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Watching Insider Trading Law Wobble: Obus, Newman, Salman, Two Martomas, and a Blaszczak

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Watching Insider Trading Law Wobble: Obus, Newman, Salman, Two Martomas, and a Blaszczak

Donald C. Langevoort*

“The crime of insider trading is a straightforward concept that some courts have somehow managed to complicate.”—Judge Jed Rakoff in United States v. Pinto-Thomaz

I. INTRODUCTION

Commentators repeatedly point out that the law of insider trading, though formally derived from Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934, is best understood read as a common law-like subject. That is because neither the statute nor the rule addresses insider trading explicitly, leaving to the judiciary to do all the work of fashioning legal doctrine about when and why insider trading operates as securities fraud. The SEC has acquiesced in this judicial law-making for the most part, preferring taking its chances in the courts (more often than

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anywhere else in the Southern District of New York) than putting the definition of insider trading up for political haggling. It has engaged in very specific rulemaking on a few contested issues, but been far from comprehensive; even when the Commission has adopted definitional rules (10b5-1 and -2), the courts do not always defer.\textsuperscript{3} Up to now,\textsuperscript{4} at least, the judiciary has “owned” insider trading law, for the most part choosing to give it broad reach.

Insider trading is a crime, often harshly penalized. Common law crimes are not in fashion, to say the least. So the accretive process by which the law on this topic evolves—for all the benefits of incrementalism\textsuperscript{5}—has many critics.\textsuperscript{6} When insider trading law wobbles visibly on some matter, there are enhanced concerns about notice, predictability and due process as well as the substantive merit of the specific principles being applied.

No subject in insider trading law has recently wobbled more than the standards for tipper-tippee liability.\textsuperscript{7} After setting a


\textsuperscript{4} In December 2019, the House of Representatives overwhelmingly passed a bill to define unlawful insider trading, perhaps signaling a shift in the locus of law-making. H.R. 2534, 115\textsuperscript{th} Cong., 1\textsuperscript{st} Sess. (Dec. 5, 2019). Its fate in the Senate is unclear.

\textsuperscript{5} See Peter J. Henning, Making up Insider Trading Law as You Go, 56 Wash. U. J. L. & Pol'y 101 (2018); Fisch, supra.


\textsuperscript{7} For a collection and assessment of the many dimensions to tipper-tippee liability, see Donald C. Langevoort, Insider Trading: Regulation, Enforcement and Prevention ch. 4 (2019 rev.ed.)
fiduciary duty-based framework for insider trading liability under Section 10(b) and Rule 10b-5 in *Chiarella v. United States*\(^8\) in 1980, the Supreme Court ruled in *Dirks v. SEC*\(^9\) three years later that tipper-tippee liability requires proof that the tipper be breaching a fiduciary-like duty in passing on the information to the tippee for the *tipper’s* own personal benefit, and that the tippee knows or should know of that breach. A host of bothersome issues thus arose, some addressed in dicta in the Court’s opinion but mostly left for future litigation—most notably, what does personal benefit mean, and how, exactly, is it applied in motions to dismiss or expressed in jury instructions? Many dozens of cases since then have confronted this question. Judge Rakoff has decided more than a few and, more candidly than most, expressed frustration via occasional lamentations to his readers (or the law-gods) about what is going on. His frustrations will be our guide to what follows, from a judge whose involvement in insider trading enforcement goes way back to the Chiarella prosecution.\(^10\)

For two decades after *Dirks*, the law steadily evolved in a way that made the personal benefit requirement either easy for enforcers to satisfy or completely inapplicable.\(^11\) When it applied,

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\(^{8}\) 445 U.S. 222 (1980). In an opinion by Justice Lewis Powell, *Chiarella* reversed the conviction of the defendant, who worked at a financial printing firm, because he owed no fiduciary-like duty to others trading the same shares in the securities marketplace.

\(^{9}\) 463 U.S. 646 (1983). *Dirks* reversed an administrative sanction imposed against a high-profile investment adviser who received material nonpublic information from whistleblowers about a fraud-riddled company whose shares he had recommended to clients, and caused them to sell their shares before the fraud was revealed.


\(^{11}\) Donna Nagy’s important work has traced this devolution in what enforcers had to show under *Dirks*. See Donna M. Nagy, *Beyond Dirks: Gratuitous Tipping and Insider Trading*, 42 J. Corp. L. 1 (2016); Donna M. Nagy, *Insider Trading and the Gradual Demise of Fiduciary Principles*, 94 Iowa
two kinds became standard: quid pro quos with some pecuniary 
pay-offs (e.g., kickbacks to the tipper), and “gifts” of information 
to family members and friends. That increasingly relaxed 
approach emboldened both criminal prosecutors and the SEC. In a 
2012 civil case, *SEC v. Obus*, the Second Circuit offered a 
sweeping restatement of all the elements of tipper-tippee liability, 
some never previously so characterized. (Rakoff famously called 
the decision “Delphic” in his first opportunity to apply its 
teachings, not in a good way). Among other things, the *Obus* 
framework allowed tippees to be held liable without knowledge of 
the tipper’s alleged benefit.

Soon thereafter, in *United States v Newman*, a panel of the 
Second Circuit addressed personal benefit more strictly, 
seemingly—but without directly saying so—rewriting *Obus* at 
least in the criminal context as to the standards for both tipper 
and tippee complicity. It sought to connect gift-giving and real 
benefit by demanding proof of a sufficiently close relationship 
between tipper and tippee “that is objective, consequential and 
represents at least a potential gain of a pecuniary or similarly 
valuable nature” and insisting that the tippee have actual 
knowledge of the breach and benefit. *Newman* was a rare god-
send to the defense side, destabilizing the doctrine on which many 
prior and on-going cases were founded. But then, on review of a 
Ninth Circuit decision that rejected the most demanding aspects 
of the *Newman* approach as to the meaning of gift in family 
settings (*United States v. Salman*), written by the peripatetic

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L. Rev. 1315 (2009). See also Donald C. Langevoort, *The Demise of Dirks: 
12 693 F.3d 276 (2d Cir. 2012). See Donald C. Langevoort, “Fine Distinctions” 
in the Contemporary Law of Insider Trading, 2013 Colum. Bus. L. Rev. 429, 
14 773 F.3d 438 (2d Cir. 2014).
15 Id. at 452.
16 792 F.3d 1087 (9th Cir. 2015).
visiting Judge Rakoff), the Supreme Court agreed that *Newman* went too far in its retrenchment.\(^ {17} \) Precisely how much too far was unclear, however, so the wobbling was far from over.

Then came the two *Martomas*. The main legal question presented on appeal in a highly publicized prosecution, though not necessarily crucial to the ultimate outcome of the case,\(^ {18} \) was whether the gift benefit prong under *Dirks* and *Salman* requires a close pre-existing relationship of family or friendship. Or is there a personal gift benefit in *any* intentional conveyance given with the purpose or expectation that the tippee will trade? In *Martoma I*,\(^ {19} \) a divided Second Circuit panel said that the expectation is enough, regardless of to whom, and abrogated *Newman* to the extent that it indicated otherwise by its reference to a meaningfully close relationship. There was a petition for rehearing en banc claiming that (among other things) the panel had no authority to overturn that holding in *Newman* absent direct Supreme Court direction. Nearly a year later, in June 2018, the panel substituted a completely new opinion (*Martoma II*) reinterpreting *Newman* rather than abrogating it, but once again making the tipper’s specific purpose to confer a benefit on the tippee sufficient and potentially dispositive.\(^ {20} \) Part of *Newman’s*
own precious gift to Wall Street and the defense side was thus taken back.\textsuperscript{21}

None of this is breaking news. \textit{Newman} and \textit{Salman} have been the subjects of extensive academic and professional commentary for the last few years, and the \textit{Martoma} cases have now joined the on-going contestation.\textsuperscript{22} Nearly everyone who writes much about insider trading (and a few interlopers as well\textsuperscript{23}) has had something to say about the wobble, with wildly mixed opinions.\textsuperscript{24} As to the panel’s authority to abrogate \textit{Newman}, for example, a case comment in the \textit{Harvard Law Review} treats \textit{Martoma II} as a “stealth overruling” of \textit{Newman}, but then concedes that \textit{Newman} was a stealth overruling of \textit{Obus} (and so on), so that what \textit{Martoma II} did should not cause great angst.\textsuperscript{25} The merits of the debate should matter more.

My essay is initially about the kind of gratuitous tipping addressed in \textit{Martoma}, which might not seem to be practically important but instead more of a legal brain teaser.\textsuperscript{26} In this

\begin{itemize}
\item \textsuperscript{21} Courts in the Second Circuit have noted the effect of \textit{Martoma} on \textit{Newman}. E.g., Gupta v. United States, 913 F.3d 81 (2d Cir. 2019); United States v. Pinto Thomaz,, supra, 352 F. Supp.3d at 301 (“What remains of \textit{Newman} therefore applies in only the rarest of cases”).
\item \textsuperscript{22} E.g,, John C. Coffee, Jr., \textit{Tippers and Tippees: The Impact of Martoma II}, Columbia Blue Sky Blog, July 23, 2018,
\item \textsuperscript{26} The closest precedent I know of involves a tip to the insider’s barber. See SEC v. Maxwell, 341 F. Supp.2d 941 (S.D. Ohio 2004).
\end{itemize}
academic spirit, Martoma I posed a hypothetical about a well-heeled apartment dweller giving a holiday gift to his doorman in the form of a stock tip in place of the usual cash. But this hypo isn’t particularly well-crafted insofar as valuable tips to doormen can be seen as an effort to buy superior service for the forthcoming year, which would be a form of pecuniary gain, not a pure gift. So Martoma II strips this down a gift of a stock tip to someone simply with the statement that he (the tippee) can make money by trading on the information. Joan Heminway’s thoughtful article on the subject uses a more compelling “Robin Hood” hypo about tips meant to take from the rich and give to the poor. All these are fun to a degree, but the fact that some version of the question presented itself in both Newman and Martoma, each a big-time hedge fund-related prosecution, shows how closely it lies to the subject of what constitutes a legitimate trading edge for securities professionals, and where the line is they cannot safely cross. Big money turns on the answer. As we shall see, the decision in Martoma arguably gives enforcers a tool against selective disclosure to market professionals they might not have realized was in the toolkit.

