No More Quid Pro Quo: Abandoning the Personal Benefit Requirement in Insider Trading Law

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A circuit split between the Second Circuit’s 2014 decision, United States v. Newman, and the Ninth Circuit’s 2015 decision, United States v. Salman, illustrates problems in insider trading law dating back over thirty years to the Supreme Court’s decision in Dirks v. SEC. Dirks held that when a corporate insider provides information to an outside party who then trades on the information, it must be shown that the insider received some form of a personal benefit for providing the information in order to impute liability. The courts in Newman and Salman disagreed on the sort of evidence that suffices to prove such a personal benefit. As this question is set to be decided by the Supreme Court, these cases provide an apt opportunity for reexamining the law of insider trading.

Although it might be argued that, for both moral and efficiency reasons, the courts in Newman and Salman reached the right outcome, the analysis in both decisions was strained as a result of the personal benefit requirement first articulated in Dirks. As this Note discusses, this split demonstrates that proof of a personal benefit as an element of insider trading in tipper/tippee cases should not be required, as it creates unnecessarily subjective inquiries into the relationship between the tipper and tippee, resulting in confusion in the boundaries of permissible trading activity. Because insider trading walks a fine line between behavior that should be encouraged (the use of information for legitimate business purposes) and discouraged (exploiting information obtained by virtue of an inside position for personal gain), it is important to more clearly define the bounds of insider trading activity. In place of requiring proof of a personal benefit, this Note argues that a wholly new statutory approach to insider trading is warranted and offers an alternative statutory proposal that may serve as a starting point for a discussion of adopting legislation.

Introduction

The Second Circuit’s 2014 decision in United States v. Newman\(^1\) became one of the most significant insider trading cases in recent years. The decision was unusual in that there was no personal benefit requirement in place, as required by Dirks v. SEC.\(^2\) The Ninth Circuit’s decision in United States v. Salman,\(^3\) which required proof of personal benefit, created a circuit split with the Second Circuit and raised questions about the Supreme Court’s decision in Dirks.

Although it might be argued that, for both moral and efficiency reasons, the courts in Newman and Salman reached the right outcome, the analysis in both decisions was strained as a result of the personal benefit requirement first articulated in Dirks. As this Note discusses, this split demonstrates that proof of a personal benefit as an element of insider trading in tipper/tippee cases should not be required, as it creates unnecessarily subjective inquiries into the relationship between the tipper and tippee, resulting in confusion in the boundaries of permissible trading activity. Because insider trading walks a fine line between behavior that should be encouraged (the use of information for legitimate business purposes) and discouraged (exploiting information obtained by virtue of an inside position for personal gain), it is important to more clearly define the bounds of insider trading activity. In place of requiring proof of a personal benefit, this Note argues that a wholly new statutory approach to insider trading is warranted and offers an alternative statutory proposal that may serve as a starting point for a discussion of adopting legislation.
years, resulting in prompt backlash from the media,\footnote{See Greg Stohr & Patricia Hurtado, Insider Trading Cases Imperiled as U.S. Supreme Court Spurns Appeal, BLOOMBERG (Oct. 5, 2015, 9:31 AM), http://www.bloomberg.com/news/articles/2015-10-05/insider-trading-cases-imperiled-as-top-u-s-court-spurns-appeal.} an appeal to the Supreme Court,\footnote{Lyle Denniston, U.S. Appeals Major Insider Trading Case, SCOTUSBLOG (July 30, 2015), http://www.scotusblog.com/2015/07/u-s-appeals-major-insider-trading-case/.} two legislative proposals to overhaul insider trading law,\footnote{Peter J. Henning, Court Strikes on Insider Trading, and Congress Lobs Back, N.Y. TIMES: DEALBOOK (Mar. 16, 2015), http://www.nytimes.com/2015/03/17/business/dealbook/court-strikes-on-insider-trading-and-congress-lobs-back.html?_r=0.} and a Ninth Circuit decision, United States v. Salman, explicitly declining to follow the holding of Newman.\footnote{United States v. Salman, 792 F.3d 1087, 1093 (9th Cir. 2015), cert. granted, 136 S. Ct. 899.} The key dispute between the courts in Newman and Salman dates back to the Supreme Court’s 1983 decision in Dirks v. SEC, which held that when a corporate insider provides information to an outside party who then trades on the information, it must be shown that the insider received some form of a personal benefit for providing the information in order to constitute insider trading.\footnote{Dirks v. SEC, 463 U.S. 646, 662–63 (1983).} While Newman interpreted this element to require proof that the insider received a benefit greater than an ephemeral friendship,\footnote{773 F.3d 438, 452 (2d Cir. 2014), cert denied, 136 S. Ct. 242 (2015).} Salman held that evidence of a friendship or close family relationship might be sufficient to satisfy the personal benefit element.\footnote{792 F.3d at 1093–94.} Though Newman’s requirement of a tangible benefit attempts to escape subjective inquiries into the closeness of a relationship, it could leave morally reprehensible trading behavior unchecked.

The Supreme Court granted certiorari in Salman to the question of whether proof of an objective personal benefit, which “represents at least a potential gain of a pecuniary or similarly valuable nature,” is needed to establish insider trading.\footnote{Petition for Writ of Certiorari at *1, Salman v. United States, No. 15-628, 2015 WL 7180648 (Sup. Ct. Nov. 10, 2015).} Oral argument took place October 5, 2016 and a ruling will be issued by June 2017.\footnote{Nate Raymond, US Top Court Leans Toward Making Insider Trading Prosecutions Easier, REUTERS (Oct. 5, 2016, 3:52 PM), http://www.reuters.com/article/us-usa-court-insidertrading-idUSKCN12510B.} Even if the Court adopts the defendant’s view that insider trading should require proof of an objective personal benefit, these cases provide an apt opportunity for reexamining the law of insider trading.

The dispute between the Second and Ninth Circuits in Newman and Salman is emblematic of larger fissures in the law of insider
trading. Because insider trading prohibitions currently rest on a vaguely-worded, catch-all anti-fraud prohibition, insider trading law has been shaped almost exclusively through the courts.\textsuperscript{11} The personal benefit requirement arose out of the Supreme Court’s belief that an insider must have breached a fiduciary duty in order to have committed insider trading. Nevertheless, subsequent decisions eroded the strict reliance on this framework,\textsuperscript{12} but still tried to operate within the confines of Supreme Court jurisprudence requiring breach of a fiduciary duty. Because any judicial reform would have to adhere to this fiduciary duty framework (or overrule thirty-year-old precedent), this Note argues that the best vehicle for reforming insider trading law is a statutory approach. A more precisely worded statute would help clarify many of the contours of the insider trading prohibition that have created controversy and confusion.

Part I outlines the moral and economic underpinnings for insider trading law and examines the development of insider trading law through precedent. Part II discusses the division between the courts in \textit{Newman} and \textit{Salman}, drawing three key observations that demonstrate the need for a new approach to insider trading law. Part III advocates for a legislative response, critiques two different legislative proposals to codify insider trading, and offers an alternative statutory proposal that may serve as a starting point for a discussion of adopting legislation.

\textbf{PART I: HISTORY OF INSIDER TRADING LAW}

The development of insider trading law over time represents a tension between the desire for both broad and narrow liability, flexibility and predictability, and fairness and efficiency. The current scope of insider trading law has broadly expanded from the strict fiduciary duty requirements articulated in early cases, but this expansion comes at the expense of clarity in the law.


A. Insider Trading Law Within the Broader Securities Regime

Securities regulation, broadly speaking, is primarily aimed at protecting investors by reducing informational disadvantages investors suffer at the expense of corporate insiders and other market professionals.13 These laws seek to protect investors through two chief means—promoting the disclosure of information,14 which provides investors with similar access to information as insiders, and deterring fraud,15 so that investors may not be taken advantage of by other market participants.

These dual concerns of disclosure and fraud deterrence, which are reflected in securities laws more generally, also animate insider trading laws. On the one hand, what makes insider trading illegal is the failure to disclose information that is not available to other market participants.16 On the other, the reason that insider trading seems so corrupt is that it enables one market participant—usually the insider of a company—to take advantage of another market participant on the basis of information they possess that is not available to the market generally.17 That is not to say, however, that the securities regulation regime is aimed at creating a perfectly level playing field—a distinction that will be explored further throughout this Note. If insider trading is conceived of as the misuse of informational advantages, insider trading law might be viewed as a way of weeding out and proscribing the sorts of impermissible informational advantages from those that are permissible.

14. Id. at 1.
15. Congress enacted the Securities Act of 1933 and the Exchange Act of 1934—the primary acts regulating the securities markets—largely in response to the failure of state laws to protect investors from being defrauded in the sale of securities. These state regulatory regimes, which came to be termed “blue sky laws” because “lawmakers believed that ‘if securities legislation was not passed, financial pirates would sell citizens everything in [the] state but the blue sky,’” were fragmented and did little to prevent fraudulent securities from being sold to the emerging middle-class of investors. Elisabeth Keller & Gregory A. Gelmann, A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934, 49 Ohio St. L.J. 329, 331–33 (1988). In fact, it was easy to evade state regulatory requirements by simply selling to investors out of state, who were frequently left without a remedy. Id. Through federal jurisdiction, the Securities Act and the Exchange Act could provide a coherent regime, patching up the holes left by state laws and providing a remedy for investors that were swindled by fraudulent sales made across state lines. Choi & Pritchard, supra note 13, at 96.
16. Choi & Pritchard, supra note 13, at 48 (“Insider trading is a fraud of pure omission.”).
B. The Need for Insider Trading Law from a Moral and Economic Perspective

Insider trading laws are predominantly justified either based on moral intuitions or from the perspective of economic efficiency. This Part briefly discusses both of these rationales to highlight some of the challenges faced by insider trading law in determining the scope of what kinds of conduct should be prohibited. While moral intuitions might drive some to say that it would be more fair for all investors to have complete access to information, that could come at the expense of market efficiency. For years, the insider trading regime has grappled with the tradeoff between these two fundamental values.18

For those that justify prohibitions on insider trading from a moral standpoint, insider trading laws serve an expressive function: they signal the appearance of fairly operating markets by stamping out the sort of behavior that manifests greed and lack of self-restraint.19 Many view the exploitation of informational advantages as morally reprehensible, particularly if such exploitation results from abuse by a person who is in a position of power or receives privileged access to information.20 Empirical studies confirm that people tend to feel that those who are entrusted with confidential information and abuse it for personal profit should be punished.21 Indeed, before the government ever prosecuted anyone for insider trading under federal securities laws, both legal scholars and those in the industry admonished the practice.22 The widespread public outrage over high-profile insider trading cases like Raj Rajaratnam of Galleon Group,23 SAC Capital,24 and Jeffrey Skilling of Enron25

20. McNamara, supra note 17, at 247.
further reveals a moral opprobrium for insider trading. As journalist Charles Gasparino wrote, “The notion that someone has an unfair advantage over someone else seems un-American; after all, our nation is built on fundamental ideas of equality and fairness.”

