to an analyst, even if, unbeknownst to the issuer, that piece helps the analyst complete a “mosaic” of information that, taken together, is material. Similarly, since materiality is an objective test keyed to the reasonable investor, Regulation FD will not be implicated where an issuer discloses immaterial information whose significance is discerned by the analyst. Analysts can provide a valuable service in sifting through and extracting information that would not be significant to the ordinary investor to reach material conclusions. We do not intend, by Regulation FD, to discourage this sort of activity.

Id.

The SEC appears to be asserting that information that changes the total mix for a sophisticated investor is not necessarily legally material. From a business property perspective, this might be sensible—if an individual sufficiently develops information, it may make sense to recognize his right to profit from that information. Cf. Macey, supra note 44, at 38–39 (criticizing the majority in Dirks for adopting a rule that tends to assign the property interest to the corporation unless the tipper gives it away for a socially beneficial purpose). But this does not appear to be the definition of materiality the SEC otherwise employs. By this reasoning, for example, Vincent Chiarella did not receive “material” information through his work at the printer’s office, because it was his own skill at sifting through and discerning redacted information that permitted him to determine the names of merging companies and capitalize on the information. See Chiarella v. United States, 445 U.S. 222, 224 (1980) (Chiarella “was able to deduce the names of the target companies”). Obviously the SEC would not agree with this position.
This was the main issue with the government’s theory of liability in *United States v. Newman*, and the real significance of that decision. In *Newman*, the nonpublic information at issue was originally disclosed by employees working for Dell and NVIDIA. These insiders may have been making disclosures authorized by their respective companies; although the government argued that they breached a duty of confidentiality to those companies, neither employee was deemed culpable of a securities violation. These insiders disclosed information to analysts, who then disclosed it to the two *Newman* defendants, who were hedge fund managers. It was not clear if the insiders had received a meaningful personal benefit from disclosing the information, and the government did not present any evidence that the defendants knew about any personal benefit. In other words, there was insufficient evidence that the insiders who disclosed the information initially, or the market professionals who received it, had done anything illegal. And because insider trading law focuses on the acquisition of information (and not on later market transactions), if the insiders

Finally, to appraise the rule based on the SEC’s asserted interest in market integrity and fairness: even if a professional investor can use particular information to his advantage in a way that others could not, he is still getting the relevant information by tip—via a special advantage that stems from his position, and not because of diligence or skill. Thus, even if the SEC vigorously enforced Reg FD, because of its definition of materiality, some market participants, particularly professional investors, would still be able to generate profits through tips.

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151 The Dell insider was an employee in the company’s investor relations department and was never charged criminally or by the SEC. *Id.* The NVIDIA insider (whose tipping was more suspect) was charged by the SEC, but settled the case without admitting wrongdoing. *In re Choi*, Exchange Act Release No. 34-72494, 109 S.E.C. Docket 957, 2014 WL 2915938 (June 27, 2014).
152 *Newman*, 773 F.3d at 443.
153 *Id.* at 453. The government argued that the insiders had received a benefit, but the Second Circuit concluded the government presented insufficient evidence of any meaningful benefit. *Id.* at 451–52. In the most controversial passage of the opinion, the Second Circuit stated that a benefit could not be shown “by the mere fact of a friendship, particularly of a casual or social nature” and that instead a benefit of this sort could only be inferred where two parties shared 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.* at 452. In *Salman v. United States*, the Supreme Court rejected this limitation as applied to a tipper who makes a gift of information to a trading relative or friend. See *Salman v. United States*, 137 S. Ct. 420, 428 (2016). The Supreme Court did not clarify the extent to which such a limitation would apply to information shared in a business or more casual social relationship. The Court also declined to provide any definition of “friend.”
who disclosed the information did nothing wrong, then downstream tippees could not be liable for a violation.

The larger context is that *Dirks* and numerous other cases have condoned information sharing between companies and select market professionals, which may be all that happened in *Newman*. The Second Circuit acknowledged—and reaffirmed the legitimacy of—this flow of information. The court noted that analysts “routinely solicited” information from corporate insiders to test the analysts’ models and predictions in advance of earnings announcements. Further, the evidence showed that Dell corporate insiders routinely “selectively disclosed confidential quarterly financial information . . . to establish relationships with financial firms who might be in a position to buy Dell’s stock.” Because these disclosures were designed to benefit the companies and not the individual insiders, they did not run afoul of insider trading prohibitions. And, as discussed, this manner of sharing information was not unique to the parties in *Newman*.