Contrary to many, I think Martoma’s holding is well-grounded. Explaining why will take us into the weeds of insider trading theory and doctrine, the overgrowth of which is widely acknowledged. This is incurable without statutory codification, but even then would still fall short of the clarity many say they want. The robust persistence of insider trading enforcement (criminal and civil) is based as much on politics as coherent policy. But unlike others who have critiqued the politics of

28 See pp. --- infra.
29 Donald C. Langevoort, Rereading Cady Roberts: The Ideology and Practice of Insider Trading Regulation, 99 Colum. L. Rev. 1319, 1320-21 (1999). To be
insider trading, I think that the expressive political dimension to the law has considerable legitimacy if kept in bounds. Insider trading enforcement has become a recognizable brand symbol for American-style securities regulation, touching on some deep-seated public fascination, envy and distaste for the arrogance of economic elites and others who exploit some undeserved edge in the stock markets. It is not about creating a level playing field, which as Judge Rakoff has pointedly said is unrealistic, but rather when to take away the edge that comes from wrongfully being high on the privileged side. The campaign against abusive trading generates public support for the complex mission of investor protection more generally, which is consequential whether or not we have a coherent theory of how and why it constitutes securities fraud.

But wait, there is more. At the very end of 2019, the Second Circuit sent the insider trading ball bouncing in an unexpected direction yet again, holding that to the extent that a tipper-tippee case is brought as either mail/wire fraud or under a (until now) rarely utilized public company securities fraud statute, personal benefit has no place at all. At first glance, the case—United States

clear, I think there are sound policy reasons to restrict insider trading but they are more wonkish than the rhetoric surrounding insider trading enforcement seems to assume.

30 See p. --- infra.

31 Some critics of the fairness approach to insider trading regulation agree with the political description of the motivation but denounce its normative justification, seeing the SEC’s efforts as pure rent-seeking either on the part of the Commission itself or certain interest groups who benefit from aggressive insider trading enforcement. E.g., Jonathan Macey & David Haddock, Regulation on Demand: The Influence of Special Interest Groups on SEC Enforcement of Insider Trading Rules, 30 J. L. & Econ. 311 (1987); more recently, see Jonathan Macey, The Central Role of Political Myth in Corporate Law, Aug. 19, 2019, available at papers.ssrn.com/sol3/papers.cfm?abstract_id=3435676. This essay is not an effort to resolve that debate but instead argues for the coherence of insider trading law as we know it as derived from an effort to promote fairness in markets, though not via egalitarianism. See pp. --- infra.
v. Blaszczak\textsuperscript{32}—provides a well-lit pathway for criminal prosecutors, but not the SEC (or private plaintiffs), to pursue tippees simply on their awareness that the inside information should be considered stolen goods. It is much too early to say what this new line of inquiry will bring, or even if the holding will survive much after its birth. On close inspection, however, it connects some dots that, in hindsight, have long been in plain sight.

So we will first address the road from Dirks to Martoma, which will then put us on a course that eventually gets us to Blaszczak and the pinball-like motion of insider trading law circa 2020, Chiarella’s fortieth anniversary. Unnecessary complication? We shall see.\textsuperscript{33}

II. READING DIRKS LITERALLY: BENEFIT TO THE TIPPER

The precise question debated in Martoma is about what to do if an insider tips someone with whom he has no close personal relationship and without any expectation of compensation in return. Both Martomas purport to draw their doctrinal


\textsuperscript{33} Michael Perino reminds us in an important article that for all the occasional doctrinal drama, most insider trading cases do not push on the boundaries of doctrine, in which case the wobbles are of importance only to a narrow band of enforcement. Michael A. Perino, Real Insider Trading, Feb. 2019, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3338536. He provides good evidence that aggressive cases are the exception, and that enforcers back off when they sense the law is moving away from being aggressive.
conclusions from a close reading of Supreme Court precedent, mainly Dirks. (Salman—a blessedly unanimous opinion by the Court given the egregious facts—says little more than Dirks was clear enough about its meaning and didn’t need or warrant Newman’s gloss.) But as shown by the ensuing debate in the two Martomas between the majority and Judge Pooler, who dissented twice, Dirks offers its reader plenty to stumble over. Seeing why requires some background.

A. History, Text and Structure

I and many others have recounted in some detail how the law of insider trading under Rule 10b-5 came to be. Historically, it is very much the product of a particular and now long gone historical period during which courts construed federal statutes and rules purposively, construing grants of law-making authority “flexibly, not restrictively.” (The Second Circuit was initially ambivalent as to this activism but soon became a convert in a long series of securities cases over the course of the 1960s and early 70s, occasionally restrained by the moderating impulses of the remarkably influential Judge Henry Friendly.) The seminal

37 Historical research shows how much Friendly, in turn, was influenced by Professor Louis Loss of Harvard, with whom he had frequent correspondence
Texas Gulf Sulphur case was an exemplary product of this kind of thinking. Even though open-market insider trading is hard to see as deceptive (the insider trader communicates nothing false or misleading simply by submitting an anonymous bona fide order to buy or sell), the word “fraud” was taken to be sufficiently elastic so as to encompass constructive fraud—an equitable principle that would allow abusive behavior (including fiduciary breaches) to be treated as if deceptive to avoid unjust enrichment, even if the common law elements of deceit are absent. Duties reached as far as need be to inspire investor faith in market integrity. Or so it was thought.

That generous approach to securities law was trashed by the Burger Court starting in the mid-1970s. The surprise, perhaps, is that insider trading regulation under 10b-5 somehow survived this retrenchment at all. In Chiarella, the Supreme Court scolded the Second Circuit for its failure to restrain the overbreadth of “abstain or disclose,” but then plastered together the doctrinal edifice under the revisionist banner of fiduciary responsibility. The fraud fiction thus continued. As a result, fiduciaries vis-a-vis the issuer had a duty to abstain or disclose material nonpublic information to marketplace traders; others not. That naturally raised concerns about tippers and tippees, on securities issues, including cases he was working on. See Margaret V. Sachs, Judge Friendly and the Law of Securities Regulation: The Creation of a Judicial Reputation, 50 SMU L. Rev. 777 (1997). Loss, in turn, was by the late 1960s working on a massive project to codify the federal securities laws and thus an interest in having the Second Circuit case law be as much in harmony with his proposals as possible.


39 See Donald C. Langevoort, From Texas Gulf Sulphur to Chiarella: A Tale of Two Duties, 71 SMU L. Rev. 835 (2018). The Second Circuit opinion in Chiarella was actually a fairly nuanced holding, contrary to what Justice Powell makes it seem in the Supreme Court’s opinion. Id. at 845-46.

40 Id. at 845-48.
because the latter were outsiders, not fiduciaries. Even though there was no tipping at issue in *Chiarella*, Justice Powell dropped a footnote to assuage this fear saying that tippees may inherit the tipper’s fiduciary duty by becoming “participants after the fact” in the tipper’s fiduciary breach, i.e., *co-venturers* with the insider.41

So when *Dirks* came to the Court three years later, Justice Powell quickly sought control of the case and insisted that it should simply follow his *Chiarella* footnote. Raymond Dirks had received material nonpublic information about a massive fraud at a well-known issuer from some whistleblowers and helped them publicly expose the fraud, though not before causing his clients to dump the stock before its collapse. Still feeling some sting from *Chiarella*, the SEC (unwisely) applied an expansive approach to tipper-tippee liability in its proceeding against Dirks that essentially made the fiduciary duty of the source run to all who

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41 This footnote itself has an interesting history. The co-venturer concept, which stresses that tippee culpability is entirely derivative of the tipper’s fiduciary duty, was recognized in a Second Circuit decision construing insider liability under state corporation law (the law of Florida). Schein v. Chasen, 478 F.2d 817 (2d Cir. 1973). But that decision was vacated by the United States Supreme Court on grounds that the issue of first impression was for the Florida Supreme Court to decide. Lehman Bros. v. Schein, 416 U.S. 586 (1974). The Second Circuit decision is interesting because it draws a clear distinction between the right approach to liability under state corporation law and under Rule 10b-5, the latter being more expansive. Presumably because the Second Circuit decision was formally vacated (and perhaps because it had distinguished this approach from how 10b-5 should be interpreted), it was not cited directly in the *Chiarella* footnote—just a reference to an American Bar Association Committee letter, which had drawn from *Schein v. Chasen*. What the court in *Schein* was describing was a form of civil conspiracy (or more precisely, a conspiracy to breach a fiduciary duty) arising from the formation of a “common enterprise” to exploit a fiduciary obligation. 478 F.2d at 822. To this end, the court also drew from the Restatement of Agency 2d, sec. 312 (1958), which provides for third party liability for intentionally causing or assisting a fiduciary breach.
came in possession of the secret with knowledge of its confidential origins, and a divided D.C. Circuit agreed.\footnote{Dirks v. SEC, 681 F.2d 824 (D.C. Cir. 1982).}

Powell was not impressed. We know that not simply because of the \textit{Dirks} opinion itself, but because of some remarkable documents that Adam Pritchard found some time ago in Powell’s archived materials—opinion drafts, marginal notes, and inter-chamber correspondence. From these, as Pritchard shows, we can piece together how the \textit{Dirks} test came to be.\footnote{A.C. Pritchard, \textit{Dirks} and the Genesis of Personal Benefit, 68 SMU L. Rev. 857 (2015). The entire \textit{Dirks} file is now available on-line via the Lewis Powell Collection at the Washington & Lee Law School library website (hereinafter as “File at –”). I have previously drawn from these documents in a number of writings; E.g., Langevoort, \textit{Fine Distinctions}, supra, at 453; Michael Guttentag has engaged in a close reading of \textit{Dirks} in light of them as well, identifying four underlying purposes in what \textit{Dirks} says—none of which, he argues, bears its weight today. Guttentag, supra, at 526-35.} In the earliest drafts, Powell had two clear objectives: to tether the test for tipper-tippee liability to his \textit{Chiarella} footnote, and to assure that the test would not unduly chill the bona fide interactions between insiders and market analysts that he saw as necessary to market efficiency.\footnote{His clerk assigned to the case, Jim Browning (now a federal judge), was much more aggressive at the outset, trying to get the Justice to at least consider either no tippee liability at all, or even no 10b-5 insider trading liability at all, \textit{Chiarella} notwithstanding. File at 8-11. Browning, in turn, drew heavily in his memos and drafts from the scholarship of Michael Dooley and Frank Easterbrook. Browning graduated from the University of Virginia School of Law, where Dooley taught.} These first drafts of the opinion were straight-forward, simply requiring a court to find that the tipper’s \textit{purpose} in passing on the information involved disloyalty to the issuer and its shareholders, which would not be the case if the insider was merely careless in divulging some bit of material information to an analyst, thinking it immaterial or already public. To this, Powell and his clerk added contrasting illustrations of bad motivations: quid pro quo tips for the pecuniary benefit of the tipper, and “gift” tips specifically intended by the tipper to benefit
the tippee. The latter are the words, unchanged throughout all the later drafts, on which Martoma ultimately turns.

This test was apparently pleasing to Powell—in essence, he was simply saying that the breach of duty on which tipper liability is premised is the duty of loyalty as opposed to the duty of care. There was nothing about making the test particularly demanding beyond this, even with respect to securities analysts. He quickly got three other votes to overturn the SEC. Somewhat resistant was Justice O’Connor, who sent Powell a memo saying that she objected to his focus on the tipper’s purpose, which she thought much too subjective. She wanted him to substitute a requirement that the SEC or prosecutors prove up an actual benefit to the tipper—an objective test.