In addition to the idea that insider trading exhibits greed and exploitation, insider trading laws may reflect the moral intuition that one should reap benefits in proportion to their efforts. Access to inside information frequently results simply from some fortuity of being in the “right place at the right time.” By contrast, if an individual achieves an informational advantage as the result of research, innovation, or other value-added behavior, the law may want to reward and encourage such action.

Indeed, securities laws currently leave some space for informational disparities, though over time the law has evolved to permit less informational disparities. Regulation FD, promulgated in 2000, prohibits the selective disclosure of information by analysts to brokers, dealers, and other investment professionals, to ensure that all such professionals receive information at the same time. Though Regulation FD represented a substantial step in leveling the playing field among professional investors, professional investors still have a distinct advantage over lay investors in the ability, time, and resources that they have to process material information. Arguably, the advantages that professional investors have over lay investors reap some benefits for society, either by enabling markets to operate more efficiently or by compensating the analyst for the efforts...
of obtaining information.\textsuperscript{33} Furthermore, while the broader investing public may be able to overcome some informational disadvantages they have vis-à-vis analysts—for instance, by purchasing analyst research or employing a stock broker—advantages held by a corporate insider who has exclusive access to a company’s information are far more difficult to overcome.\textsuperscript{34} Hence, there is a need for prohibitions on insider trading in order to achieve fairness.

In addition to these moral underpinnings, insider trading laws can be rationalized from an economic perspective: insider trading prevents the markets from functioning efficiently. Though the impact of insider trading on market efficiency has been a matter of substantial academic debate, on balance, the empirical evidence suggests insider trading has harmful effects on the market and, thus, its regulation has positive effects.\textsuperscript{35} Intuitively, this makes sense. If investors perceive the markets as operating unfairly, they may be chilled from transacting. Moreover, insider trading imposes transaction costs: because investors cannot identify those in the market who enjoy an informational advantage, stock prices will deviate more from their true value.\textsuperscript{36} Chilling effects and transaction costs both occur in the secondary markets, but insider trading can also have negative impacts on primary markets, that is, for corporations issuing new shares. Issuers may not be able to fetch as high of a price as they could otherwise, because investors will automatically discount to compensate for the risk that insider traders could take advantage of them.\textsuperscript{37} Conversely, market efficiency may also be inhibited by \textit{too much} regulation of insider trading. More regulatory

\begin{footnotesize}
\begin{enumerate}
\item \textit{Id.} at 1032.
\item The harmful market effects that have empirically been shown to result from insider trading are numerous: stock market volatility, imposing unfair costs on market makers, decreasing market liquidity, raising the cost of capital, and disadvantaging small shareholders. Prentice, \textit{ supra} note 22, at 385; \textit{contra} Henry Manne, \textit{Insider Trading and the Stock Market} (1966) (arguing that insider trading causes security prices to more accurately reflect their true value); Jonathan R. Macey, \textit{Getting the Word Out About Fraud: A Theoretical Analysis of Whistleblowing and Insider Trading}, 105 YALE FACULTY SCHOLARSHIP SERIES 1899 (2007), http://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=2346&context=fss_papers (arguing that insider trading can serve valuable signaling functions and thus help uncover corporate fraud and corruption); Stephen J. Crimmins, \textit{Insider Trading: Where is the Line?}, 2013 COLUM. BUS. L. REV. 330, 333 (2013) (arguing that too much insider trading regulation chills investors from making legitimate trades because they are not sure whether their conduct will be prohibited).
\item \textit{Choi & Pritchard}, \textit{ supra} note 13, at 330.
\item \textit{Id.} at 330–31.
\end{enumerate}
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red tape may prevent market professionals and other investors from making legitimate trades.\footnote{38}

Yet aside from these moral and efficiency concerns, which define many of the limits on the scope of insider trading, it is important to consider the practical limits to what conduct can be proscribed. As Justice Powell noted in \textit{Dirks v. SEC}, insider trading laws may not capture all types of behavior that are morally reprehensible:

> Depending on the circumstances, and even where permitted by law, one’s trading on material nonpublic information is behavior that may fall below ethical standards of conduct. But in a statutory area of the law such as securities regulation, where legal principles of general application must be applied, there may be “significant distinctions between actual legal obligations and ethical ideals.”\footnote{39}

This statement predicted the course that insider trading law would take as it formed in the years following that precedential 1983 decision. In particular, insider trading law as expressed by the Supreme Court largely represents an under-inclusive regime, where not all immoral activities are punishable by law.\footnote{40} In part, this may be because comporting insider trading law with moral sensibilities would require a flexible and expansive reach of insider trading law. Such flexibility in the law would be at odds with the need for predictability and clarity in the law to put investors and traders on notice before inflicting the severe civil and criminal penalties of insider trading. However, in recent years, the SEC has pushed courts to recognize new forms of insider trading using the existing molds of precedent, expanding liability to a broader range of contexts.\footnote{41} These decisions have created divergences amongst circuits, resulting in a muddled body of law that is at times perplexing, sometimes even incoherent.\footnote{42} As Professor Langevoort writes, “Much of the complexity of the law of insider trading—something long recognized as a problem in this area—is a product of quixotic attempts by the courts to resolve this tension [between flexibility and predictability].”\footnote{43}

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\footnote{38. See \textit{infra}, Part I.D.}
\footnote{39. \textit{Dirks v. SEC}, 463 U.S. 646, 661 n.21 (1983).}
\footnote{40. See \textit{18 INSIDER TRADING: REGULATION, ENFORCEMENT, & PREVENTION} § 2.01 (West Group 2001) [hereinafter \textit{REGULATION, ENFORCEMENT, & PREVENTION}].}
\footnote{41. \textit{Crimmins}, \textit{infra} note 35, at 332–33.}
\footnote{42. See \textit{id.} at 356 n.83.}
\footnote{43. \textit{REGULATION, ENFORCEMENT, & PREVENTION}, \textit{infra} note 40, at §1.02[4].}
C. The Early Development of Insider Trading Law Through Precedent: A Tale of Two Regimes

Neither the Securities Act of 1933 (“The Securities Act”) nor the Securities and Exchange Act of 1934 (“The Exchange Act”)—the primary acts governing federal securities laws violations—contain a provision specifically forbidding insider trading. In fact, the words “insider trading” appear nowhere within these acts. Insider trading actions are widely understood to fall under the reach of SEC Rule 10b-5 (promulgated under Section 10(b) of the Exchange Act), the catch-all anti-fraud prohibition also used to prosecute corporations for making false or misleading statements to investors. Rule 10b-5 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

. . . .

c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. 44

In part, Congress’s reluctance to clearly define insider trading law has been explained as a conscious decision on the part of the SEC and Congress—they don’t want to provide would-be wrongdoers with a “blueprint for fraud.” 45 Furthermore, it may reflect a reluctance to make the law so inflexible that it is inapplicable in novel situations—especially those novel situations that appear morally reprehensible. 46 As a result of the vagueness in the language of Rule 10b-5, insider trading law is predominantly the product of precedent.

A “watershed step” 47 in the development of insider trading law, In re Cady, Roberts, 48 laid the foundation for a broad interpretation of Rule 10b-5 by recognizing that fraud did not have to take place through a face-to-face transaction: open market insider trading also

44. 17 C.F.R. § 240.10b-5 (2016) (emphasis added).
45. Regulation, Enforcement, & Prevention, supra note 40, §2.01. However, in 2000 the SEC did adopt three specific insider trading rules. These rules relate to the scienter required for insider trading liability (Rule 10b5-1), when a fiduciary duty is present in a misappropriation case (Rule 10b5-2), and selective disclosure by companies and their senior executives (Regulation FD). Id. at §2.04[4].
46. Id. at §2.01.
47. Id. at §2.02[2].
constitutes fraud. According to Cady, Roberts, the anti-fraud provisions of Rule 10b-5 “are not intended as a specification of particular acts or practices which constitute fraud, but rather are designed to encompass the infinite variety of devices by which undue advantage may be taken of investors and others.” Cady, Roberts suggested two different rationales that give rise to a corporate insider’s duty to abstain from trading on inside information. First is “the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone.” Second, “inherent unfairness” results “where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.” Depending on which Cady, Roberts rationale was understood to define insider trading, the scope of liability would vary. Insider trading liability would be more narrow if it focused merely on a special relationship between the insider and the source of the information. By contrast, the latter articulation of the “inherent unfairness” of such informational advantages suggests a broader duty to the market to forgo trading on material, non-public information.

The Second Circuit adopted this latter theory of broad liability in its 1968 decision, Texas Gulf Sulphur. In adopting what is known as a parity-of-information rule, the Second Circuit interpreted Rule 10b-5 as promoting “relatively equal access to material information,” suggesting that all investors should have the same opportunities to reap the rewards of the securities markets and, likewise, bear similar risks. But when insider trading came before the Supreme Court in Chiarella, the case that “laid the groundwork” for the Supreme Court’s treatment of insider trading, Justice Powell focused on the first Cady, Roberts element, the existence of a duty, as the crux of an insider trading violation. Justice Powell wrote that Section 10(b) was not
intended to reach “every instance of financial unfairness”; rather, a duty to forgo trading arises merely “from a specific relationship between two parties.” Concerned with chilling legitimate trading activity and investment research, Justice Powell wanted to reign in the SEC by significantly pushing back on the broad “equal access” regime articulated in Texas Gulf. But, the decision did not entirely prevent the SEC from pursuing more novel theories of insider trading in ensuing years.