So to return to what “unfairness” means in the context of insider trading law, if we are honest, “unfairness” is not unequal access to information, or acquisition of information by reason of position or acquaintance, as opposed to skill. It means nothing more than getting information the owner did not authorize you to have: with corporate authorization, many individuals have access to nonpublic information based on their employment or relationships, which they can use to gain advantages over others in the market. The recipients of this information may be skilled investors or professionals, but they are nonetheless profiting from tips received due to their special position.

The professional versus personal context is the critical distinction between *Newman* and *Salman v. United States*, and explains the divergent outcomes in those two cases. *Salman* involved information shared in personal relationships: an investment banker disclosed information to his brother, who in turn shared that information with a brother-in-law (both of whom

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154 See, e.g., Pritchard, supra note 40, at 17–19, 23–24 (arguing that *Newman* represents a correct interpretation of *Dirks* based on analysis of Justice Powell’s judicial records, and tracing the SEC’s efforts to undermine *Dirks’s* limitations on liability).
155 *Newman*, 773 F.3d at 454.
156 Id. at 455 (“Dell and NVIDIA regularly engaged with analysts and routinely selectively disclosed the same type of information.”).
157 See supra notes 144–49 and accompanying text.
traded). In contrast to communications made in the course of professional relationships, traders who receive information through personal relationships such as these—either from insiders or quasi-insiders, as in Salman, or through a more convoluted misappropriation theory under Rule 10b5-2—are much more likely to be liable for insider trading. There will rarely be a tenable business rationale for the tipper’s disclosure of information in these relationships. And as the Supreme Court reaffirmed in Salman, the sharing of information among family members or friends is by itself sufficient to establish the requisite personal benefit. While the Second Circuit in Newman precluded liability based on amorphous personal benefits in the professional context—and this portion of the opinion appears untouched by the holding in Salman—the Supreme Court has sanctioned liability based on such “benefits” in the context of personal relationships.

As a result, and particularly following Newman and Salman, the current insider trading regime simply privileges what we might call professional insider traders over others. Preferred analysts who are given nonpublic information can trade on this information or pass it to others for trading. So long as the disclosure is authorized by the corporate owner of the information, there is no legal violation. And even if there was no explicit authorization, in the context of a typical business relationship, unless there is some tangible payoff to the tipper, this likely will not meet the definition of improper insider trading because there will be no clear personal benefit to the individual who shared the information.

159 Id. at 427; see also Dirks v. SEC, 463 U.S. 646, 664 (1983) (“The 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.”).
160 Salman dealt exclusively with a tipper making a gift of confidential information to a family member or friend. See Salman, 137 S. Ct. at 425; see also id. at 428 (abrogating Newman “[t]o the extent the Second Circuit held that the tipper must also receive something of a ‘pecuniary or similarly valuable nature’ in exchange for a gift to family or friends”). The Court did not endorse the government’s contention that a gift of confidential information to anyone, not just a relative or friend, would be sufficient for securities fraud liability. See id. at 426–27.
Insider trading law has thus reached a point where trading on the same tip is likely to be treated differently depending on whether it is done by professional versus nonprofessionals. The SEC has sought expansive liability for trading while in possession of nonpublic information, even promulgating rules to impose obligations of loyalty and confidentiality on groups, such as friends, whose communications were not previously regulated by law. *Newman* restricted liability for those who receive information through professional contacts, but, following *Salman*, cannot be read to alter cases where information is received through personal relationships. The result is that the advantages of professional investors will further outstrip nonprofessional investors, even when the professionals are simply getting information from tips.

Imagine a corporate insider, say someone working in his company’s investor relations department, who shares the same bit of nonpublic information with a professional analyst during the workday, and then later with his brother. If the analyst trades, he is unlikely to face any penalty; if the brother trades, he is likely to go to prison. The law permits one kind of special access, but penalizes another. This may not be arbitrary, but it is difficult to characterize as fair.