From his notes, Powell seems reluctant; as a former corporate lawyer, it was natural for him to think of fiduciary duty in terms of an attitude of loyalty and good faith. And fiduciary duty law has never required an actual benefit to the fiduciary or harm to the beneficiary; quite the opposite. O’Connor, the former trial judge in Arizona, was coming from another place entirely, concerned about evidence. Compromise ensued, which produced a semantic mess. To preserve his initial approach, Powell kept most of his language about purpose, along with all his illustrations. But he also inserted the requested language about proof of actual benefit, without much effort to reconcile the two, which if anything suggests (as Pritchard argues) that both

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45 Pritchard, supra, at 861-63.
46 Id. at 865-66.
47 At first glance, Powell may be read to welcome O’Connor’s suggestion (he writes back about her “quite constructive” memo) but his notes on her memo twice say “no” to what she is pushing. Id. at 866. More importantly, his edits to the opinion by no means jettison his preferred purpose-based standard. Quite the contrary is true.
48 The draft with the O’Connor revisions can be found in File at 371. A heavily marked up page shows how much Powell was trying to keep as much of his approach as possible. File at 385-86.
motivation and benefit-in-fact may be required, even though neither justice was advocating that dualism.\textsuperscript{49} It was in doing this, relatively late in the drafting process, that Powell also added reference to the possibility of a reputational benefit, presumably to take in the more speculative possibility of gains to the tipper that may (or may not) be anticipated later on even if nothing is delivered at the moment.\textsuperscript{50}

My point here is not to suggest that these early drafts and private letters are authoritative as to \textit{Dirks'} precedential meaning, any more than the private explanations of a legislative drafter determine the meaning of a statute.\textsuperscript{51} But cases like \textit{Obus} and \textit{Martoma} explicitly struggle with the overlapping references to objective and subjective benefit, so the back story at least helps explain the confusion.\textsuperscript{52}

\textbf{B. Martoma and the Mighty Comma}

\textsuperscript{49} Pritchard, supra, at 870.
\textsuperscript{50} I suspect that Powell feared that the insistence on objective evidence of pecuniary gain might be taken too far, and thus made clear by reference to reputation that an inference of possible future benefit would suffice. Powell also struggled (and never really resolved) with the overlapping relationship between his duty-based approach to tipper liability and the separate 10b-5 requirement of scienter. This becomes even more vexing when he turns to tippee state of mind, discussed infra.
\textsuperscript{51} Pritchard agrees. Id. at 874-75, citing Adrian Vermeule, \textit{Judicial History}, 108 Yale L.J. 1311 (1999).
\textsuperscript{52} The best practical reconciliation I can think of is that the government must show that there was some disloyalty vis-à-vis the issuer or source by offering objective direct or circumstantial evidence of potential gain from which to infer subjective intent to benefit. The real question is whether this evidence indicates, at the time of the tip, the tipper could reasonably expect to benefit. This is important, because as courts have repeatedly pointed out, the very nature of reputational and sometimes even pecuniary benefits is that their value usually comes much later, and maybe never.
Back to the question: under Dirks, is the intent to make a gift of the information disloyal per se, or is that category limited to meaningfully close relationships with family and friends, for which it may be said—as is repeatedly emphasized by the Supreme Court in Salman—that tipping someone close to you is like the tipper trading on his own and then giving the proceeds to the loved one? I will come back to this simile in a bit.

Chief Judge Katzman’s majority opinion in Martoma is a hyper-close reading of Dirks’ text (almost as if it were a statute being interpreted by a strict originalist) in support of a stand-alone “intent to benefit the tippee” route to tipper-tippee liability. In so doing, Martoma seizes on language in Dirks that had been in plain sight but largely ignored in tipping jurisprudence up until then.53 The analytical progression in the key paragraph in Dirks says, as discussed above, that while purpose may be the ultimate question, objective proof as to benefit is required.54 It then refers to pecuniary and reputational benefit as two ways to do this (oddly using “i.e.” rather than “e.g.”) After a citation on that point to some secondary authority, it gives examples for when the inference of such benefit is proper, which had been in multiple earlier drafts: “there may be a relationship between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the particular recipient.”55 Martoma seizes on the comma in the middle of this sentence to claim that the Court is offering two distinct routes to proving a tip, the latter being a simple intention to benefit the tippee without the need for any pre-existing relationship.56 Only in the next sentence—with

53 Not surprisingly, Martoma claims that this language is familiar, put to use in SEC v. Warde, 151 F.3d 42, 48 (2d Cir. 1998) and even Newman. 894 F.3d at 74, 77. But in neither does the court put much if any weight on it as a distinct route to liability.
54 463 U.S. at 664.
55 Id. (emphasis added).
56 This reading makes the reference to relationships at the beginning of the sentence applicable only to what comes before the comma.
the word “also” to suggest that this is additional, not defining or limiting—is there any specific reference to friends or family or (in the sentence that follows that one) the foggy point about such tips being the equivalent of trading followed by a gift of the proceeds.

What the panel majori ty is doing here is clinging desperately to Justice Powell’s original focus on the tipper’s purpose—the particular words that are important to Katzman are ones that appeared in draft opinions in Dirks early on, well before O’Connor. From the archives we see that the distinct idea of an intentional tip to give someone a marketplace advantage as a clear breach of loyalty stated in the first draft and Powell’s accompanying notes without any reference to family or friends. With all the subsequent changes that go on elsewhere in the drafting, that distinctive language about the purposeful tip remained. In dissent, Judge Pooler does just the opposite: seizing on the handful of O’Connor inspired snippets that reject purpose in favor actual benefit, objectively demonstrated. She is insistent that gift benefit arguments be accompanied by a convincing (if often circumstantial) story about the potential for some kind of gain, such as the inference that giving a tip to a close family member or friend will naturally enrich all those in the relationship. She wants nothing to do with purpose as such.

The Dirks Court’s failure to reconcile the two inconsistent ideas explains much about Martoma’s difficulty. It comes down to whether one can fairly read the insistence on benefit-in-fact as entirely evidentiary in assessing the presence of disloyalty, or something more dispositive. How much did Powell give away to O’Connor, in other words? Different sentences or fragments suggest different answers to this question, which is not surprising given that Powell was trying to satisfy O’Connor without silencing

57 See pp. – supra.
his own strong views about the motivational nature of fiduciary duty and good faith.\textsuperscript{58}

Textualism aside, is it cogent and sufficiently compelling to proscribe deliberate gift tips outside the circle of family and friends as breaches of loyalty? Commenting on \textit{Obus} and \textit{Newman}, Pritchard says no;\textsuperscript{59} in contrast, Donna Nagy and Joan Heminway both say yes in part by reference to more recent Delaware fiduciary duty case law,\textsuperscript{60} which puts in the category of disloyalty and bad faith actions deliberately taken without regard for the interests of the corporation. Even without such resort, I think that there is benefit whenever fiduciaries takes something valuable as their own to do with as they please without serving their master (the issuer or source), regardless of what they ultimately choose to do. \textit{The exercise of dominion is itself a form of (unjust) enrichment}.\textsuperscript{61} Judge Rakoff seems to agree, saying in \textit{Pinto-Thomaz} that the “use of the term ‘personal purpose’ or ‘personal advantage’ [in \textit{Dirks}] could have averted subsequent

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\textsuperscript{58} I see little in \textit{Salman} to resolve any of this confusion. \textit{Salman} quotes \textit{Dirks} extensively, including both Powell and O’Conner inspired sentences as if there is no tension. Curiously, the Court puts the distinct “intent to benefit the tippee” language in italics, without explanation. Judge Pooler in \textit{Martoma I} (see 869 F.3d at 86-87) and others note that the government in \textit{Salman} made broad arguments about the meaning of tip and the role of personal benefit, which the Court sets forth. The opinion then immediately says that the case can be resolved on narrow grounds—the nature of gifts in a family setting. She suggests that this is an implicit repudiation of the government’s argument. I don’t see it as such, but rather the common approach of not seeking to resolve doctrinal issues beyond what is necessary to answer the question posed by the grant of certiorari. The Court gives no reasons why it would reject the government’s position.

\textsuperscript{59} Pritchard, supra, at 869-74.

\textsuperscript{60} Nagy, supra, at 42; Heminway, supra, at 90-91.

\textsuperscript{61} Jill Fisch seems to be making a similar point about the tipper’s increase in utility. See Jill Fisch, \textit{Family Ties: Salman and the Scope of Insider Trading}, 69 Stan. L. Rev. Online 46, 51 (2016).
confusion;”62 the stand-alone inference, in other words, coheres well enough with the Dirks Court’s intent.

Martoma also makes a structural argument. It dismisses the idea that a deeply meaningful relationship between tipper and tippee is necessary by reference to the two other (less controversial) kinds of personal benefit, pecuniary and reputational. If the former can be satisfied by as little as a couple of lobsters, theater tickets or jars of honey from the tippee, or the hope of a bright future, it is not doing all that much work.63 So, according to the panel, it hardly makes sense to be so elastic there yet arbitrarily strict for pure gifts. But this proves too much. I am fairly sure that Judge Parker in Newman would have liked, if he could, to attach his requirement of “objective and consequential” pecuniary-like expectation to all three prongs, not just gifts. To him, I suspect, a jar of honey for a big tip shouldn’t suffice to create a co-venture either. And I’m not sure that the Supreme Court would disagree if faced with those facts (as opposed to the egregious family sharing plan in Salman).

Reputational benefit deserves more thought than it has been given—this remains the most undertheorized form of personal benefit. Powell adds it to the Dirks opinion relatively late as part of the O’Connor edits, perhaps to make clear (as against what O’Conner was pushing) that personal benefit does not have to involve an immediate or certain payoff to the tipper; it is enough to reasonably hope that something good may come as a thank you kind of payback later on. We are back to purpose, in other words. No prior relationship is necessary here: consider a hypothetical where a young investment banker brazenly seeks out a big-name hedge fund manager whom he has never met and simply delivers a valuable tip with the words “you’re welcome.”

62 352 F. Supp.3d at 299.
63 See United States v. Jiau, 734 F.3d 147, 153 (2d Cir. 2018).
Given how the favor bank works on Wall Street, this might be characterized as seeking a reputational benefit, and given the cronyism involved, certainly should be. On the other hand, hoping for something of significant value in return may seem delusional, failing Judge Pooler’s reasonable expectations approach. So while a sensibly broad approach to reputational benefit would obviate the need to address my hypo as a form of gift-giving, I think the stand-alone intent to benefit standard is better aligned with what animates the inclusion of reputation in the personal benefit analysis. Gratuitous tips may be good conversation starters, with the relationship coming later.