D. Tipper/Tippee Liability and the Personal Benefit Requirement

In 1983, the Supreme Court expanded insider trading liability beyond situations where an insider, or one who otherwise had access to inside information, personally traded on such information. In Dirks, the Court recognized liability under some circumstances where the insider does not necessarily trade on information, but rather provides a tip to someone outside the organization who then trades on the information. Echoing Chiarella, the Court emphasized the need for a special relationship giving rise to a fiduciary duty to support a finding of insider trading liability. The tippee has an obligation not to trade on information received from an insider given his “role as a participant after the fact in the insider’s breach of a fiduciary duty.”

But when is the tipper, the one who provides the information, liable? Without having breached a fiduciary duty, so Justice Powell’s argument goes, there can be no deception, as Rule 10b-5 requires. The Court concluded that in order to establish the breach of a fiduciary duty, an improper purpose must be shown. The fiduciary duty to which the court implicitly referred is the duty

59. Id. at 232.
60. Id. at 233.
64. Because Justice Powell grounded insider trading law in the breach of a fiduciary duty in Chiarella, this was the necessary starting point for the analysis in Dirks. See Genesis, supra note 61, at 860; see also Dirks, 463 U.S. at 666 n.27.
65. Genesis, supra note 61, at 872 (“The breach of fiduciary duty by the insider is the gravamen of the deceptive conduct”).
66. Dirks, 463 U.S. at 659.
of loyalty, under which an agent or employee may not misappropriate the assets of the firm for an improper use. Just as insiders are prohibited from trading on inside information, insiders cannot provide inside information “to an outsider for the . . . improper purpose of exploiting the information for their personal gain.” Thus, for the insider to have breached a duty in situations where, rather than trading on inside information, an insider discloses it, the insider must personally have obtained some benefit from making the disclosure.

In determining whether the insider received a benefit, Justice Powell instructed that the focus should be on “objective criteria”: i.e., “a pecuniary gain,” “a reputational benefit that will translate into future earnings,” “a relationship between the insider and the recipient that suggests a quid pro quo from the latter,” “an intention to benefit the particular recipient,” or “a gift of confidential information to a trading relative or friend.” In Dirks, because the insider’s information sharing was motivated merely by a desire to expose fraud and resulted in no direct or indirect benefit from having shared the information, he could not be held liable for insider trading.

In limiting the scope of insider trading liability to situations where a fiduciary duty had been breached, the Court rejected a rule of equal access, explaining that such a rule could greatly inhibit the role of market analysts. The market depends on the existence of analysts to “ferret out” information, which promotes efficiency because stock prices incorporate new information and better represent a company’s true value.

As the next Part will illustrate, in subsequent years, the Court’s efforts to both remain faithful to the breach of a fiduciary duty as the crux of insider trading liability and expanding liability beyond the mere trading on inside information by a corporate insider, has resulted in analytical difficulties. In particular, these subsequent decisions raised significant questions about how to apply the personal benefit requirement articulated in Dirks.

67. Id. at 866.
68. Restatement (Second) of Agency § 387 (1995) (“[A]n agent is subject to a duty to his principal to act solely for the benefit of the principal in all matters connected with his agency.”).
69. Dirks, 463 U.S. at 659.
70. Id. at 662.
71. Id. at 663–64.
72. Id. at 667.
73. Id. at 657-58.
74. Id. at 658.
E. The Personal Benefit Requirement Under Expanding Theories of Insider Trading

Insider trading continued to expand beyond the violation of a fiduciary duty owed by a corporate insider to the corporation’s shareholders, but this expansion raised questions about when the personal benefit should apply to more novel theories of insider trading, such as the misappropriation theory and theories of remote tipping.

In the 1997 *O’Hagan* decision, the Supreme Court recognized a theory of liability long-advanced by the SEC, called the misappropriation theory. Before *O’Hagan*, the Court had only recognized insider trading falling under the pattern of what is termed the “classical” theory of insider trading. Under classical insider trading theory, a corporate insider commits insider trading when he trades securities of a corporation to whom he owes a fiduciary duty on the basis of material, nonpublic information. However, the Court recognized that the classical theory of insider trading did not capture all of the sorts of conduct that seemed morally abhorrent.

In *O’Hagan*, the defendant, an attorney, traded on the options of the target firm when he learned of a potential tender offer by virtue of his employment with the law firm. Though the defendant owed no duty to the corporation whose shares he traded on because his law firm represented the acquirer, the Court nevertheless held that he owed a fiduciary duty to the source of the information, that is, his employer and the firm’s client. The misappropriation theory premises the trader’s liability on his “deception of those who entrusted him with access to confidential information.” The Court further explained:

Although informational disparity is inevitable in the securities markets, investors likely would hesitate to venture their capital in a market where trading based on misappropriated nonpublic information is unchecked by law. An investor’s informational disadvantage vis-a-vis a misappropriator with material, nonpublic information stems from contrivance, not

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76. *Id.* at 651–52.
77. *Id.* at 647–48.
78. *Id.* at 655–56.
79. *Id.* at 652. Nevertheless, in remaining faithful to the earlier decisions, Justice Ginsburg noted in *O’Hagan* that had the defendant disclosed to his sources the intent to trade on the information, his conduct would not be deceptive, and hence he could not be held liable for insider trading. *Id.* at 659 n.9.
luck; it is a disadvantage that cannot be overcome with re-
search or skill.\textsuperscript{80}

As the Court’s dicta suggests, the \textit{O’Hagan} decision expanded insi-
der trading liability to behavior that seems morally wrong: in-
vested should not be allowed to profit from mere dumb luck of
being in the right place at the right time.\textsuperscript{81} The Court’s dicta also
suggests an efficiency rationale for recognizing the misappropria-
tion theory—regardless of where inside information is obtained
from, such informational disadvantages could have a chilling effect
on trading activity.

However, in so expanding insider trading liability, the Court cre-
ated further incoherencies and confusion in the law of insider
trading, in particular, whether proof of a benefit to the tipper
should be required in cases arising under the misappropriation the-
ory.\textsuperscript{82} In fact, earlier decisions—mostly pre-dating \textit{O’Hagan}—
suggested the \textit{Dirks} personal benefit requirement would not apply
in cases arising under the misappropriation theory.\textsuperscript{83} In cases
brought under the classical theory of insider trading, the applica-
tion of the \textit{Dirks} test appeared fairly straightforward: \textit{Dirks}
represented a case of classical insider trading, and a series of lower
court opinions accordingly construed the meaning of “benefit”
quite broadly.\textsuperscript{84} Yet in \textit{SEC v. Yun},\textsuperscript{85} the SEC argued that the per-
sonal benefit requirement was premised on the idea that a tippee
inherited the fiduciary duty owed to the corporation’s sharehold-
ers. Since under the misappropriation theory, no such duty is owed
to the shareholders by the trader, it would be nonsensical to apply
the \textit{Dirks} test, since it was a means of proving whether a fiduciary
duty had been breached.\textsuperscript{86}

\textsuperscript{80} \textit{Id.} at 658–59.

\textsuperscript{81} \textit{See} McNamara, \textit{supra} note 17, at 265–66.

\textsuperscript{82} \textit{William K.S. Wang \& Marc I. Steinberg, Insider Trading} \textsection 5.4.4 (3d ed. 2010).

\textsuperscript{83} \textit{Id.}

\textsuperscript{84} \textit{Compare} \textit{SEC v. Warde}, 151 F.3d 42, 49 (2d Cir. 1998) (close relationship between
tipper and tippee suggested that tip was intended to benefit tippee) \textit{and} \textit{SEC v. Maio}, 51 F.3d
623, 633 (7th Cir. 1995) (holding that where tipper and tippee were friends, “[a]bsent some
legitimate reason for [the] disclosure, . . . the inference that [the] disclosure was an im-
proper gift of confidential corporate information is unassailable”), \textit{with} \textit{SEC v. Maxwell}, 341
F. Supp. 2d 941, 948 (S.D. Ohio 2004) (no benefit found where defendant did not stand to
gain from disclosing inside information to his barber) \textit{and} \textit{SEC v. Anton}, No. 06-2274, 2009
WL 1109324, \textsuperscript{85} \textit{9} (E.D. Pa. Apr. 23, 2009) (no benefit found where testimonies of both tipper
and tippee suggested the two were not friends and did not have a social or personal rela-
tionship. The tipper had only been to tippee’s house once, did not have his personal contact
information, and had never received a gift from tippee).

\textsuperscript{85} \textit{SEC v. Yun}, 927 F.3d 1263 (11th Cir. 2003).

\textsuperscript{86} \textit{Id.} at 1275.
The Eleventh Circuit rejected the SEC’s argument in *Yun*, instead holding that, as with classical insider trading cases, the SEC must prove that a tipper expected to benefit from a tip in misappropriation cases.\(^87\) Otherwise, the plaintiffs could simply skirt the requirement of proving a personal benefit by recasting a case under the misappropriation theory instead of the classical theory.\(^88\)

Another area in which the personal benefit test appears strained is in situations of remote tippees—where a tippee improperly receives information and then discloses such information to another tippee, who trades on it. The remote tippee is thus at least one layer removed from the insider. Courts generally recognize the personal benefit requirement still holds when there is a chain of tippers,\(^89\) even though as one gets further removed from the initial tip, it may be difficult to know whether a tipper received a personal benefit.\(^90\)

This Part has described courts’ growing tendencies to recognize more novel theories of insider trading, often in situations where the defendants’ moral culpability seemed apparent. But as the scope of insider trading expands, it creates incoherencies in elements of proof required for insider trading, which are premised on Supreme Court cases recognizing more narrow incidents of insider trading liability. The next Part will explore an issue that has become a matter of much debate following two conflicting Circuit Court decisions—namely, what constitutes sufficient evidence to prove that a tipper received a personal benefit for disclosing inside information.