This underscores the problem with basing expanded insider trading liability on arguments related to fairness and market integrity. If trading on nonpublic information meaningfully undermines market integrity, then it should not matter who is doing the trading or from whom they received the information: “From the investors’ point of view, insider trading is a matter of concern only because they have traded with someone who used their superior access to information to profit at the investor’s expense.”162 Or, to return to the SEC’s words, presumably trading on nonpublic information “has the same impact on the market and investor confidence” regardless of who does that trading.163 Yet the current legal framework penalizes trading on information by some, while permitting trading on that same information by others.

Rather than furthering market fairness, current insider trading rules are best understood as protecting certain powerful interests:

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162 Bainbridge, *supra* note 10, at 1244.
the corporations which own nonpublic information, and the market professionals and preferred investors who enjoy special relationships with these corporations. Several commentators have argued that insider trading prohibitions are largely shaped by market professionals, who have sought their own insulation from insider trading liability. The current legal framework is compelling evidence of their success: these professionals appear to have persuaded the SEC and courts of the importance of their continued special access to nonpublic information, while others who receive and trade on the same information can be penalized.

In the end, this may be a rational framework from the perspective of the business property model because corporations may benefit from the selective disclosure of information to their preferred investors. But, it highlights the distance between what insider trading law is actually about and the rhetoric around enforcement actions. This rhetoric suggests that insider trading law is working to purge the market of unfair advantages based on special access, privilege, and favoritism. To the contrary, the law today protects and promotes the special advantages enjoyed by securities analysts and other professional investors, while increasingly penalizing the use of inside information by others.

164 See Bainbridge, supra note 10, at 1249–50 (citing and discussing Jonathan R. Macey, INSIDER TRADING: ECONOMICS, POLITICS, AND POLICY 64 (1991) and arguing that, consistent with public choice theory, the ability of market professionals, who have greater influence than insiders, to profit is protected while insiders and quasi-insiders are not). The first step in this process was linking insider trading to fiduciary duties: this ensured that market professionals would not be limited in their trading, but that others who might have equal or greater access to nonpublic information (such as insiders and quasi-insiders, like lawyers) would be barred. Id. at 1250; see also Fisch, supra note 7, at 229–32 (describing groups that profit from insider trading laws, including professional investors and market analysts, who enjoy “regular access to material nonpublic information without restrictions on its use” (footnotes omitted)).

165 For example, the SEC proclaims on its website that it has filed hundreds of claims against “financial professionals, hedge fund managers, corporate insiders, attorneys, and others whose illegal tipping or trading has undermined the level playing field that is fundamental to the integrity and fair functioning of the capital markets.” SEC Enforcement Actions: Insider Trading Cases, U.S. SECURITIES AND EXCHANGE COMMISSION, https://www.sec.gov/spotlight/insidertrading/cases.shtml (last visited Mar. 23, 2016). This rhetoric, and the increased enforcement of insider trading prohibitions, is hardly surprising given the severe criticism that the SEC faced in the wake of large scale market crises and the Bernie Madoff scandal. The agency faces severe pressure to deliver results, and individual insider trading prosecutions are fairly low-hanging fruit. See, e.g., Macey, supra note 103, at 660 (noting that the SEC’s optimal rule would make insider trading a status offense).
V. CONCLUSION

One might consider *Newman* by returning to the analogy between insider trading and honest services fraud. *Skilling v. United States* presented a question akin to that taken up by the Supreme Court in *Dirks*: whether this type of fraud required proof that a defendant was acting for personal gain, rather than to further the interests of his fiduciary-employer.\(^{166}\) In *Skilling*, the Court required evidence of some explicit personal gain, like a kickback or bribe, to save the statute from unconstitutional vagueness.\(^{167}\) In *Newman*, the Second Circuit may have been reading *Dirks* through this lens: requiring a *quid pro quo* and more explicit benefit to alleviate concerns about improper vagueness.\(^{168}\) In *Salman*, however, the Supreme Court refused to extend this limitation on liability for information shared in personal relationships. The Court also evinced a disinclination to impose limits on insider trading liability generally, or to grapple with the many problems and complexities within the current doctrine.\(^{169}\) The likely long-term effect of *Newman* and *Salman* will be to further push insider trading enforcement from the professional to the nonprofessional—creating an increasing divergence in how the law treats different parties even when they are trading on the same tips.