There is one more textual clue in Dirks that bolsters the Martoma conclusion, though the panel didn’t stress it. Toward the very end of the Supreme Court’s opinion, in concluding that there was no breach for personal benefit by the whistleblowing insiders—which resolves the case—it says “nor did they make a gift of valuable information to Dirks.” If a meaningfully close personal relationship was essential to gift-giving, the Court presumably would have noted that, because there was no such relationship. This language, which seems to admit of the possibility of a gift benefit in a tip to an investment professional with whom they had no prior relationship, much less a close personal one, thus fits better with Martoma’s reading.

This, however, brings us to the two “friends and family” sentences in Dirks, and the thought that tipping friends and family members “resembles” the insider trading and then giving the

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64 Tom Wolfe’s memorable image from The Bonfires of the Vanities (1987), about doing favors on Wall Street without asking for anything in return, just with the hope/expectation that something good will come of it down the line. See Coffee, supra.


66 646 U.S. at 665-66.
proceeds to them. The analogy is only superficially helpful, because the same thing could be said about many tips; indeed, in early drafts of the opinion this form of “indirect benefit” was invoked to justify the entire idea behind the personal benefit test, not just the gift prong. If the idea is that the gains to the tippee will somehow come back to enrich the tipper because of the close relationship, that seems both speculative and poorly defined. Think of the many cases that could not easily be categorized—a tip to the portfolio manager of the endowment fund of her alma mater. There are just too many forms the relationship between tipper and tippee can take for the analogy to bear much weight in disposing of cases.

That said, I have to concede that the two sentences have come to be part of the canon of tipper-tippee law, and not so easily by-passed. **Salman** jumped right to them to conclude that the gift-giving language in **Dirks** needs no further elaboration making them the rationale for rejecting **Newman’s** tightening. And as Jack Coffee points out, if we take the facts in **Martoma** (ignoring the pecuniary quid pro quo), it is very hard to see what Dr. Gilman did as “resembling” trading massively for his own account and gifting the proceeds to a hedge fund by way of Mathew Martoma.68 The friends and family qualifier to gift benefit has been around, used and quoted long enough for it to have taken on a life of its own, pre-dating **Newman** and its gloss. So while I have come to be

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67 In the evolution of the **Dirks** opinion, the idea and language about friends and family, including the simile, is taken almost verbatim from an opinion piece in the Legal Times by Leonard Chazen that appeared roughly at the time the case was being argued. Chazen, **Dirks Presents Unique Corporate, Social Issues**, Legal Times of Washington, March 14, 1983, at 14, 18. For a while, the draft opinion gave Chazen credit for the concept with an extensive quotation, but Powell later directed his clerk to remove the citation on grounds that reliance on such media commentary might not be appropriate. File at 225. Much the same idea was also expressed in the ABA letter cited in the **Chiarella** footnote (see note – supra), with reference to friends, family “or others;” this cite was eliminated in editing as well. File at 216.

68 Coffee, supra.
persuaded that Martoma’s reading probably makes better sense of the law of fiduciary responsibility on which insider trading theory is grounded, the more conventional reading of gift benefit—bolstered by Salman’s fascination with the simile—may be the more likely one, at least outside the Second Circuit or until the next stealth overruling.

III. TWO THEORIES, CONFLICTING PRINCIPLES

“Essentially, insider trading is a variation of the species of fraud known as embezzlement, which is defined in Black’s Law Dictionary as ‘[t]he fraudulent taking of personal property with which one has been entrusted, especially as a fiduciary.’ If the embezzler, instead of trading on the information himself passes on the information to someone who knows it is misappropriated” information but still intends to use it in connection with the purchase or sale of securities, that ‘tippee’ is likewise liable, just as any knowing receiver of stolen goods would be”—Judge Rakoff in Pinto-Thomaz69

Judge Rakoff has for some time now expressed the wish that insider trading law be thoroughly grounded in misappropriation, from which a simpler “stolen goods” approach to tipper-tippee liability would naturally follow. He has expressed no affection for the classical “abstain or disclose” theory, from which the Dirks test was derived. Yet today, Dirks controls under both theories. Perhaps that is one of the unnecessary complications some courts have fostered. Again, we have to go back in time.

69 352 F. Supp. 3d at 295-96. Previously, see SEC v. Payton, 97 F. Supp.3d 558, 559 (S.D.N.Y. 2015)(Rakoff, J.: insider trading “is a form of cheating, of using purloined or embezzled information to gain an unfair trading advantage”).
A. More Doctrinal History

The federal securities law of insider trading through (and including) the retrenchment in *Chiarella* and *Dirks* was entirely about the duties to abstain or disclose that traders with an informational advantage owe to others trading contemporaneously in the securities markets. The Supreme Court held that such a duty exists when the defendant is a fiduciary who trades or tips, because others trading in the marketplace can be seen as the beneficiaries of that trust. This is the classical theory, for which *Dirks* sets the rule for tipper-tippee liability.

When *Chiarella* was being briefed and argued before the Supreme Court, the Solicitor General’s office abandoned the more expansive conceptions of duty that flourished in the aftermath of the Second Circuit’s *Texas Gulf Sulphur* decision and tried to get the Court to buy into a narrower framework, which it presumably thought had a better chance before an increasingly conservative lineup of justices.70 The SG’s approach made the law turn on misappropriation, which was presented in two distinct versions in the government’s brief. One retained the focus on protecting contemporaneous marketplace traders by imposing a duty to abstain or disclose to the market anytime the information has been misappropriated, whether by breach of fiduciary duty or

mere theft. The other was to find deception in the breach of entrustment itself, where the trader is pretending to be a faithful fiduciary to the source of the information, but in fact acting disloyally. In Chiarella, the majority accepted neither argument on the merits, finding them insufficiently charged below, therefore leaving both for future consideration if and when properly pled and charged. For the time being, at least, fiduciary duty was it. In dissent, Chief Justice Burger said he would apply the market-facing disclosure approach to misappropriation to sustain Chiarella’s conviction. In a concurring opinion, Justice Stevens agreed with the majority but said encouraging things about the fraud on the source argument for future cases.

The Supreme Court eventually embraced the misappropriation theory a decade and a half later in United States v. O’Hagan.71 But which version? The Second Circuit’s early cases supporting misappropriation were somewhat ambiguous on this, not seeming to put much weight on (or even noticing) much in the way of substantive distinction.72 Since then, however, it has become clear that it was not Burger’s conception73 but rather the argument that Justice Stevens liked. By feigning fidelity, the misappropriator deceives the source of the information, taking advantage of misplaced trust. To experts in white collar crime, this version of misappropriation bears a close family resemblance to the “honest services” idea that for so long drove many high-

72 In the first Second Circuit decisions applying the misappropriation theory, the “Burger” and “Stevens” approaches to the theory were intermingled. E.g., United States v. Carpenter, 791 F.2d 1024, 1032-33 (2d Cir. 1986)—which, by the way, Jed Rakoff argued on the defense side. It appears that Justice Powell considered the misappropriation theory an invalid application of Section 10(b), but left the Court shortly before he would have been able to reject it in Carpenter. A.C. Pritchard, United States v. O’Hagan, Agency Law and Justice Powell’s Legacy for the Law of Insider Trading, 78 B.U. L. Rev. 13 (1998).
73 Contrary to Judge Rakoff’s attribution, see Pinto-Thomaz, 352 F. Supp.3d at 297.
profile mail and wire fraud prosecutions, which might explain its quick take-up among prosecutors and judges at the time. The biggest practical difference between the two theories has to do with the “mere theft” of information. The Burger approach readily includes all purloined information within the duty to disclose, no matter how obtained, while the fraud on the source theory only kicks in when the theft takes a deceptive form (like embezzlement). As the quotes from Judge Rakoff show, it is tempting today to treat misappropriation as the theory of insider trading, expressing the first principles from which insider trading doctrine should follow. After all, most all classical cases are also misappropriation case (though not vice versa). Indeed, Rakoff seems anxious to throw the classical theory into deep storage.

It is also tempting to speak of misappropriation in property-like terms, although this steps into intellectual quicksand. The resemblance to embezzlement has been noted in the case law for decades (pointedly made in the government’s brief in Chiarella),

74 About the same time as Chiarella was decided, not yet Judge Rakoff wrote an extensive survey of the history and use of the mail and wire fraud statutes: Jed Rakoff, The Federal Mail Fraud Statute (Part I), 18 Duq. L. Rev. 771 (1980); on the subsequent evolution of mail fraud as applied to insider trading, see William K.S. Wang, Application of Federal Mail and Wire Fraud Statutes to Criminal Liability for Stock Market Insider Trading and Tipping, 70 U. Miami L. Rev. 220 (2015).
75 This is what made a hacking SEC v. Dorozhko, 574 F.3d 42 (2d Cir. 2009), involving insider trading via hacking.
76 Pinto-Thomaz, 352 F. Supp.3d at 297 n.3 (“While the ‘classical theory’ may still be occasionally employed even today, it is hard to imagine an insider trading case that does not fit comfortably within the confines of the misappropriation theory”). For an argument for a misappropriation-based unified theory of insider trading, see Zachary Gubler, A Unified Theory of Insider Trading Law, 105 Geo. L.J. 1235 (2017).
77 Judge Ralph Winter played a considerable judicial role in translating an academic theory to doctrine. See his concurring and dissenting opinion on the application of the misappropriation theory in United States v. Chestman, 947 F.2d 551, 567 (2d Cir. 1991(en banc). He sought to draw a line between business-related misappropriation and more informal settings in a case involving a family-controlled business.
but of course embezzlement takes money or property away from its rightful owner; insider trading is merely the unauthorized use of the information, often without any measurable harm to its owner.\textsuperscript{78} To be sure, there \textit{might} be a threat to the value of the information in a given case—and so good reasons to proscribe the misconduct. But ultimately the misappropriation theory is more about the abuse of trust in the sharing of secrets, applicable to settings where the “owner” of the information has invested in the gathering valuable information that has been entrusted to agents of the firm, but extending well beyond. It is more contract than property, and even then, can be as much in the hands of the courts as a matter of law (fiduciary duty) than expressed intent of the parties. Still, the embezzlement and stolen goods rhetoric persists.\textsuperscript{79} It appeals especially to conservative-leaning academics and judges because it appears to privatize the interests at stake, reducing judicial discretion to the identification of pre-existing protectable economic interests rather than searching for more public-regarding duties.

The case law on tipper-tippee liability under the misappropriation theory took a solid turn the “stolen goods”

\textsuperscript{78} Rational insider traders take pains to conceal their trading from all but a close circle, if that, because leakage erodes the trading advantage.