**PART II: THE FAILINGS OF THE PERSONAL BENEFIT TEST IN **
**NEWMAN AND SALMAN**

Two recent cases, arising in the Second and Ninth Circuit respectively, called the application of the personal benefit test further into question. Despite the generally broad definition of personal benefit embraced by lower courts, the Second Circuit’s decision in *United

\(^{87}\) *Id.* at 1276.  
\(^{88}\) *Id.* at 1279.  
\(^{89}\) See, e.g., SEC v. Obus, 693 F.3d 276, 288 (2d Cir. 2012); *Maio*, 51 F.3d at 632 (7th Cir. 1995).  
\(^{90}\) *Wang & Steinberg*, *supra* note 82, at 409.
States v. Newman\(^{91}\) significantly narrowed the definition. The following year, in United States v. Salman, the Ninth Circuit squarely rejected this narrow reading of a personal benefit.\(^{92}\)

In particular, Newman and Salman called into question whether a gift of information to a relative or friend is sufficient to satisfy the personal benefit element of insider trading. In dicta, the Dirks opinion suggested that “[t]he elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend.”\(^{93}\) Yet Newman held that evidence of friendship or a personal relationship alone was insufficient to support an insider trading charge.\(^{94}\) Rather, the SEC must offer proof of “a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.”\(^{95}\) However, in Salman, decided in July 2015, the Ninth Circuit came out on the exact opposite side of the issue, creating a circuit split by holding that tipping information to a relative or friend was sufficient to support a charge of insider trading.\(^{96}\) In January 2016, the Supreme Court granted the petition for a writ of certiori in Salman to review the question of whether objective criteria must be demonstrated to prove personal benefit, as Newman held, or whether merely evidence of a close familial relationship such as that presented in Salman can satisfy the personal benefit requirement.\(^{97}\)

Part II provides a close examination of these two important cases in turn and then draws a few important lessons from the comparison. First, these cases demonstrate that moral intuitions may point in different directions based on the context in which insider trading occurs—namely, whether the relationship is a familial one or predominantly within the business context. Second, they reveal that courts’ attempts to discern insider trading from purely objective criteria can lead to a regime that is underinclusive in terms of its alignment with moral sensibilities. Finally, they underscore the logical failings of the personal benefit test as applied to the more novel

\(^{92}\) United States v. Salman, 792 F.3d 1087, 1088 (9th Cir. 2015), cert. granted, 136 S. Ct. 899.
\(^{94}\) 773 F.3d at 452.
\(^{95}\) Id.
\(^{96}\) 792 F.3d 1087, 1093–94.
\(^{97}\) Salman v. United States, 792 F.3d 1087 (9th Cir. 2015), cert. granted, 136 S. Ct. 899 (No. 15-628); Appellate Motion, United States v. Salman, 2015 WL 7180648 (No. 15-628).
theories of liability advanced by the SEC post-Dirks, such as the remote tipping chains at issue in both Newman and Salman.

A. United States v. Newman

In Newman, the defendants, two portfolio managers, traded on information provided by analysts working for them. The analysts received the information as part of an exchange amongst analysts from various firms, and the case concerned two separate tipping chains involving information concerning two different stocks. In one of the charged tipping chains, an analyst received information regarding Dell’s earning numbers before they were publicly released from the investor relations department. He relayed this information to an analyst at another firm, Diamondback, who in turn relayed it to the defendant Todd Newman, a portfolio manager at Diamondback. The Diamondback analyst also passed the tip to an analyst at Level Global, who passed the information to Level Global’s portfolio manager Anthony Chiasson, also a defendant in the case. Both Newman and Chiasson traded on this information and were three and four levels removed from the source of information, respectively.

In the other tipping chain, which involved the stock of NVIDIA, an employee of NVIDIA’s finance group tipped earnings numbers to a former technology company executive who was a friend of his from church. The executive then passed the information to co-defendant Danny Kuo, an analyst. Kuo tipped the Diamondback and Level Global analysts, who passed the information to Newman and Chiasson, respectively. Therefore, defendants Newman and Chiasson were four levels removed from the tipper with respect to the NVIDIA stock.

The defendants in Newman argued that the circumstantial evidence was insufficient to establish that the corporate insiders had provided the information in exchange for a personal benefit. For one, the Dell insider was not close friends with the analyst that he provided a tip to, though they had known each other for years, worked at Dell together, and attended business school with one another. Though the evidence showed the Dell insider wanted to

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98. Newman, 773 F.3d at 442.
99. Id.
100. Id. at 443.
101. Id.
102. Id. at 444.
103. Id. at 451–52.
become an analyst, too, and that the analyst gave career advice to the Dell insider, even passing his resume on to Wall Street recruiters. The Second Circuit found that the evidence did not establish a sufficiently “objective, consequential” exchange for such assistance to constitute a personal benefit. The Second Circuit noted that the assistance given by the analyst to the Dell insider was “little more than the encouragement one would generally expect of a fellow alumnus or casual acquaintance.” This assistance included “minor suggestions” on a resume and advice prior to an informational interview. The Second Circuit found it particularly significant that the analyst testified he would have given the Dell insider advice even had the insider not given him information, because he routinely did so for other colleagues in the industry, and had been providing the Dell insider with advice for over a year before the insider began providing any tips to the analyst—suggesting that his motive for providing career advice was not a quid pro quo to receive inside information.

With respect to the NVIDIA tipping chain, the evidence established that the NVIDIA insider and analyst tippee met through church, were family friends, and occasionally socialized together. The Second Circuit noted that the two were merely “casual acquaintances,” and furthermore, that the insider did not know that the analyst was trading the stock of NVIDIA, which undermined the inference that the two had swapped information as part of some sort of exchange.

Writing for the majority, Judge Parker wrote that an inference that the insider received a personal benefit was “impermissible in the absence of proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.” The “mere fact of a friendship, particularly of a casual or social nature” was insufficient to satisfy the personal benefit element. The Second Circuit expressed fear that inferring that an insider received a personal benefit from such circumstantial evidence would allow the government to meet its burden of proof by

104. Id. at 452.
105. Id.
106. Id. at 453.
107. Id.
108. Id.
109. Id. at 452.
110. Id. at 453.
111. Id. at 452.
112. Id.
simply “proving that two individuals were alumni of the same school or attended the same church,” rendering the personal benefit requirement a “nullity.”

Regardless of whether there was a personal benefit exchanged, the Second Circuit further noted that there was no evidence that the defendants Newman and Chiasson knew that the insiders had personally benefitted from providing information. Because the insider’s liability is derivative of a fiduciary duty, the disclosure of confidential information, standing alone, is not a breach—the tippee must know that the insider received some personal benefit in exchange for the disclosure. The opinion suggests that, without requiring knowledge of the personal benefit received, the law would verge on the parity-of-information scheme rejected in Chiarella and again in Dirks. Therefore, the rationale in Newman, notably, was consistent with the Supreme Court line of cases decided under Justice Powell, which focused merely on the fiduciary duty element as proof of fraud and rejected the notion that insider trading law should be concerned with leveling the playing field between all market participants.

B. United States v. Salman

The Ninth Circuit in Salman unequivocally refused to adopt the standard for personal benefit as established by Newman. In Salman, the insider, Maher Kara, worked as an investment banker for Citigroup’s healthcare group and provided his older brother, Michael, with information about upcoming mergers and acquisitions of and by clients of Citigroup. Maher provided Michael with the information despite knowing that he was trading on it. Michael then further passed this information along to defendant Bassam Yacoub Salman, Maher’s future brother-in-law, whom Michael had become close to during the course of Maher’s engagement to Salman’s sister. Michael encouraged Salman to “mirror-

113. Id.
114. Id. at 453.
115. Id. at 448.
116. Id. at 448–49.
117. Id. at 449.
118. United States v. Salman, 792 F.3d 1087, 1089 (9th Cir. 2015), cert. granted, 136 S. Ct. 899.
119. Id.
120. Id.
image” his trading activity.\textsuperscript{121} Significantly, Salman knew that Maher had been providing the information to Michael.\textsuperscript{122}

The evidence established that Michael and Maher “enjoyed a close and mutually beneficial relationship.”\textsuperscript{123} Michael had helped pay for Maher’s college, helped teach Maher some of the scientific concepts relevant to Maher’s work in the healthcare industry, and stood in Maher’s wedding.\textsuperscript{124} Maher further testified to his deep love for his brother and that he had provided the information in order to “benefit him” and “fulfill whatever needs he had.”\textsuperscript{125} When Maher knew that Michael was in need of money, he provided him with inside information.\textsuperscript{126} For his part, Salman was aware of the close relationship between Michael and Maher, and even agreed to “protect” Maher from liability.\textsuperscript{127} The Court found such awareness on the part of Salman sufficient to establish that Salman knew that Maher intended to benefit Michael by providing him with confidential information.\textsuperscript{128}

The Ninth Circuit held that Maher’s disclosure of confidential information to Michael “was precisely the ‘gift of confidential information to a trading relative’ that \textit{Dirks} envisioned.”\textsuperscript{129} Furthermore, the Ninth Circuit rejected Salman’s argument that the holding in \textit{Newman} counseled that \textit{Dirks} required evidence of a tangible personal benefit.\textsuperscript{130} The Ninth Circuit noted that, to the extent \textit{Newman} could be read to require a showing of a tangible benefit, this would clearly depart from the \textit{Dirks} holding that a gift of information to a relative or friend was sufficient to establish the personal benefit. As such, the Ninth Circuit declined to follow \textit{Newman}.\textsuperscript{131}

\textbf{C. Lessons to be Drawn from Newman and Salman}

The Second Circuit’s interpretation of the personal benefit standard as articulated in \textit{Newman}, which suggested that a personal benefit must be tangible, could have significant ramifications for

\textsuperscript{121} \textit{Id.}
\textsuperscript{122} \textit{Id.}
\textsuperscript{123} \textit{Id.}
\textsuperscript{124} \textit{Id.}
\textsuperscript{125} \textit{Id.}
\textsuperscript{126} \textit{Id.}
\textsuperscript{127} \textit{Id.} at 1089, 1092. The Ninth Circuit in \textit{Salman} noted that, on a visit to Salman’s office, Maher noticed papers relating to their stock trading activity out in the open. Maher admonished Salman and instructed him to be more careful with the information. \textit{Id.} at 1089.
\textsuperscript{128} \textit{Id.} at 1094.
\textsuperscript{129} \textit{Id.} at 1092 (quoting \textit{Dirks v. SEC}, 463 U.S. 646, 664 (1983)).
\textsuperscript{130} \textit{Id.} at 1093.
\textsuperscript{131} \textit{Id.}
insider trading law. The facts of Salman may not have been the best test case for disputing the Second Circuit’s interpretation of the required benchmark to prove a personal benefit, as they suggested that Maher Kara did receive tangible returns for providing the information. Given that the court in Salman probably could have found a showing of a tangible benefit on the facts before it, some have suggested that Salman did not actually require the Ninth Circuit to outwardly reject the Newman standard in the manner it did. These cases therefore may be emblematic of deeper divisions among courts regarding the merits of the personal benefit test.