This is one reason the Court should have taken the opportunity to reconsider its earlier insider trading decisions and to dial back the expansions precipitated by *Dirks* and *O'Hagan*—to limit the

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\(^{166}\) See *Skilling v. United States*, 561 U.S. 358, 368 (2010) (vacating conviction and holding that honest services wire fraud only reaches bribery or kickback schemes, not more amorphous conflict-of-interest prosecutions); Brief for Petitioner at i, *Skilling v. United States*, 561 U.S. 358 (2010) (No. 08-1394), 2009 WL 4818500.

\(^{167}\) See 561 U.S. at 368 (explaining that construing the honest-services statute beyond its “core meaning” of prohibiting bribes and kickbacks “would enter a vagueness shoal”).

\(^{168}\) See *United States v. Newman*, 773 F.3d 438, 446 (2d Cir. 2014) (discussing the requirement that the tipper personally benefit from the breach of fiduciary duty).

\(^{169}\) This may be because the facts of *Salman* were easily resolved by Dirks's earlier dicta. *See Salmon v. United States*, 137 S. Ct. 420, 427 (2016) (“We adhere to Dirks, which easily resolves the narrow issue presented here. . . . Our discussion of gift giving resolves this case.”); id. at 429 (“[T]here is no need for us to address [] difficult cases today.”). The outcome of *Salman* was also likely impacted by the death of Justice Scalia, which occurred before argument and the Court’s decision. *See Adam Liptak, A Supreme Court Not So Much Deadlocked as Diminished*, N.Y. TIMES (May 17, 2016), https://www.nytimes.com/2016/05/18/us/politics/consensus-supreme-court-roberts.html?r=0 (noting that since Justice Scalia’s death in February 2016, the eight-member Court has sought consensus and narrow resolutions of cases).
law to misconduct that occurs in market transactions themselves and to require more meaningful proof of fraud.170 As the above discussion shows, insider trading law has already expanded well beyond even pre-Skilling wire fraud’s outer reaches to regulate what might be characterized as unethical conduct in a variety of personal relationships.

The jurisdictional hook for this current effort to criminalize personal unethical conduct has been the trading of securities, but it would be a mistake to see trading as anything other than a jurisdictional hook. The unethical conduct or “fraud” targeted by today’s insider trading law is not any form of misrepresentation in the context of market transactions (or even necessarily a “misrepresentation” in the legal sense), but rather some separate theft or betrayal. Under the Supreme Court’s earlier insider trading decisions, the actionable misconduct should at least have been limited to an employee or other fiduciary’s misappropriation and misuse of confidential corporate information. But with the executive’s expansions of liability, the unethical conduct can now be nothing more than betraying the implied confidence of a family member or friend.

While recent enforcement efforts have enlarged the pool of those subject to prosecution for insider trading, it would also be a mistake to see this expansion as promoting the purposes of insider trading law, such as they have been articulated by the Supreme Court. Rule 10b5-2, for example, actually undermines a corporate owner’s ability to control and direct the use of its proprietary confidential information—the interest at the heart of the Supreme Court’s insider trading cases.

Similarly, it would be a mistake to see the overarching legal framework of today’s insider trading law as substantially advancing overall market fairness and integrity. To the contrary, professional investors continue to enjoy special access to valuable nonpublic information, among other advantages, while other traders are increasingly prosecuted for using the same information.

170 This seems unlikely to hinder efforts to prevent fraud in securities markets, since it would leave untouched the classical theory of liability, and truly fraudulent conduct previously pursued under the misappropriation theory of insider trading could be challenged under other federal fraud statutes.
In the end, this divergence between the treatment of professional versus nonprofessional trading on tips reveals the fundamental and somewhat intractable irrationality at the heart of insider trading prohibitions. The ostensible bad act is trading securities based on nonpublic information that one has obtained by special position or privilege. We claim to criminalize this act in particular because it undermines market fairness and integrity. At the same time, however, we allow many other individuals in the market to conduct this same trading because they enjoy the benefit of tips and other special advantages based on position, which have been sanctioned by the law. This irrationality was perhaps less of a concern when enforcement was less aggressive, or the punishment less severe. But those convicted of insider trading today face severe criminal penalties, including significant prison sentences. Given the potential consequences, the law should no longer allow and encourage such irrationality.