\textsuperscript{79} There is also a conceptual difference. The Burger-endorsed misappropriation theory was grounded in investor protection and avoiding marketplace abuse by embezzlers and thieves. By contrast, the theory underlying fraud on the source in its pure form is the protection of the owner’s property interest in exclusive use of the secrets from embezzlement and deceptive thievery. The first makes insider trading a matter of public law; the second smacks of private law. I suspect that many judges who apply the misappropriation theory as we know it today instinctively think of it as grounded in investor protection, in the spirit of Chief Justice Burger. Justice Ginsburg tries hard in \textit{O’Hagan} to make this connection, though formally adhering to the victimization of the source alone. See Donna Nagy, \textit{Reframing the Misappropriation Theory of Insider Trading Liability: A Post-O’Hagan Suggestion}, 59 Ohio St. L.J. 1223 (1998). Rakoff can be read as doing so as well. But there are profoundly different implications to following the property rights view, including about the treatment of tippers and tippees.
direction in the 1990s. Both the SEC and criminal prosecutors took the litigation position that personal benefit was required only in classical cases, which found some (though not uniform) support. This distinction came to matter more and more as misappropriation grew in reach. The pivotal case was United States v. Libera, involving “tippers” who worked at the plant where Business Week magazine was printed and distributed, and who—for very little, if any, compensation—delivered advance copies to recipients who used the advantage to buy and sell stocks mentioned favorably in the investment column. The Second Circuit affirmed 10b-5 liability in a striking opinion written by Ralph Winter, rejecting defendants’ main argument that the workers did not actually even know what the recipients intended to do with the information (i.e., it wasn’t obviously a tip to facilitate trading because the recipients could have had many reasons for wanting an advance look). Judge Winter anticipates Rakoff with repeated references to embezzlement and stolen information, and firmly embraces a property rights approach. Misuse of someone else’s information was enough, apparently, and as far as what was in it for the workers, the panel said simply that “it may be presumed that the tippee’s interest in the information is, in the contemporary jargon, not for nothing.” Dirks is cited, but reference to personal benefit was conspicuously absent. A few years later, in United States v. Falcone, the court

81 989 F.2d 596 (2d Cir. 1993).
82 Id. at 600. The court does insist on a fiduciary breach by the insider and that the tippee know or have reason to know of the breach. In that sense, Dirks has an influence, but personal benefit is not part of it.
83 257 F.3d 226 (2d Cir. 2001). Falcone (written by now Justice Sotomayor) seems clear to me that there are separate and distinct tests for tipper-tippee liability for classical and misappropriation cases, with personal benefit relegated to the former. Id. at 231-32.
reaffirmed *Libera* in concluding that nothing in the Supreme Court's intervening *O'Hagan* decision in any way undercut its reasoning. The exclusion of personal benefit from the analysis was even more palpable in *Falcone*. Misappropriation law was heading in its own direction, hastening *Dirks*’ demise. Trial judges were confused.

Yet that turn in the maze led to a dead end. *Obus, Newman* and *Martoma* now all say without hesitation that the *Dirks* test for tipper-tippee liability applies equally to classical and misappropriation insider trading cases, as if the stolen goods line of cases never happened. *Obus* (which *Newman* and *Martoma* simply follow on this point) cites *Falcone* alone for this proposition, even though *Falcone* reads as just the opposite. In this sense, *Obus* put a sudden stop to one wobble in the tipper-tippee case law, but set another in motion as district judges faced up to the challenges of applying the personal benefit test in the wave of hedge fund trader prosecutions that were cresting at the time, including the prosecutions leading to *Newman* and *Martoma*.

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84 In contrast to *Libera, Falcone* and other cases distancing misappropriation cases from *Dirks*, an Eleventh Circuit case squarely adopting a unified standard noted that *Dirks* could be rendered moot simply by avoiding the lesser-included classical theory in a charge, and it seemed too consequential a holding to allow that to happen. SEC v. Yun, 327 F.3d 1263 (11th Cir. 2003).

85 For an expression of angst about this direction the Second Circuit law was taking at that time, see SEC v. Smath, 277 F. Supp.2d 186 (E.D.N.Y. 2003).

86 693 F.3d at 286. Neither *Falcone* nor *Libera* says explicitly that they are rejecting personal benefit. But both (especially *Falcone*) subdivide the discussion of tippee liability with personal benefit playing a significant role in the classical context, while there is no mention of it in the separate articulation of tipper-tippee liability for misappropriation. An SEC administrative law judge took the implausible view that the latter omission is only because it was not something that needed to be mentioned by the court of appeals. In the Matter of Boylan & Ruggieri, 112 SEC Docket 2469 (2015). On review by the Commission, dismissal of the SEC’s case by the ALJ was affirmed by an equally divided Commission, which at the time consisted of only two Commissioners. Commissioner Stein disagreed and would have overturned the ruling; Commissioner Piowar voted to affirm, but on grounds that no tip was satisfactorily proven, not on personal benefit grounds.
B. *Dirks* as a Workhorse

“Anyone who thinks that the stock market is a level playing field obviously has no contact with reality.”—Judge Rakoff, cautioning prosecutors from the bench in *Pinto-Thomaz*.

Rakoff is right, of course. But insider trading law has never really promised a level playing field. There was a brief period of time after *Texas Gulf Sulphur* when it might have been so read, but that passed surprisingly quickly. By the mid-1970s, even the SEC had rejected strict egalitarianism as bad law and bad policy; the courts in the Second Circuit distanced themselves from it unrealistic implications as well. As I have written elsewhere recently in tracing this history, by the time of *Chiarella*, the equality principle had mainly become a bogeyman for Wall Street to use in pushing back against insider trading law’s reach, though I concede (from personal recollection) that some enforcers at the time and even to this day still yearn for a restoration.

Since that time, insider trading law has been read mainly for the work it does. Most courts and commentators treat the Supreme Court’s decision as straight-forward and (assuming they take it seriously) functional in design—about sorting the circumstances in which outsiders gain an informational advantage into the good and the bad. As courts up through *Obus* made light of personal benefit, critics saw this as a perversion of the Court’s original intent that could undermine the work it is supposed to be

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doing, although for most of that time neither the SEC nor prosecutors were targeting market professionals in a way that pushed hard on these efficiency concerns. With the hedge fund cases, that changed; Newman and its enthusiasts were resurrecting Dirks not only in form but in function. Two recent empirical studies of stock trading by market professionals determine that the Newman decision was followed by a noticeable step-up in aggressiveness by savvy traders in the form of larger orders and larger trading duration in the face of informational asymmetry.89

The stock story is that Dirks is all about market efficiency and (to some at least) protecting property rights in private information. As to the former, legitimate information search should not be chilled by the threat of liability; the elements of tipper-tippee liability should thus work to protect analysts and professional traders. As we have seen, this idea gets prominence in both Chiarella and (especially) Dirks, so there is no doubt it was important to Justice Powell and his colleagues in the majority of those two cases. But it is also important not to overstate this. The Court had ample opportunity to restrain or reject insider trading law and tipper-tippee liability much more radically in the name of efficiency, but didn’t. Fiduciary obligation seemed to matter a lot to Powell,90 even though the Court had said just a couple of years


90 I have imagined in earlier work a conversation between Powell and William Cary, the SEC Chair who inspired the Commission to go after insider trading as a form of (constructive) fraud. Cary’s opinion in the Cady Roberts case was repeatedly cited in both Chiarella and Dirks, in a very supportive tone that suggests that Powell was a believer in what Cary was trying to
earlier that fiduciary duties were for state corporation law to enforce, not 10b-5.\textsuperscript{91} As noted earlier, his explicit concern with market efficiency was real but mainly about avoiding liability for carelessness as opposed to disloyalty in the course of insider-analyst meetings. Stronger readings of \textit{Dirks} about promoting efficiency may project more onto the Court’s intent than necessary.\textsuperscript{92}

This is why the portion of \textit{Newman} at issue in \textit{Salman} gathered so little concern from commentators. \textit{Salman} involved a market professional, but as intra-family tipper, not tippee. \textit{Newman}’s point—in the selective disclosure context—was to warn prosecutors away from making “friend” claims too liberally to evade the personal benefit filter, which the Court in \textit{Salman} easily cabined by focusing on the stench of intra-family cronyism. Even Richard Epstein writes that \textit{Salman} was an easy case for the government under his neoconservative assessment of tipper-tippee law.

By contrast, \textit{Martoma} is much more threatening insofar as it rejects the family and friends collar entirely when there is sufficient (objective) evidence that the purpose of the tip was to enrich the recipient. I have already suggested a reading of Powell’s opinion that permits precisely that, even as it takes us into more contestable territory about selective disclosure. Before we go there, however, we should take stock of the high-level public policy at issue as it has been used to critique the wobble from \textit{Obus} to \textit{Martoma}.

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\textsuperscript{91} Santa Fe Industries v. Green, 430 U.S. 462 (1977).
\textsuperscript{92} As to Justice O’Connor, her suggestion to objectify the inquiry was seemingly to make the trial judge’s job easier Pritchard, supra, at 866 (“I am not sure about what will be gained from an inquiry into intent, but from my past experience on the bench, I know that a great deal of time will be lost!”)
Deciding doctrinal issues by reference to first principles is hard without a clear theory of what those principles should be. A fairness-based, level playing field principle is sometimes put forth in favor of aggressive regulation (which almost automatically signals disdain for *Dirks* and *Newman*), but notoriously difficult to substantiate via hard evidence. More sophisticated versions focus on market liquidity and cost of capital. For example, Merritt Fox, Larry Glosten and Gabe Rauterberg argue that insider trading doctrine should be premised on achieving an optimal balance between encouraging bona fide fundamental market research and minimizing the adverse selection problems (liquidity costs) that come when uninformed traders fear that they can be exploited by informed traders.93 This leads them to conclude that, contrary to *Obus* et al., there should be a stark difference between classical and misappropriation cases as to personal benefit. In terms of *Dirks*’ expressed imperative of not chilling analyst information search, which is presumably a virtue of a personal benefit standard, that applies well to interactions between analysts and insiders (classical theory) but not to information held secretly by persons other than the issuer (misappropriation).94 Analysts mainly focus on the former, and not the latter. Besides suggesting this wrong turn on the road to *Martoma*, they argue that *deliberate* issuer-authorized tips to analysts should be banned whichever theory applies—the adverse selection problem dominates the need to encourage research once the problem of inadvertent leakage is addressed.

The “alt” theory in insider trading, as noted, is to protect the property rights belonging to the owner of the information

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93 See Fox et al., supra.