To the extent these two opinions diverge, it could have significant ramifications on insider trading law. If, on appeal, the Supreme Court requires a showing of a tangible personal benefit, the government’s burden of proof in insider trading cases will become substantially higher. In fact, in the weeks following the Newman decision, the SEC and DOJ vacated a number of guilty pleas by remote tippees, suggesting that the agencies would have a more difficult time establishing liability for insider trading if required to prove a tangible benefit.

But aside from differences in prosecution that could result depending on the standard adopted, the differing outcomes in these cases highlight broader issues relating to insider trading law. These differences may provide guidance on directions for future reform in the law of insider trading.

One key distinction between Newman and Salman is that while the former may be interpreted as occurring predominantly within the context of a business relationship, the latter dealt with a familial

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132. For instance, Michael had helped pay for Maher’s college and the SEC also presented direct evidence that the information was intended as a gift, since Maher testified that he hoped to benefit and provide for Michael. Id. at 1089, 1094.
133. See, e.g., Genesis, supra note 61, at 859 (arguing that the outcome in Newman is consistent with the logic in Dirks and the history subsequent to Dirks).
134. The Salman opinion is interesting in its own regard, for reasons existing wholly outside the facts of the case itself. Judge Rakoff, sitting by designation in the Ninth Circuit, had the rare opportunity to question an opinion from the Second Circuit, the bench on which he usually sits. See Jacob Gershman, Rakoff and Ninth Circuit Throw Cold Water on Insider Trading Ruling, WALL STREET J. (July 6, 2015, 5:20 PM), http://blogs.wsj.com/law/2015/07/06/rakoff-and-ninth-circuit-throw-cold-water-on-insider-trading-ruling/.
relationship.\textsuperscript{137} In \textit{Newman}, unlike \textit{Salman}, the entire tipping chain involved professional investors. Thus, the \textit{Newman} decision might be interpreted to mean that information shared in the context of a businesslike relationship will generally be insufficient to satisfy the personal benefit requirement.\textsuperscript{138}

In fact, familial cases, for the most part, are the easiest ones to resolve. If the insider, as in \textit{Salman}, provides stock tips to his brother, who works in a wholly unrelated industry, it is exactly the sort of “gift of confidential information”\textsuperscript{139} contemplated by \textit{Dirks}, and, having no “corporate purpose,”\textsuperscript{140} manifests the sort of unfair, exploitative behavior that moral intuitions counsel should be prevented by insider trading laws. By contrast, for efficiency reasons, it may make sense to safeguard the exchange of information in pure business relationships. As Justice Powell pointed out in \textit{Dirks}, legitimate business reasons may exist for exchanging information.\textsuperscript{141} Indeed, market analysts’ value is highly dependent on seeking out new information.\textsuperscript{142} Moreover, the SEC’s adoption of Regulation FD, which prohibits issuers from making selective disclosures to analysts and investors, seemingly solves the problem of informational advantages within the context of those investor/issuer relationships, mitigating much of the need for insider trading prosecution.\textsuperscript{143}

Not all cases will be as black and white as the fact patterns in \textit{Newman} and \textit{Salman}, however. Though mere acquaintances, such as the church friends in \textit{Newman}, will probably not be sufficient for a finding of personal benefit, one can easily imagine circumstances where evidence of a more substantial friendship would lead to difficult questions for courts to resolve. Determining how close is “close enough” in the context of personal relationships is a fact-intensive endeavor, and one that courts should understandably be hesitant to

\begin{itemize}
  \item[138.] Id.
  \item[140.] Id. at 654.
  \item[141.] See id. at 658–59.
  \item[142.] Id.
  \item[143.] While Regulation FD specifically imposes liability on issuers not to disclose inside information, rather than imposing punishment on those who trade on inside information, this nevertheless is intended to serve as a stopgap to prevent issuers from according informational advantages to particular investors at the expense of other investors. Admittedly, this largely serves to create more parity only amongst \textit{sophisticated investors}, as those are the sorts that would likely benefit from selective disclosures.
\end{itemize}
undertake.\textsuperscript{144} Even to the extent \textit{Newman} can be interpreted as permitting information exchanges in the context of business relationships, this standard will not always be clear. \textit{Newman} itself involved a situation where the two not only traded professional advice, but also had attended business school and church together, suggesting a friendship element in addition to the business relationship.

Perhaps recognizing the difficulty in making these fact-intensive inquiries, the \textit{Newman} court emphasized the importance of focusing on objective criteria. This leads to a second lesson to be drawn from a comparison of these two cases, which is that courts’ attempts to discern insider trading from purely objective criteria might lead to a regime that is under-inclusive in terms of its alignment with moral sensibilities. In \textit{Newman} itself, the relationship could be seen as toeing the line between business and personal, but the court downplayed the personal element by focusing on an objective \textit{quid pro quo}. Yet, as the opinion in \textit{Salman} noted, if the \textit{Newman} standard is read literally, it would enable an insider in possession of inside information to “disclose that information to her relatives, and they would be free to trade on it, provided only that she asked for no tangible compensation in return.”\textsuperscript{145} Not only would such a result clearly misalign with notions of fairness, it would permit insider trading that had no legitimate business purposes.

A final observation on \textit{Newman} and \textit{Salman} is that both involved chains of tipping. As discussed in Part I, the logic behind applying the personal benefit test in the context of remote tipping chains is attenuated, particularly as the tippees get further away from the initial source of the information. In \textit{Newman}, a key issue was whether the defendant knew the insider had received a personal benefit for the information,\textsuperscript{146} which was particularly difficult to show given the defendants were three or four layers removed from the source of the information.\textsuperscript{147} In \textit{Salman}, by contrast, there was merely one link between the defendant and the source of the information. On that evidence, it was much more apparent that the defendant knew who the source of information was. These cases, therefore, illustrate that as tipping chains become more complex, it will be harder to show that a defendant knew of a personal benefit received by the

\textsuperscript{145} United States v. Salman, 792 F.3d 1087, 1094 (9th Cir. 2015), cert. granted, 136 S. Ct. 899.
\textsuperscript{147} Id. at 443.
insider, thereby undermining the personal benefit test. More importantly, it seems much harder to say that the personal benefit received by the insider is related in any meaningful way to someone who trades on the information three or four levels down the line, since there will often be little connection between the two.

D. Abandoning the Personal Benefit Requirement

These lessons drawn from a comparison of Newman and Salman underscore the failings of the personal benefit requirement in important ways. First, to the extent that insider trading laws should not inhibit legitimate analyst research efforts—such as the information exchanged in the context of purely business relationships—the personal benefit requirement can result in difficulties. This is because it is often difficult to draw such fine lines when business relationships spill over into other contexts. Second, if courts look to objective criteria to resolve such subjective inquiries, they could fail to capture some information exchanges that many think should be subject to insider trading liability for moral reasons. Finally, these cases demonstrate the already recognized problems of applying the personal benefit test in cases arising under the remote tippee theories of liability.

Taken together, these lessons suggest that the personal benefit test—a required element for establishing insider trading liability—is problematic, if not entirely unworkable. Part III advocates that the personal benefit requirement should be abandoned, and a new statutory scheme adopted.

PART III: A LEGISLATIVE APPROACH TO REFORMING INSIDER TRADING LAW

Newman and Salman are revealing cases, in that both moral sensibilities and reliance on market efficiency principles seem to warrant the same conclusions the courts reached. Yet Newman provoked great outcry, prompting multiple federal statutory proposals to reform insider trading law,148 an appeal of the decision to the Supreme Court,149 and a fervent dialogue in the mainstream media regarding what this case means for the future of insider trading prosecutions.150 Insofar as the trading in Newman occurred

149. Denniston, supra note 3.
150. See, e.g., Stohr & Hurtado, supra note 2.
predominantly in the realm of a business relationship, it might be said that Newman reached the right result. So why was the reaction to the decision so negative?

Perhaps what seems so appalling about the result in Newman is that the court’s rendering of personal benefit is at odds with the plain language of Dirks, leaving confusion in the decision’s wake.151 Though the Newman and Salman decisions received a unique level of public attention, the confusion resulting from these decisions is consistent with lower courts’ struggles over the decades following the Dirks decision to apply the personal benefit test in a way that makes logical sense. Part III argues that the difficulty in applying the personal benefit test, as manifested in the most recent circuit split, demonstrates the need for a new approach to insider trading. Part III examines where insider trading law would stand if the personal benefit test were eliminated, and critiques two current legislative proposals, neither of which rely on a showing of personal benefit as necessary to establish insider trading liability. It will be demonstrated that both of these proposals are overbroad and poorly-crafted, and would result in liability in a number of situations where it should not apply. Finally, Part III will propose alternative statutory text that may serve as a starting point for discussion of adopting legislation.