94 See also Merritt B. Fox & George Tepe, *Personal Benefit Has No Place in Misappropriation Tipping Cases*, 71 SMU L. Rev. 767 (2018)(arguing that the law is not so clear that further change could not take place to restore the view that the *Dirks* test be confined to classical cases). In many ways they anticipate the *Blaszczak* case, discussed infra.
from embezzlement or its equivalents. Judge Winter’s opinions in Chestman and Libera took this on as their mission, as we saw.95 A fundamental implication of the property rights idea is that the owner gets to do with the information as it wishes, free of government meddling at least so far as the securities laws are concerned. A large body of scholarship (mostly conservative) agrees, with Frank Easterbrook as an early and influential proponent. While an early version of this said that there was no need for federal regulation at all—owners can protect themselves using common law agency, fiduciary, tort, contract and property principles—that idea has faded in favor of seeing insider trading law as a useful federal law tool for sanctioning informational embezzlers. But recall that Winter wanted no place for personal benefit. In his commentary on Newman and Martoma I, by contrast, Jon Macey argues that a personal benefit requirement is crucial to cement into place a strict property-rights/private-ordering approach. He thus treats the Dirks test (including personal benefit strictly applied) as a necessary protection for dissemination of information that serves the owner’s private self-interest.96

95 See pp. --- supra.
96 See Macey, supra; see also Jonathan Macey, The Genius of the Personal Benefit Test, 69 Stan. L. Rev. Online 64 (2016). Macey reads Martoma I as endorsing a definition of unlawful tipping that applies anytime information is imparted with an expectation that the tippee will trade. He notes, rightly, that that would indeed set Dirks on its head if read literally—under the facts in Dirks, it could fairly be said that the whistleblowers should have “expected” Dirks to tip his clients to sell while helping expose the fraud, yet the Court held that there was no insider trading liability for anyone involved. To be sure, if the tipper-tippee test were reformulated to say that there is a tip anytime information is imparted by an insider with such an expectation, the test would be overbroad. By reference to text extracted verbatim from Dirks about “intention to benefit,” however, Martoma I is plainly using the word expect to mean a motivation to facilitate or enable as a form of selfish use. In any event, Martoma II discarded this emphasis on expectation in favor of intent.
If we are reasoning from first principles, it is unclear why personal benefit is a better test than what Macey really seems to want to get at—business purpose—as suggested in Martoma II. The standard reading of Dirks from the beginning is that a tip genuinely motivated by a belief that the tip is in the issuer’s best interest does not violate Rule 10b-5. A handful of courts in the Second Circuit have suggested that business purpose or not is indeed a sound way to apply Dirks: if no plausible business purpose can be gleaned from the facts, the presumption is of personal benefit.\(^97\) Indeed, this follows from the reading of Dirks given earlier: objective evidence from which to infer subjective (selfish) purpose.

However this particular issue is resolved, I worry that it concedes too much authority to the “owner” of the information. This is inevitable under the fraud-on-the-source approach to misappropriation, where it is clear that the owner can license others to trade on the information for any reasons it wishes, regardless of any adverse effects on the marketplace. The law is far less clear under the classical theory, which makes me less inclined to put it in storage the way Judge Rakoff seems willing.

Suppose an independent, disinterested board of directors authorizes the CEO and CFO (and others, perhaps) to trade with abandon on any inside information they possess. (A more realistic example might be to allow senior executives to trade without restriction for 48 hours after the latest 10-K or 10-Q.) Would that provide a complete defense to an insider trading charge brought by the SEC, assuming that the defendant possessed material non-public information at the time of the trade? Property-rights advocates would argue, with some force,

\(^{97}\) See LANGEVOORT, INSIDER TRADING, supra, sec. 4:7 at 4-20, 4-21, citing, e.g., SEC v. Rubin, Fed. Sec. L. Rep. (CCH) par. 97,784 (S.D.N.Y. 1993); see also SEC v. Maio, 51 F.3d 623 (7th Cir. 1995). The government made this argument to the Supreme Court in Salman, but the Court affirmed on narrower grounds.
that the issuer owns the information, so that assuming proper corporate governance principles are satisfied, those in authority can waive the fiduciary obligations that would otherwise attach, just as under the misappropriation theory. But if we see the classical theory as a federally created duty owed to marketplace traders, it is far from clear that such absolution would work simply by operation of the principles of corporate governance, especially given the anti-waiver provisions of the ’34 Act.\(^{98}\)

Precedent favors treating trading by the issuer itself (stock buybacks in particular) as unlawful under Rule 10b-5 if the issuer is in possession of undisclosed material facts.\(^ {99}\) But if the issuer cannot trade based on inside information, why is Dirks commonly read to say that selective disclosure (tipping to an analyst or active shareholder) is permissible so long as intended to carry out company policy, which is Newman’s high ground?\(^ {100}\) I have already given reasons why Dirks can (and should, I think) be read to preclude issuer-authorized selective disclosure as an intentional gift, though I realize the conventional reading of Dirks

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\(^{98}\) Both Chiarella and Dirks triggered some debate about “issuer-authorized” insider trading. For an extensive discussion with citations as the pros and cons of insider trading as a default rule, see Gubler, supra, at 1263-67. For an argument in favor, see John P. Anderson, Where’s the Harm in Issuer Authorized Insider Trading?, 69 U. Miami L. Rev. 795 (2015). At least under Delaware corporate law, securities law liability is outside the scope of the internal affairs doctrine, see Sciacabucchi v. Salzburg (Del. Ch. 2018), and the duty of loyalty is non-waivable in the face of claims of unfairness.


\(^{100}\) I and other academics have posed some version of this question for some time. See Donald C. Langevoort, Investment Analysts and the Law of Insider Trading, 76 Va. L. Rev. 1023 (1990); see also Langevoort, INSIDER TRADING, supra, sec. 4:7 at 4-22 to -24. More recently, with reference to Newman and Martoma, see Fox et al., supra; Guttentag, supra.
has been otherwise for long enough to make it seem taken for
granted. There are also functional ones, as offered by Fox et al. or
the concern—much more evident today than when Dirks was
decided—that analysts and traders have conflicts of interest than
can distort efficiency when trying to curry favor with issuers;
conversely, executives of the issuer are tempted to use tips as a
currency, favoring those who recommend the company’s stock (or
might be willing to do so) but freezing out the nay-sayers.101 And
then there is Regulation FD, which is a distinct duty of public
disclosure imposed on issuers when choosing to convey
nonpublic information to market professionals or professional
traders. As Donna Nagy has pointed out, an issuer-authorized tip
is almost always an FD violation, from which it follows that any
authorized agent of the issuer is choosing to violate the law when
engaged in selective disclosure—something readily seen as a
breach of good faith and loyalty. FD has vocal critics102 but is the
law, which severely undermines the point of view that Dirks
wants to protect and encourage informal disclosure. But here,
too, there may well be enough water over the dam that selective
disclosure intended for company benefit will not seriously be
questioned by the courts. The insider trading canon may be
closing.

IV. TIPPEE LIABILITY AND THE CRIMINALIZATION OF INSIDER TRADING
DOCTRINE

101 Powell’s view of the entirely healthy activities of analysts ignored the role
of conflicts of interest; the crackdown on analysts who “sold” positive spins
on their recommendations for either access or banking business suggests a
more measured endorsement.
102 For a balanced discussion of costs and benefits, see Jill Fisch, Regulation
FD: An Alternative Approach to Addressing Informational Asymmetry, in
Bainbridge, Research Handbook, supra.
All the debate over gratuitous tips was really just a preface to the bigger question of what a tippee has to know about the tipper and the tip in order to face liability. This is Newman’s surviving contribution: the tippee has to know of the tipper’s breach of duty, including the personal benefit.\(^{103}\) Martoma acknowledges that this contribution stands unchallenged, at least in criminal cases, notwithstanding the trashing of the gift holding.\(^{104}\)

That can be a tough standard for enforcers to meet when there is a chain of tippees who have not directly observed how the conveyance of inside information happened. Dirks seems to speak to this clearly, but in a way that seems to contradict Newman: liability follows when the tippee “knows or should know” of the tipper’s breach.\(^{105}\) That language flummoxed the courts shortly after the Court’s ruling, and still does.\(^{106}\) The main question was how this interacts with the scienter requirement under Rule 10b-5 (the product of an earlier Powell opinion for the Court in the Hochfelder case\(^ {107}\)). “Should know” suggests a negligence standard, whereas Hochfelder rules that out. Courts in the Second Circuit and elsewhere never quite sorted this through. Many took the pragmatic step of substituting a recklessness standard, or conscious disregard.\(^{108}\)

This particular muddle, along with others we have seen, led to Obus. Somewhat heroically, Obus tore notice and scienter asunder, holding that the former addresses the duty issue alone—when is it fair to treat the tippee as participant in a co-venture that somehow fiduciarizes him? A liberal notice approach suffices

\(^{103}\) 773 F.3d at 449.  
\(^{104}\) Of course a more expansive approach to gift tips makes it somewhat easier to argue that the defendant knew that the tip was meant as a gift.  
\(^{105}\) 646 U.S. at 660.  
\(^{106}\) See Langevoort, Insider Trading, supra, sec. 4:10 at 4-36 to -40.  
for that, said the court. Separately, enforcers must show scienter, but that only goes to whether the tippee or traded “while in knowing possession” of such information. Neither notice nor awareness was required of the benefit sought by the insider-tipper. This was not what Southern District judges, for the most part, thought the law was, and Judge Rakoff was particularly taken aback.\footnote{United States v. Whitman, 904 F. Supp.2d 363 (S.D.N.Y. 2012).} A split within the district ensued, which brought us \textit{Newman}.

Going back to \textit{Dirks’} original intent, \textit{Obus} is right about one thing. Justice Powell did not see his test (which for him was all about the tipper’s disloyal purpose) as addressing the scienter requirement.\footnote{See Pritchard, supra, at 867-68.} His notes show that he was troubled by this state of mind duality, but in early drafts the tension was minimal: the tippee had to know of the breach (and presumably the benefit). But without much explanation, the crucial words “or should know” were later inserted. (Powell’s clerk at the time, now a federal judge, recalls vaguely that this was just an effort to conform to language in pre-\textit{Chiarella} precedent.\footnote{Id. at 864-65 & n. 43. This makes some sense in that the more expansive formulation could be found in two authorities cited at around this point in the opinion, Professor Louis Loss, and former SEC Commissioner Richard Smith, whose concurring opinion in an SEC administrative proceeding in many ways gave Powell a roadmap for (and was repeatedly cited in) \textit{Chiarella} and \textit{Dirks}. See In re Investors Management Co., 44 S.E.C. 633, 650 (1971). On the context in which both Smith and Loss were working with respect to insider trading, see Langevoort, \textit{Two Duties}, supra.}) But the purported separation of duty and scienter is grossly unsatisfying; as courts quickly realized, scienter logically extends to all facts relevant to culpability. Awareness of the breach, in other words, \textit{should} be crucial to determining tippee guilt.