A. Starting from a Blank Slate: The Benefits of Pursuing a Legislative Approach

The difficulty in attempting to rationalize—and reconcile—the differing opinions reached by the Second Circuit in Newman and Ninth Circuit in Salman illustrates just how unpredictable and murky the personal benefit requirement seems to be in application.

Some of this mess derives from the attempts to fit insider trading law within 10b-5, the vaguely worded anti-fraud provision of the 1934 Exchange Act. As Professor Langevoort noted, treating insider trading as a form of fraud in itself is “intellectually awkward because there is relatively little about unlawful insider trading that can fairly be considered deceptive, yet deception is the essence of fraud. The result is a crazy-quilt of made-up doctrinal innovations to declare abusive trading fraudulent.”152 Such “intellectual awkwardness” is

151. But see Genesis, supra note 61, at 873 (stating that whether the definition of “personal benefit” adopted in Newman is actually at odds with Dirks is a matter of “close” debate).
152. Donald C. Langevoort, What Were They Thinking? Insider Trading and the Scienter Requirement, in RESEARCH HANDBOOK ON INSIDER TRADING 52, 52 (Stephen M. Bainbridge & William D. Warren eds., 2013) [hereinafter What Were They Thinking?].
apparent in Justice Powell’s opinion in Dirks.153 The Court felt that requiring proof of a personal benefit received by the insider would provide an objective inquiry into whether the defendant breached a fiduciary duty.154 Given that the personal benefit test itself was an attempt to apply more objective criteria to insider trading, it is somewhat ironic that the current debate about the meaning of the personal benefit test centers around whether objective criteria is required to prove that element itself.

The complex chain of logic leading to the adoption of the personal benefit test illustrates the difficulties with insider trading jurisprudence. The personal benefit test cannot easily be abandoned without rejecting the very fiduciary requirement at the heart of Supreme Court insider trading jurisprudence, dating back to Chiarella and Dirks. Enacting legislation specifically directed towards insider trading would thus provide the most straightforward route to reforming the law, since attacking specific problematic elements of insider trading law—namely, the personal benefit test—would consequently begin to unravel more of the underlying assumptions and precedent that comprise the judge-made body of law that controls insider trading today.155 Significantly, the political climate seems ripe for a new statutory framework for insider trading. In 2015, both the House and the Senate issued separate proposals for statutes that would codify insider trading laws and remove insider trading from the confines of Rule 10b-5.156

A legislative approach to insider trading would reap benefits for both prosecutors and defendants. By divorcing insider trading law from Rule 10b-5, an insider trading statute would ideally codify the law in language that makes the law’s application more predictable, thus alleviating some of the due process concerns that have been raised with insider trading prosecution under Section 10(b).157 Some degree of predictability is necessary when the stakes are as high as those here, where defendants face potentially severe civil

153. See supra Part I.D.
154. Justice O’Connor proposed the personal benefit test as an alternative to Justice Powell’s original proposal of considering the purpose or intent of the tipper in providing this information. Justice O’Connor feared that such a test would require a difficult subjective inquiry into the minds of defendants. Genesis, supra note 61, at 865–66.
155. A number of critics argue that the way insider trading prosecutions play out today, the existence of a fiduciary duty breach as the basis for an insider trading violation has already eroded. See supra Part I.A.
penalties and even possible criminal liability. Of course, this predictability would come at some expense to the flexibility the SEC has exercised by developing novel theories of insider trading. In particular, a statute should not be so inflexible as to provide a “blueprint for fraud,” enabling insiders to find loopholes in the law to exploit. However, a statute that meets the right balance between flexibility and predictability could still give recognition to more novel theories the SEC has pursued, such as the misappropriation theory and tipper/tippee liability. Moreover, such legislation could enable insider trading law to balance the twin rationales of insider trading as articulated by Cady, Roberts—both eliminating informational disparities and preventing insiders from abusing their inside position. In that sense, it would be a “win” for the SEC, since it envisions a broader regime of insider trading liability than one grounded in the breach of a fiduciary duty. Of course, there will be tradeoffs: the more the law moves towards a parity-of-information scheme, the more market efficiency may suffer from sophisticated investors having to police their conduct internally and refrain from trading on information that has not been made available to the rest of the market, as Justice Powell expressed his concern with in Dirks. A thorough examination of the House and Senate Proposals will illustrate some of these tradeoffs.

B. An Analysis of Two Legislative Proposals to Insider Trading Law

This Part will evaluate the House and Senate proposals by applying them to the fact patterns of Newman and Salman. These two cases provide a useful illustration. If the outcome in Newman is correct for reasons of market efficiency, then an ideal insider trading statute should permit the sort of information exchange amongst professional investors that occurred in Newman. By contrast, moral intuitions suggest that the tipper in Salman abused his insider position by providing gifts to close family members of information he knew to be confidential. Such an exchange was entirely lacking in business-related motives that might be justified for efficiency reasons.

Since Newman is the narrower case of liability than Salman, it provides a good barometer of the breadth of liability the statutes would

158. One who is found guilty of insider trading may face up to twenty years in prison and a $5 million fine. 15 U.S.C.A. § 78ff (2002).
159. Regulation, Enforcement, & Prevention, supra note 40, at §2.01.
160. Supra Part I.D.
result in. While the House and Senate proposals—both issued within a month or two of the Newman decision—come across largely as a knee-jerk reaction to an isolated case that provoked staunch criticism from Congress and the media, they nevertheless illustrate what an insider trading statute might look like.

1. The Senate Proposal

The Senate proposal presents numerous problems, most notably that it would result in liability in a far broader range of situations than the type of conduct that is morally reprehensible. The Senate proposal would amend §10 of the Exchange Act to make it illegal:

162. Id.

1. (d)(1)(A) To purchase, sell, or cause the purchase or sale of any security on the basis of material information that the person knows or has reason to know is not publicly available.  
2. (B) To knowingly or recklessly communicate material information that the person knows or has reason to know is not publicly available to any other person under circumstances in which it is reasonably foreseeable that such communication is likely to result in a violation of subparagraph (A).  

This proposal is vaguely worded and would have far-reaching consequences. Under this proposal, it is clear that the conduct of Salman would be impermissible, given his knowledge that the information was not publicly available. But it would also go much further, catching a great deal of conduct that is not morally reprehensible.

First, the Senate proposal prohibits the purchase or sale of a security on the basis of any material information that is not publicly available. It defines “not publicly available” very broadly to exclude “information that the person has independently developed from publicly available sources.” Essentially, it is advocating for a parity-of-information scheme. However, in seeking to level the playing field as between all market participants—both sophisticated and non-sophisticated—this proposal is unrealistic about how professional investors really operate. Given their more proximate relationships with issuers, there may be situations in which analysts and institutional investors receive information that has not been broadly publicly disseminated. That is not to say it is right for them
to receive such information when other investors do not have access—and potentially even profit off of it—but the important point is that issuers are prohibited from selectively disclosing information to analysts under Regulation FD. The intent of the Senate proposal may have been to create a net underneath this conduct by holding the investors equally liable, but such a regime would create inefficiencies. From the perspective of the analyst, it may not always be clear whether the information is publicly available or not, and to put the onus on investors to root out whether the information has been publicly disclosed makes little sense—particularly where criminal liability could attach. The issuer, not the investor, is in the best position to make such a determination of whether the information is public; that is why Regulation FD sensibly holds the issuer accountable.

Second, the Senate proposal does not consider how the defendant obtained the information. It contains no requirement that the defendant misappropriated the information or that the defendant obtained the information in violation of a fiduciary duty or breach of confidentiality. The lack of a threshold requirement that the information somehow be obtained improperly marks a very broad departure from the current regime of insider trading. Worse, it conceivably could be used to pin liability on one who somehow stumbles upon nonpublic information and trades on it, presuming that they should have known better.

Third, the Senate’s proposed scienter requirement poses significant problems. It would impose liability not just on those who know, but also on those who should have known. This sounds like it is suggesting a standard of recklessness—a standard many critics have rejected as too low a threshold for liability for potential criminal penalties imposed by insider trading laws.163 Moreover, such a low standard in the context of business relationships might be inefficient if overly cautious managers asked analysts to diligently and carefully account for every source on which they based their recommendations, or even worse, refrain from making legitimate trades altogether. Such an approach would be neither practical nor desirable.

When these shortcomings are taken together, the Senate proposal risks chilling a great deal of legitimate investing behavior. Consider the facts of *Newman*. There is no doubt that the information at issue there was not publicly available at the time it was tipped, and few would argue that advance earnings information is not material. Given that there is no threshold requirement that the

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163. *What Were They Thinking?*, supra note 152, at 53.
defendants Newman and Chiasson obtained the information through some improper means, all that would remain to be shown was that when Newman and Chiasson purchased the stock of Dell and NVIDIA, they knew, or had reason to know, that the information was not publicly available.

Though in Newman, the Second Circuit found the defendants did not know the information was not publicly available, it is easy to see that they could have potentially been found liable under the Senate’s proposed scienter of recklessness. The earnings information that comprised the alleged tip in Newman was the sort of routine financial information analysts can regularly predict with relative precision by using financial models. Hence, given the routine nature of the information, the defendants might be able to argue they had no reason to know that the information was not publicly available, and the Newman case might still achieve the same result under the Senate proposal. But the SEC could conceivably argue that the defendants should have known the information was nonpublic because they should have asked the analysts presenting the models where they obtained the information. This creates a slippery slope. It is unrealistic to think that, in the regular course of investment, managers will engage in extensive conversations with their analysts about every assumption upon which a financial model was built. Furthermore, situations could arise where the information divulged was more unique than in Newman, and hence, should arguably raise questions in the eyes of the portfolio manager. This would result in difficult line-drawing problems for the courts, as it would be unclear whether the information was routine, and therefore should not have prompted further questioning, or if it was the sort of information that the defendant should have known was not publicly available.

Today, securities laws recognize that there will necessarily be some imbalance between professional investors and the general investing public. The Senate’s broad proposal fails to recognize this

164. United States v. Newman, 773 F.3d 438, 453 (2d Cir. 2014), cert. denied, 136 S. Ct. 242 (2015) (“It is largely uncontested that Chiasson and Newman, and even their analysts... knew next to nothing about the insiders.”).