\textit{Newman} makes tippee knowledge of the breach and the benefit essential, which does quite a beat-down on \textit{Obus}. With a wink to Judge Rakoff about Delphic opinions, \textit{Newman} largely
ignores both *Obus* and the “should know” language in *Dirks*.\(^{112}\) There is a fairly clear way of explaining the result and minimizing the damage to *Obus*, which I have always assumed to be the case. *Newman* strongly suggests that Judge Parker was addressing the *criminal* standard for liability,\(^{113}\) which (in addition to demanding proof beyond a reasonable doubt of the 10b-5 violation) insists on a showing of willfulness. If the decision had been based on what willful should mean in prosecutions of remote tippees, the analysis would have some appeal. But it doesn’t say that explicitly (though he mentions willfulness briefly), leading to still unresolved uncertainty (noted even in Judge Pooler’s dissent in *Martoma I*\(^{114}\)) about the applicability of the strict *Newman* test in civil cases. Rakoff took note of this shortly after *Newman*, suggesting that appellate judges pay more attention to willfulness and be clearer about the civil-criminal divide, and concluding that allegations of recklessness or conscious avoidance suffice with respect to the tippee’s awareness of the personal benefit in SEC cases.\(^{115}\)

But perhaps something more subtle is also going on. Judge Rakoff points out that when insider trading cases are brought

\(^{112}\) *Newman* quotes the language from *Dirks* but never comes back to address it.

\(^{113}\) For an out-of-circuit decision concluding that this is the proper interpretation, see United States v. Parigian, 824 F.3d 5, 10-11 (1st Cir. 2016). *Salman* takes as a given the government’s acknowledgement that *Newman*’s knowledge test applied in that case, which was criminal. See generally Strader, *(Re)conceptualizing Insider Trading: United States v. Newman and the Intent to Defraud*, 80 Brook. L. Rev. 1419 (2015).

\(^{114}\) 839 F.3d at 77 n.9

criminally, courts may feel "obliged to define unlawful insider trading narrowly, so as to provide the fair notice that due process requires before a person may be placed in jeopardy of imprisonment. Other times those cases are civil proceedings, most often brought by the U.S. Securities and Exchange Commission, in which circumstance a court is inclined to define unlawful insider trading broadly, so as to effectuate the remedial purposes behind the prohibition of such trading." To think of insider trading as embezzlement, or tippee liability as a straightforward stolen goods problem, is to frame insider trading as naturally and ordinarily criminal. But that is a late arriving point of view. For most of the first two decades of federal insider trading enforcement, insider trading law was entirely generated by SEC administrative proceedings and enforcement action. Given the entirely equitable nature of the remedies available to the SEC back then (disgorgement and/or an injunction), it was not surprising that the law could be applied so flexibly. Private rights of action seeking damages for insider trading (part of the Texas Gulf Sulphur story) became of serious concern, but soon enough was calmed via a distinctly restitutionary approach to measuring damages. Criminal insider trading cases did not happen at all until Chiarella’s time; the Boesky-era spate of high visibility prosecutions didn’t come until later in the 1980s.

I do worry that as we think and talk about insider trading more through the lens of criminality, courts have come to fashion

116 97 F. Supp.3d at 559.
117 See Langevoort, Two Duties, supra.
118 Until 1984, the SEC’s remedy in an insider trading matters was disgorgement of profits and, possibly, an injunction against future violations—both purely equitable remedies. See Langevoort, Insider Trading, supra, sec. 8:1 at 8-2 to -3
119 This was first by judicial ruling, Elkind v. Liggett & Myers Inc., 635 F.2d 156 (2d Cir. 1980), and then incorporated into Section 20A(b)(1) of the Insider Trading Sanctions Act of 1984.
120 Langevoort, Insider Trading, at 1-3 to -4; see generally James Stewart, Den of Thieves (1991).
the law accordingly. By the criminalization of doctrine, I mean doctrinal choices made by the courts either to reflect its peculiarly criminal nature or attend to concerns about lenity, notice and due process under the threat of incarceration.\textsuperscript{121} My concern is that insider trading law may suffer when tweaks in doctrine occur that have prosecution in mind but then also burden the SEC in civil cases because they affect the meaning of the rule. This is part of what Rakoff was saying.

Consider the facts of \textit{Newman} in a civil enforcement context. The defendants were third and fourth level tippees of earnings-related information from Dell and Nvidia, which came from mid-level insiders at the issuers. The “gift” part of the case arose because it was not obvious why they leaked the information; there were casual relationships between the insiders and the analyst/acquaintances who were the first-level tippees, not known on down the chain of other tippees. However, the leaks were high quality and repeated, suggesting deliberateness from within the companies. The court (and notable commentators\textsuperscript{122}) stressed that these leaks might well have been designed to serve the issuer’s interests, but if these particular tippers were acting with authorization, we would seem to have a gross violation of the SEC’s Regulation FD.\textsuperscript{123} As quite a number of courts have said, it

\textsuperscript{121} See Justice Scalia’s objections to the denial of certiorari in United States v. Whitman, 135 S.Ct. 352 (2014).
\textsuperscript{122} See Macey, supra.
\textsuperscript{123} As noted, Regulation FD is an SEC disclosure rule requiring that if material non-public information is to be given to analysts or active shareholders, it must simultaneously be disclosed to the public. See \textsc{Langevoort, Insider Trading} sec. 12:12. By all accounts, it was adopted by the SEC because of concern that under \textit{Dirks}, selective disclosure is hard to sanction. The category of persons whose disclosure trigger the FD obligation include lower or mid-level personnel authorized by higher ups to convey such information; unauthorized personnel are presumed to be acting for personal benefit. I agree with Donna Nagy, supra, that FD ought to play a role in fashioning insider trading rules, even though it explicitly is not an insider.
can be reckless to ignore the likelihood that multiple accurate tips were somehow the product of innocence.\textsuperscript{124} If brought by the SEC, I believe, such a case should go to a well-instructed jury for a determination of liability. Nothing in \textit{Obus} stands in the way, while the language in \textit{Newman} encourages resistance.

There are other places where insider trading law has been narrowed seemingly out of fear of the consequences in criminal prosecutions. Another has to do with the meaning of “tip,” also addressed in \textit{Martoma}. It is not hard to find recent case law saying that there is only a tip if the tipper “expects” the tippee to trade; others have suggested different wording: “intending” there to be trading, or “with the understanding that” there will be trading,” for example.\textsuperscript{125} But in the civil context, \textit{Obus} had clearly opened the possibility to reckless tips.\textsuperscript{126} This harkens back to cases like \textit{Libera}, before it was clear that \textit{Dirks’} personal benefit standard even applied to misappropriation claims. Recall that it was not clear that the insiders knew what the recipients intended to do with the leaked copies of Business Week. The court affirmed the conviction, refusing to impose more exacting definition of tip.

\begin{itemize}
    \item[\textsuperscript{124}] See note --- supra.
    \item[\textsuperscript{125}] See United States v. Stewart, 907 F.3d 677 (2d Cir. 2018)(“intended”); United States v. Gannsman, 657 F.3d 86, 92 (2d Cir. 2011)(“expects”). In the arguments in the \textit{Salman} case in the Supreme Court, the government acknowledged an “expectation” test to what constitutes a tip in order to reduce concerns about its broad approach to personal benefit. Again, the position is set forth in the \textit{Salman} opinion, without necessarily any endorsement or criticism. 137 S.Ct. at 427. This is relevant to the curious conundrum about whether 10b-5 applies to a “tip” where the tipper’s purpose is to freeze the recipient from trading for fear of liability once material nonpublic information has been imparted. See Andrew Verstein, \textit{Informational Tainting: Strategic Tipping of Material Nonpublic Information}, 112 Nw. U. L. Rev. 725 (2018).
    \item[\textsuperscript{126}] 693 F.3d at 287, offering a hypothetical of an insider on a commuter train talking about work on his cell phone while aware that potential traders are in earshot. I have wondered about how this squares with the personal benefit requirement. See Langevoort, \textit{Fine Distinctions}, supra, at 446-51.
\end{itemize}
The circumstances made clear that it was “not for nothing” that the misappropriation was occurring, and that was enough to hold the tippees liable. That makes a great deal of common sense, but might not pass today’s stricter test as the intentionality locution becomes the common reading.

A third example goes back a bit further, to the debate over whether liability for insider trading requires proof that the trader bought or sold because of the inside information, or merely that he or she possessed it at the time of the trading (possession versus use). The Second Circuit settled on and has stuck to a possession test,¹²⁷ which is more enforcer friendly. By contrast, the Ninth Circuit insisted on use in a criminal case,¹²⁸ and the Eleventh Circuit followed its lead even in an SEC enforcement action,¹²⁹ albeit with a rebuttable presumption of use upon a showing of possession. The SEC tried to resolve this conflict by rule-making, saying in Rule 10b5-1, which somewhat oddly says that unlawful must be “on the basis of” the inside information (suggesting the possibility of a use standard) but then defining that phrase to be satisfied upon a showing that the person in question “was aware of” the information at the time of trading. Even this, however, has not put an end to the disagreement in the circuits, with many courts outside the Second Circuit holding to a use standard at least in criminal cases, and perhaps civil as well.¹³⁰ Some simply ignore 10b5-1; others express doubt about the Commission’s power to take this doctrinal issue away from them.¹³¹

My point here is not to criticize these moves, but rather to urge caution. At heart, insider trading liability is an equitable

¹²⁷ See Steginsky v. Xcelera Inc., 741 F.3d 365 (2d Cir. 2014); United States v. Teicher, 987 F.2d 112 (2d Cir. 1993).
¹²⁸ United States v. Smith, 155 F.3d 1051 (9th Cir. 1998).
¹²⁹ SEC v. Adler, 137 F.3d 1325 (11th Cir. 1998).
¹³⁰ See LANGEVOORT, INSIDER TRADING sec. 3:14, at 3-43 (collecting cases).
¹³¹ E.g., United States v. Nacchio, 519 F.3d 1140, 1168-70 (8th Cir. 2008).
doctrine, with a duty to disclose imposed on fiduciaries and their confederates as a market cleansing device, a signal of commitment to the idea that while the playing field will never be even, disparities shouldn’t be exploited by those who are supposed to be acting for the benefit of others in handling sensitive secrets. This requires some balance and restraint, as Merritt Fox and his co-authors stress.\footnote{See Fox et al., supra.} Insider trading threatens liquidity, as a matter of adverse selection; at the same time, we don’t want to interfere with legitimate efforts to make prices more efficient. They think insider trading law as currently formulated does reasonably well at this balance under both the classical and misappropriation theories, and civil remedies give the SEC and the courts great discretion in matching the remedy to the conduct.

My fear is that thinking about insider trading mainly as a crime pulverizes these nuances. On one hand, it leads to an inflation of the perceived harm from insider trading and tipping, causing enforcers and judges to get on a rhetorical high horse to justify the painful criminal sanctions that we now expect upon conviction. None of this is to advocate for a robust permission to engage in insider trading \textit{a la} Henry Manne and the (relatively few) of his evangelists who remain\footnote{E.g., Mercer Bullard, \textit{Insider Trading in a Mannean Marketplace}, 88 Temple L. Rev. 223 (2016).}—cumulatively, the threats to good disclosure practices, corporate confidentiality and market liquidity mount up to good cause for regulation and enforcement. I don’t even object to the dramaturgical nature of the campaign, given the branding effect mentioned earlier. But in making doctrine, judges and enforcers shouldn’t lose sight of what really is at stake, and, as Rakoff says, choose their words carefully.

\section*{V. Never Mind: The \textit{Blaszczak} Detour}
With this we come to the Second Circuit’s most recent judicial revisionism of insider trading law, *United States v. Blaszczak*. In it, we receive the news that the *Dirks* personal benefit test only applies to claims securities fraud within the confines of Rule 10b-5 (or more precisely, the Securities Exchange Act of 1934), not to mail or wire fraud prosecutions or the “new” criminal securities fraud statute (18 USC section 1348) enacted as part of Sarbanes-Oxley’s response to the financial reporting scandals almost twenty years ago. In other words, forget all the foregoing discussion of personal benefit when prosecutors choose to attack insider trading under one of those alternative criminal statutes.

By now, it should be clear that I do not think that *Dirks* personal benefit test accomplishes much, and so I am not by any means displeased with the result in *Blaszczak*. On the other hand, the result invites bringing challenging tipper-tippee cases (especially chain-link ones) as criminal rather than civil cases, contrary to how insider trading enforcement is meant to work—the point made in the previous section.

Judge Sullivan’s opinion is an embrace of embezzlement as the touchstone for these Title 18 statutes, which does connect it to all the foregoing in this essay. He is channeling (with attribution via multiple citations) what both Judges Winter and Rakoff have said: that when we think of insider trading as misappropriation akin to embezzlement, a stolen goods approach

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134 F.3d --- (2d Cir. 2019).
135 In his concurring opinion in *Chestman*, 947 F.2d at 581, Judge Winter explicitly addressed the relationship between Rule 10b-5 and mail fraud doctrine as to personal benefit, acknowledging that it was a hard question he was not ready to answer.
136 *Pinto-Thomaz*, 352 F. Supp.3d at 298; see also Rakoff’s opinion in *United States v. Whitman*, 904 F. Supp.2d at --.
to the liability of those who receive tips makes sense without any personal benefit gloss. As we have seen, until Obus, that was arguably the 10b-5 law in the Second Circuit, and so—albeit only in the criminal context—Blaszczak may just be correcting the wobble from Obus’ earlier apparent mischaracterization of Libera and Falcone.\(^{137}\) This makes it at least a partial stealth overruling, without even touching Rule 10b-5.\(^{138}\)

Blaszczak treats wire fraud and the SOX crime as essentially the same for this purpose, but they really are two distinct statutes. The law of mail and wire fraud is massive, even as to the specific issue of misappropriation of intangible property, and certainly as to the “honest services” jurisprudence that went into its own wobble and hasn’t ever, so far as I can tell, found stability.\(^{139}\) In its decision in Carpenter,\(^{140}\) the Supreme Court explicitly accepted the possibility that mail and wire fraud can reach insider trading even when Rule 10b-5 doesn’t;\(^{141}\) starting immediately in the aftermath of its decision (which made many securities law types uncomfortable\(^{142}\)), commentators and judges asked whether

\(^{137}\) See text accompanying notes --- supra.

\(^{138}\) Judge Sullivan wrote the district court opinion in the Newman case that took Obus about awareness of personal benefit at its word, and was then famously reversed.

\(^{139}\) Illustrated most notably the Supreme Court decision in United States v. Skilling, 130 S.Ct. 2836 (2010). See Note, Reframing the Right: Using Theories of Intangible Property to Target Honest Services Fraud after Skilling, 112 Colum. L. Rev. 359 (2012).


\(^{141}\) See O’Hagan, 521 U.S. at 678 n. 25. The Court indicated that it was not its job to decide whether this kind of result was good enforcement policy. In Blaszczak, puzzlingly also sought to bolster the case for allowing mail fraud to have a broader reach than Rule 10b-5 by reference to Justice Thomas’s dissenting opinion in O’Hagan, and United States v. Bryan, 58 F.3d 933, 953 (4th Cir. 1995), both of which were efforts to strike down the misappropriation theory under Rule 10b-5—which the majority of the Court rejected.

Dirks’ personal benefit test should have any continuing place with respect to crimes akin to embezzlement.¹⁴³ Whatever the preferred answer, the issue was always in plain sight but of little import so long as personal benefit was easily found, which only changed after Newman. Judge Rakoff has long been a mail/wire fraud exceptionalist (he once called mail fraud the prosecutors’ “Stradivarius”¹⁴⁴), wanting to treat securities fraud as a mere “specialized subspecies” of the more fundamental mail and wire fraud prohibition.¹⁴⁵

Section 1348, on the other hand, is meant for the world of public company securities fraud, though characterized by immense confusion about why it was needed, what it does differently from Section 32(a) of the ’34 Act, etc. whether as to insider trading or more generally.¹⁴⁶ There are some obvious possibilities, but none make it easy to walk the line between undue vagueness on one hand and duplication of Section 32(a) on the other.¹⁴⁷ Judge Sullivan takes some liberties here when he

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¹⁴⁴ Rakoff, supra, at 771.


¹⁴⁶ A principal proponent in Congress was Senator Patrick Leahy, who indicated the need to create a mechanism for prosecution not bounded by technical limitations. That is odd, because that is precisely why Section 10(b) was created. See Steve Thel, The Original Conception of Section 10(b) of the Securities Exchange Act, 42 Stan. L. Rev. 385 (1990). Perhaps Leahy would point to the decision by Enron prosecutors to charge a margin violation to avoid a more complicated route to convictions. See William Widen, Enron at the Margin, 58 Bus. Law. 961 (2003).

¹⁴⁷ On the possibilities, see Woody, supra; Couture, supra (suggesting a lower threshold of materiality); Langevoort, INSIDER TRADING, sec. 8:13. The most noteworthy decision of relevance to insider trading until Blaszczak was United States v. Mahaffy, 693 F.3d 113 (2d Cir. 2012), which tracked the
says that “as Dirks explained, in order to protect the free flow of information into the securities markets, Congress enacted the Title 15 fraud provision with the limited ‘purpose of . . . [e]liminating [the] use of inside information for personal advantage.’” Actually, that sentence in Dirks (ignoring all the brackets and ellipses) says that removing personal advantage was just a purpose, among many.148

My unease with Blaszczak simply takes us back to what we said earlier about the embezzlement/stolen goods label. Information use and dissemination from inside public companies is immensely weighty as a matter of policy, much more than the simplistic invocation of embezzlement can bear. “Akin to” is not the same as “is.” Reference to breach of fiduciary duty is required in ordinary classical and misappropriation enforcement proceedings in order to address the “fine distinctions” between good and bad ways of obtaining or using material nonpublic information. Existing doctrine could surely do better, but it would require something more than reference to stolen goods. Imagine if Raymond Dirks was prosecuted for mail fraud. My sense is that Equity Funding’s property right in the exclusive use of its inside information (or Dirks’ awareness of Secrest’s interference) would not play much of a role in its outcome. It’s in Title 15 that we see so much more to the conundrum, which shouldn’t be shoved aside simply by invoking Title 18.

Newman provides another good example. We have already seen that its outcome could have been different if brought as a civil enforcement action by the SEC. There was surely ambiguity about how and why the information leaked from the two companies and made its way into the hands of the portfolio managers three or four times removed. Dirks’ “should know” misappropriation theory in a front-running case involving broker-dealer dissemination of “squawk box” information to favored clients.

148 Dirks, 463 U.S. at 662.
phrase helps to make sense of competing narratives as to the insiders’ motives. Note that back in the days when tipper-tippee law drew a distinction between classical and misappropriation cases, cases like Libera and Falcone still applied everything about the Dirks test except personal benefit. If we do indeed move to a world where Title 18 crimes are charged more frequently to avoid Dirks, there will be much more work for the courts to do in fashioning good policy and doctrine, and getting the enforcement incentives right. Again, I’m happy to see personal benefit go, whatever the enforcement vehicle. But Title 15 “theory” deserves its say in puzzling through what should take its place in hard cases.

VI. CONCLUSION

“But the uneasiness of sending a good person to jail for a long time based on a very abstract definition of harm was tough to swallow, because Rakoff understood the intellectual disconnects very well. There was a special irony in invoking [the misappropriation] doctrine designed to promote [a more] even playing field for public investors in a case where the role of poor victim was played by Goldman Sachs.”

All the previous quotes have been Rakoff’s. This last one is mine, which I wrote a few years ago about the difficulties Judge Rakoff faced and to an extent expressed in sentencing Rajat Gupta to two years in prison in one of the biggest insider trading cases of the time. Rakoff was trying to make sense of how and why a seemingly good man like Gupta acted as he did, and the right penalty for a crime that might well have caused no direct pecuniary harm at all to its victim, notwithstanding what the

Sentencing Guidelines were saying about a longer period of incarceration. My impression was that Rakoff understood very well the uneasy nature of insider trading law and enforcement, more than he could say out loud in sentencing Gupta.

The best animating rhetoric for insider trading regulation today can be found in Rakoff’s own words: the promise to fight against a playing field that is tilted in favor of cheaters, i.e., those who would wrongfully exploit their access to secrets.\(^\text{150}\) His insider trading jurisprudence (holdings, dicta and asides) harkens back to Chief Justice Burger in *Chiarella*, who had the good idea of building a more expansive source of wrongful access or use while avoiding the unrealism of equal access.\(^\text{151}\) Going back a number of years now, Rakoff has been calling for Congress to replant the garden maze of doctrine that has too many circles and dead ends by writing a clear statutory definition of insider trading.\(^\text{152}\) Putting aside his claim that insider trading is a straightforward concept (with which I disagree), he is surely right about the unnecessary complications some courts have caused. Surely there is a better way going forward.

\(^{150}\) SEC v. Payton, 97 F. Supp.3d 558, 559 (S.D.N.Y. 2015)(Rakoff, J.: “The Unites States securities markets—the comparative honesty of which is one of our nation’s great business assets—cannot tolerate such cheating if those markets are to retain the confidence of investors and the public alike”).

\(^{151}\) See Donald C. Langevoort, *Words from on High about Rule 10b-5: Chiarella’s History, Central Bank’s Future*, 20 Del. J. Corp. L. 866, 883-84 (1995). Donna Nagy has long championed Burger’s view of misappropriation as well. See sources cited in notes – supra. I read Burger as grounding the case against *Chiarella* in terms of embezzlement or theft, but not confining the 10b-5 duty to violations of positive criminal law. His approach presumably takes in all wrongful ways of obtaining or using inside information.