165. Id. at 454 (“[A]nalysts at hedge funds routinely estimate metrics such as revenue, gross margin, operating margin, and earnings per share through legitimate financial modeling using publicly available information and educated assumptions about industry and company trends.”). Given the precision with which financial models are able to predict earnings information, one might wonder whether the tipped information really provided much benefit to the defendants at all. Certainly, an insider trading regime concerned with prosecuting situations where defendants accorded only a minimal informational advantage over the marketplace would seem to be a vast waste of resources, and little help to the policy goal of reducing information asymmetries.
nuance in its attempt to cast a wider net to find more insider trading violations.

2. The House Proposal

Prior to the Senate proposal, Representative Stephen Lynch of Massachusetts introduced legislation, the Ban Insider Trading Act of 2015, in the House in direct response to the Newman decision.\textsuperscript{166} Notably, the bill, as proposed, specifically states that proof of a personal benefit is \textit{not} required to prove liability.\textsuperscript{167} The bill would make it illegal:

To purchase or sell any security, or any securities-based swap agreement, based on information that the person knows or, considering factors including financial sophistication, knowledge of and experience in financial matters, position in a company, and amount of assets under management, should know is material information and inside information.\textsuperscript{168}

Further, it establishes liability for aiding and abetting liability to capture the act of tipping information by deeming it a violation:

If the person intentionally discloses without a legitimate business purpose to another person information that the discloser knows or, considering factors including financial sophistication, knowledge of and experience in financial matters, position in a company, and amount of assets under management, should know is material information and inside information.\textsuperscript{169}

The House proposal offers at least some advantages over the Senate proposal since it does not go so far as to say that all investors should have equal access to information. Rather, it requires that information somehow be obtained \textit{improperly} by defining “inside information” as information obtained illegally, “directly or indirectly from an issuer with an expectation of confidentiality or that


\textsuperscript{168} \textit{Id.}

\textsuperscript{169} \textit{Id.}
such information will only be used for a legitimate business purposes” [sic], or “in violation of a fiduciary duty.”170 This language seems to be a direct response to the dicta in Newman discussing Dirks by specifying that only a breach of the duty of loyalty, not confidentiality, could constitute deception and hence violate Rule 10b-5.171 The idea that only a breach of the duty of loyalty, and not confidentiality, suffices for insider trading liability seems to be founded on the premise that deception is necessary for conduct to be considered “fraudulent.” But once insider trading is removed from the statutory confines of Rule 10b-5—as any legislative proposal almost certainly would—such limits no longer are necessary to preserve this logic. A legislative proposal that recognizes a duty of confidentiality has the virtue of reducing informational asymmetries. It also comports with moral intuitions that it is wrong for one to breach a promise to keep information confidential.

Another virtue of how the House proposal defines “inside information” is that it recognizes that there may be some business situations in which information that is nonpublic might be traded for legitimate reasons—perhaps in the case of professional investors. Thus, this language saves the statute from being overly broad, and adopts what might be interpreted as a “parity-lite” scheme. It helps level the playing field, but does not go so far as to say that the playing field between all market players—particularly, as between professional investors and non-professionals—must be completely even.

Nevertheless, the House proposal, too, has its shortcomings. First, like the Senate proposal, reckless use of inside information would suffice to establish liability. For reasons discussed earlier, this is problematic. Second, it is unclear from the definition what would qualify as a “legitimate business purpose.” Third, and perhaps most problematic, it focuses on financial sophistication as a nexus for whether or not one is liable. This eschews the fact-intensive personal benefit test for another fact-intensive test.172 How are courts to decide what constitutes a requisite level of financial sophistication? Even within the finance industry itself, a wide range of financial sophistication is evident.173 Additionally, aligning liability

170. Id.
172. See supra Part II.C (discussing why fact-intensive tests are particularly problematic in the insider trading context).
173. In effect, the House proposal is saying that some investors are more in need of protection than others, but it may not be the case that those with the greatest level of "financial
with one’s level of financial sophistication does not reflect the moral culpability of the investors. Someone who is greedy but stupid might be able to claim they had no reason to know they were trading on inside information. Moreover, correlating liability with a level of financial sophistication would capture—and hold liable—some of the very legitimate professional investing behavior that should be insulated from insider trading liability.

Certainly, an ideal insider trading regime should not give every professional investor a free pass to take advantage of inside information just because they are sophisticated. But it also should not chill the sort of productive analyst research that is vital to healthy functioning markets. Furthermore, it must not be forgotten that issuers have every incentive not to disclose information in violation of a duty of confidentiality, because they can then be held liable under Regulation FD for making a selective disclosure.174

A final problem with the House proposal is that it defines “inside information” to include information obtained “in violation of a fiduciary duty.”175 Missing from the statute is how prosecutors would go about proving that the defendant breached a fiduciary duty without proving a personal benefit. In this regard, it is hard to see how the House proposal entirely escapes the personal benefit requirement that it explicitly shuns.

Applying this statute to the fact patterns of Newman further elucidates these problems with the House proposal, which in many ways appears tailor-made to pin liability on the defendants in Newman. Recall that in Newman, the portfolio managers-cum-defendants, Newman and Chiasson, received information three or four levels removed from the source. This information fits the House’s definition of “inside information” because the defendants obtained the information “indirectly from an issuer with an expectation of confidentiality.”176 As to the requisite level of financial sophistication, it seems almost certain that both portfolio managers have a high level of sophistication" are in the know. As an illustration, compare the “garage” investors of the firm Cornwall Capital Management with the prototypical “sophisticated” investor, the world’s largest and most sophisticated investment banks (known as the “bulge bracket”). As depicted in Michael Lewis’s book The Big Short, the investors of Cornwall started an investment firm in a garage in Berkeley, California, and profited over 80:1 (an $80 million profit from a $1 million bet) by purchasing credit default swaps. Through the purchase of credit default swaps, Cornwall, in effect, bet against securities known as collateralized debt obligations composed of hundreds of mortgage bonds, which provided astronomical returns when the housing market crashed. Standing on the other sides of these bets were some of the most “sophisticated” investment firms, including Bear Stearns and Deutsche Bank. MICHAEL LEWIS, THE BIG SHORT, 104–35, 222 (1st ed. 2010).

174. See supra Part II.C; supra Part I.B.
of financial sophistication and experience in financial matters as defined by the statutory proposal. Chiasson cofounded the hedge fund Level Global, and the firm had $4 billion in assets under management at one point in time.177 Newman served as a portfolio manager for Diamondback Capital, a hedge fund that at one point had over $6 billion in assets under management.178 Given this financial sophistication, the SEC could easily prove that the portfolio managers “should have” known that the information was inside information. Particularly because Newman and Chiasson occupied high positions in companies that managed significant assets, they should have known that they would be under the scrutiny of the SEC, and therefore should have done more due diligence into the sources of their information.179 But this is the type of overly-cautious, inefficient behavior the law should not compel.

3. An Alternative Proposal

Both the House and the Senate proposals were knee-jerk reactions to the Newman decision, and the language seems crafted to directly target the sort of conduct at issue in Newman without thinking about the consequences such broad restrictions would have on legitimate trading activity. After discussing the shortcomings of the House and the Senate proposals, we now turn to consider what an insider trading statute that strikes the right balance between preventing the sort of insider trading that interferes with our moral sensibilities and not unduly intruding on productive investing activity, might look like.

This statute would have a few key features. First, an ideal insider trading statute would put into explicit language the theories of insider trading that courts have already reached broad consensus on, such as the misappropriation theory and theories of tipper/tippee liability. Second, the statute would wipe away all of the language that has created confusion in insider trading precedent, including


178. Chad Bray, Diamondback is Shutting Down, WALL STREET J., Dec. 6, 2012, at C3. At the time the SEC brought charges against Newman, Diamondback had approximately $2 billion in assets under management. Id.

179. In fact, the SEC did make such an argument in Newman, alleging that as sophisticated traders, the defendants must have known that information was disclosed by insiders in breach of a fiduciary duty. United States v. Newman, 773 F.3d 438, 443–44 (2d Cir. 2014), cert. denied, 136 S. Ct. 242 (2015).
attempts to tie the conduct to some sort of deception, a requirement of a fiduciary duty, and a finding of a personal benefit. Third, it would provide enough flexibility to capture unusual fact patterns that seem particularly morally reprehensible, but not become so flexible as to make it difficult for defendants to recognize when their conduct is within permissible bounds, thus chilling legitimate exchanges of information for business purposes. Notice may result from two sources—language that is clearly written and prohibitions that generally comport with moral intuitions of what sort of behavior is appropriate. The closer insider trading law can come to aligning with moral intuitions about what kind of conduct is and is not permissible, the greater its predictability, since defendants can hardly argue that they were caught off guard by the law. Fourth, in that same vein, an ideal approach would require a scienter of knowledge in order to establish criminal liability. A lower level of scienter, such as recklessness, would suffice as an element for civil penalties. Fifth, an insider trading statute should recognize that there may be professional investment activity that seemingly toes the line between legitimate and non-legitimate uses of nonpublic information. The use of information in a professional investing context should not be chilled.

To clearly articulate what conduct is prohibited, this proposal will lay out separate standards for each tipper, tipping, and tippee liability. Neither the House nor the Senate proposal take such an approach. The House proposal relies on confusing language of aiding and abetting liability to establish tipper/tippee liability. The Senate and House proposals both impose the same prohibitions on an insider who trades on inside information and on an outsider (tippee) who trades on information. It is useful to set out different standards for tipper, tippee, and tipping liability in order to account for the various sorts of activity that might fall under an insider trading prohibition, and more closely reflect the sort of mindset and conduct that should attach for different types of activities to be considered morally culpable. Finally, these standards will be tested against the fact patterns of Newman and Salman as benchmarks. As discussed, the courts in both cases arguably reached the right results for reasons of market efficiency and morality, but a key reason for the backlash in Newman was its unfaithful application of the Dirks standard.180

The case of an insider who trades on information obtained or misappropriated through an employment relationship represents the prototypical case of insider trading. The corporate officers and

180. Supra Part III.
executives who trade in advance of the announcement of drilling results to the public in *Texas Gulf Sulphur*\(^{181}\) represents a straightforward case. But insider trading liability has also expanded to align with moral intuitions in misappropriation cases like *O’Hagan*, where the employee received access to information by virtue of his employment as a lawyer, even though he did not necessarily owe a fiduciary duty to the corporation whose shares he traded on.\(^{182}\) A prohibition on insider trading in the case of an insider should cover both sorts of cases, and might be defined as follows:

To purchase or sell any security, or securities-based swap agreement, based on material information that an employee has access to by virtue of the employment relationship, where that information has been entrusted to the employee or the employee knows or has reason to know the information is undisclosed to the public.

“Employment relationship” would be defined broadly to include the sorts of temporary insiders, such as attorneys, accountants, and investment bankers that regularly receive inside access to information.\(^{183}\) Where an employee knows or has reason to know that the information is undisclosed,\(^{184}\) or where that information has been entrusted to the employee, there is no problem of notice: it is clear that such trading activity would take unfair advantage of information that is not available to others, and, thus, imposing liability here comports with our moral intuitions.

In the case of an insider tipping information to an outside party, it would be illegal:

To communicate material information, that has been entrusted to a person and that the person knows has not been disclosed to the public, to another person with the knowledge

\(^{181}\) SEC v. Texas Gulf Sulphur, 401 F.2d 833 (2d Cir. 1968).

\(^{182}\) Kugler and Green’s study suggests that people view insider trading fitting the classical and misappropriation fact patterns as being similarly blameworthy. Green & Kugler, *supra* note 21, at 463.

\(^{183}\) Borderline cases might arise in situations such as with *Chiarella*, where the defendant obtained access to information by virtue of his employment as a printer. Directorships may also present difficulties, since directors are not technically employees of a corporation but nevertheless have access to material nonpublic information. Moral intuitions would counsel in favor of a broader definition of “employment relationship” that includes directors and others who obtain inside information solely as a result of that employment relationship.

\(^{184}\) As noted above, a lower level of scienter, such as recklessness, could be sufficient for civil penalties to attach. *Supra* Part III.B.1.
or intent that the other person will purchase or sell any security, or securities-based swap agreement, on the basis of that information.

Significantly, this definition dispels the requirement that the insider receive a personal benefit in exchange for tipping information. Rather, receipt of a personal benefit might serve as part of a larger inquiry into whether the tipper knew or intended that the outsider trade on the information, but it would not be a required element of proof to establish tipping liability, as it is under current law. Other evidence may also suffice to establish that the tipper knew or intended that the information be traded on.\textsuperscript{185}

Whereas this proposed standard for insider liability focuses primarily on the employment relationship providing special access to information, in the case of tippee liability, the emphasis would be on what it means to be “entrusted” with confidential information. As with the proposed definition for insider liability, the existence of an employment relationship providing access to confidential information would certainly be sufficient to show that one had been entrusted with information. SEC Rule 10b5-2 further outlines circumstances for when a duty of trust exists for the purpose of misappropriation cases, and could provide a definitional starting point for other situations in which one might be considered to be “entrusted” with information. Such circumstances include an agreement to maintain information in confidence; a history, pattern, or practice of sharing confidences; or the receipt of information from a relative.\textsuperscript{186}

This proposal would capture conduct like the tipping in \textit{Salman}. Maher, the brother who worked as an investment banker at Morgan Stanley, would be liable as a tipper because of his employment relationship giving him access to non-public information. The evidence certainly suggested that Maher had knowledge that his brother Michael traded on the information Maher provided him, and perhaps that he even so intended. For instance, even as Michael

\textsuperscript{185} These forms of proof that a tipper knew or intended that the information be traded on could come in a variety of forms. See, e.g., United States v. Salman, 792 F.3d 1087, 1089 (9th Cir. 2015), \textit{cert. granted}, 136 S. Ct. 899. (tipper’s instruction to tippee suggesting that he get rid of papers), SEC v. Rocklage, 470 F.3d 1, 4 (1st Cir. 2006) (understanding that woman would inform her brother with “a wink and a nod” if she learned significant news about a stock’s value), SEC v. Vaskevitch, 657 F. Supp. 312, 314 (S.D.N.Y. 1987) (pattern of telephone calls to tipper’s home from locations tippee had access to, shortly followed by large volumes of trading in securities of company tipper knew from his work at Merrill Lynch would soon be engaging in a merger).

\textsuperscript{186} 17 C.F.R. § 240.10b-5 (2016).
became “more brazen and more persistent” in his requests for information, Maher continued to provide information. 187 Maher even testified that he hoped to benefit and provide for Michael, suggesting he intended for Michael to trade on the information. 188

Maher’s brother, Michael, would also be liable as a tipper for providing information to Salman, as Maher entrusted him with the information. That relationship of trust arose from their relationship as brothers and Maher’s history of sharing information with Michael. Michael further intended that Salman trade on it, “encouraging Salman to ‘mirror-image’ his trading activity.” 189

Finally, an insider trading statute would necessarily need to define what suffices to establish tippee liability, by making it illegal:

To purchase or sell any security, or any securities-based swap agreement on the basis of material information that the tippee knows (a) that the source of the information has access to by virtue of the employment relationship; and (b) has not been disclosed to the public.

Tippee liability is perhaps the most difficult to define, as tippee trading often treads a fine line between immoral and efficient behavior. It should not suffice merely that the tippee knew the information to be undisclosed to the public, since such a broad definition could have a chilling effect on productive analyst behavior. 190 This proposal thus requires that, in addition to knowing that the information is non-public, the tippee must know that the source of the information accessed such inside information by virtue of the employment relationship. Another virtue of this definition is that it aligns squarely with the proposed standard for insider liability, providing additional clarity to put traders on notice of prohibited conduct.

To see how such a definition might apply in practice, consider the facts of *Salman*. As a tippee, Michael of course knew that his brother was accessing the inside information through his employment with Morgan Stanley. Salman would further be liable as a tippee because he knew that Maher was the source. Additionally,

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187. United States v. Salman, 792 F.3d 1087, 1089 (9th Cir. 2015), cert. granted, 136 S. Ct. 899.
188. *Id.*
189. *Id.*
190. Justice Powell made this observation in *Dirks*, 463 U.S. 646, 659 (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.”).
they both knew the information was non-public. Based on Salman’s attempts to cover up his knowledge of the inside information, largely at Michael’s urging, the circumstantial evidence demonstrated that they both knew the trading activity was illegal.\textsuperscript{191} Such attempts to cover up trading activity are not the sort of acts undertaken by one who believes his or her conduct is innocent.

But this proposal for tippee liability also reflects the fact that, as tipping chains get longer, such as that in \textit{Newman} where the defendants were three or four levels removed from the source of the information, moral culpability is often diminished because it is less clear to the ultimate tippee that the information received was inside information. Importantly, both defendants in \textit{Newman}, Chiasson and Newman, would not be liable under this definition because the SEC failed to prove that the defendants knew the information to be inside information.

These fact patterns illustrate that liability under this proposed standard for tippee liability requires some degree of moral culpability. Liability would not extend to situations where a tippee merely overhears information and trades on it, such as if a third party overheard a conversation in a public forum, unless the tippee somehow knew both that the information was nonpublic and that the insider had access to such information by virtue of their employment.\textsuperscript{192} It is unlikely that they would know such things without having a pre-existing relationship with the insider or having engaged in some form of surreptitious conduct.

Clearly then, these proposals for tippee, tipping, and insider liability would still capture the type of morally reprehensible conduct at issue in \textit{Salman}, where the defendant took advantage of information he had no business to know, from the type of legitimate trading activity occurring in \textit{Newman}. These proposals seek a balance between market efficiency and the sort of behavior—taking advantage of one’s inside access to information—that is widely viewed as morally abhorrent.

\section*{PART IV: CONCLUSION}

This Note has argued that the need for reform in insider trading law is evident following the decisions in \textit{Newman} and \textit{Salman}. The

\begin{footnotesize}
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\item \textsuperscript{191} \textit{Salman}, 792 F.3d at 1089 (describing testimony that Salman agreed to “protect” Maher by shredding papers relating to his stock trading activities).
\item \textsuperscript{192} Green and Kugler’s study confirmed that people are significantly more reluctant to impose punishment on one who trades on inside information acquired only incidentally or through happenstance. Green & Kugler, \textit{supra} note 21, at 464.
\end{itemize}
\end{footnotesize}
central dispute in these cases—whether a gift of information to a relative or friend is sufficient to satisfy the personal benefit element of insider trading—highlights the failings of the test itself. First, it results in ambiguity when applied to relationships that are neither purely business nor purely personal. Second, it may not capture every instance of trading behavior that appears morally reprehensible. Finally, the logic behind the personal benefit test appears particularly unstable in cases of remote tipping like that at issue in *Newman*.

Moreover, the difficulty in applying the personal benefit test is emblematic of larger problems in insider trading law, which has departed over time from the strict fiduciary duty framework articulated in early Supreme Court decisions. Because the reliance on a breach of a fiduciary duty itself stemmed from the vaguely worded antifraud provision used to prosecute insider trading, Rule 10b-5, *Newman* and *Salman* demonstrate the need for a new statutory approach to insider trading free from the forced antifraud framework. In critiquing the House and Senate proposals offered in response to *Newman*, this Note identified some key features of an insider trading statute. First, such a statute would clearly articulate the various theories of insider trading liability that courts have already acknowledged. Second, the statute would no longer attempt to tie the violating conduct to some sort of deception, breach of fiduciary duty, or finding of a personal benefit. Third, it would provide flexibility to prevent traders from exploiting loopholes, but would also clearly define when trading activity violates the statute. Fourth, it would require a scienter of knowledge in order to establish criminal liability. Finally, it would prevent insider trading in the sort of circumstances where it seems morally reprehensible, without chilling the use of inside information for legitimate business purposes.