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Breaking Up the Focus on Relationships for Nonpecuniary Insider Trading Personal Benefits

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BREAKING UP THE FOCUS ON RELATIONSHIPS FOR NONPECUNIARY INSIDER TRADING PERSONAL BENEFITS

*Bradley Larkin**

In 1983, the U.S. Supreme Court adopted the "personal benefit" requirement as an objective test for insider trading to help determine when confidential information is tipped for an improper purpose. Under this test, a tipper acts improperly by receiving a personal benefit for sharing confidential, nonpublic information, even if the tipper does not trade using the information. For instance, when a tipper leaks confidential information to a trading friend or relative, the tipper benefits personally because this amounts to trading on the confidential information and then gifting the profits. The personal benefit requirement is applied differently among the circuits, however, and the Second Circuit has changed its interpretation of the personal benefit test three times since 2014. Currently, it requires prosecutors to show a meaningfully close personal relationship between tipper and tippee using evidence suggesting either a quid pro quo relationship or the tipper's intention to benefit the tippee. This Note argues that personal benefit tests that evaluate the closeness of a tipper-tippee relationship detracts from the Supreme Court's goal of separating tips leaked for proper and improper purposes. Instead, this Note proposes two distinct tests for nonpecuniary personal benefits: one test for gifts of confidential information and another test for a tipper's intention to benefit a particular recipient. The new test for gifts would apply to anyone, not just close friends or family members, but would require prosecutors to prove the tipper's intent to gift the information. The new test for determining whether a tipper intended to benefit a particular recipient would establish a rebuttable presumption that the tipper disclosed information for a proper purpose. The prosecution could overcome this presumption with evidence of an improper purpose for the disclosure. These two tests would help to implement the goals

* J.D. Candidate, 2020, Fordham University School of Law; B.A., 2013, University of Virginia. I would like to thank Kelly Larkin and my colleagues on the *Fordham Law Review* for helping me discover the legal controversy for the basis of this Note. I would also like to thank my faculty advisor, Caroline Gentile, for guiding my research and helping me learn about the current insider trading regulations and congressional intent behind federal securities laws. I would also like to thank my family for helping me talk through the issues discussed in this Note and for supporting me throughout the process.

of securities regulation to increase the accuracy of prices, protect investors from harm, and maintain fairness and confidence in securities markets.

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INTRODUCTION

In current jurisprudence, criminal violations for insider trading fall under the umbrella of securities fraud and do not constitute distinct crimes. The

Securities Exchange Act of 1934[1] (the "Exchange Act") does not explicitly prohibit insider trading.[2] Since the passage of the Exchange Act, neither Congress nor the Securities and Exchange Commission (SEC) have defined insider trading because both worried that a specific definition would limit the broad and flexible language in section 10(b) of the Exchange Act, which was designed to react to developments in the securities industry.[3] Recognizing this ambiguity, the current SEC Commissioner Robert J. Jackson, Jr. and former United States Attorney for the Southern District of New York Preet Bharara recently formed the Bharara Task Force on Insider Trading ("Bharara Task Force") to consider insider trading reforms.[4] Tipper-tippee liability is one subset of insider trading liability that the Bharara Task Force may seek to reform.

To better discuss the elements of tipper-tippee insider trading liability, this Note will first define certain key terms. A "tipper" is someone who discloses material nonpublic information (MNPI) to another person.[5] A "tippee" is the person who receives the MNPI and trades on that information.[6] "Material" describes any information that a reasonable person would consider important before deciding to trade securities.[7] "Nonpublic" means any information "not widely disseminated or . . . received with the expectation it will remain confidential."[8] For a tippee to be criminally liable for insider trading, a tipper must receive a "personal benefit" from tipping the MNPI.[9]

Part of the ambiguity the Bharara Task Force must resolve stems from the Second Circuit's affirmation of Mathew Martoma's conviction for securities fraud in *United States v. Martoma*[10] (*Martoma I*) and *United States v.*

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1. 15 U.S.C. § 78 (2012).

2. *See* Stephen M. Bainbridge, *An Overview of Insider Trading Law and Policy: An Introduction to the* Research Handbook on Insider Trading, *in* RESEARCH HANDBOOK ON INSIDER TRADING 1, 1–2 (Stephen M. Bainbridge ed., 2013); Jon Eisenberg, *Insider Trading Law After* Salman, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 18, 2017), https://corpgov.law.harvard.edu/2017/01/18/insider-trading-law-after-salman/ [https://perma.cc/6D8D-UZGJ].

3. *See* H.R. REP. NO. 98-355, at 13 (1983), *as reprinted in* 1984 U.S.C.C.A.N. 2274, 2286; H.R. REP. NO. 94-229, at 92 (1975) (Conf. Rep.), *as reprinted in* 1975 U.S.C.C.A.N. 321, 323–24*; Corporate Take-Overs and Insider Trading Scandals in the 1980s*, SEC. & EXCHANGE COMMISSION HIST. SOC'Y, http://www.sechistorical.org/museum/galleries/it/raisingStakes_a.php [https://perma.cc/GR8P-9KN6] (last visited Aug. 22, 2019) [hereinafter *SEC Historical Society 1980s Scandals*].

4. Preet Bharara & Robert J. Jackson Jr., Opinion, *Insider Trading Laws Haven't Kept Up with the Crooks*, N.Y. TIMES (Oct. 9, 2018), https://www.nytimes.com/2018/10/09/opinion/sec-insider trading-united-states.html [https://perma.cc/235X-4T8B].

5. *See* Sara Almousa, Note, *Friends with Benefits?: Clarifying the Role Relationships Play in Satisfying the Personal Benefit Requirement Under Tipper-Tippee Liability*, 23 GEO. MASON L. REV. 1251, 1251 (2016).

6. *See id.*

7. *See* Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988).

8. SHEELAH KOLHATKAR, BLACK EDGE 119 (2017) (quoting a slide presentation of former SEC Chairman Harvey Pitt at SAC Capital).

9. Dirks v. SEC, 463 U.S. 646, 663–64 (1983) (noting that examples of personal benefits include pecuniary gain, reputational benefit, quid pro quo, an intention to benefit a particular recipient, and a gift to a close friend or family member who trades).

10. 869 F.3d 58 (2d Cir. 2017), *amended by* 894 F.3d 64 (2d Cir. 2018).

Martoma[11] (*Martoma II*). Dr. Sidney Gilman tipped confidential drug trial information to Martoma, who traded using the information.[12] Martoma's appeal raised the issue of whether Dr. Gilman personally benefited from tipping the information, which was a necessary element for Martoma's liability.[13] Martoma paid Dr. Gilman $1000 per hour for consulting sessions but did not pay for the sessions in which Dr. Gilman leaked the confidential information.[14]

Initially, a three-judge panel found that the jury instructions regarding the closeness of Dr. Gilman and Martoma's relationship were not erroneous and the evidence sufficiently established that Dr. Gilman personally benefited because sharing the confidential information with Martoma helped develop their friendship.[15] The same three-judge panel later issued an amended opinion and clarified that while the jury instructions were erroneous regarding the necessary closeness of Martoma and Dr. Gilman's relationship, this error did not prejudice Martoma because the evidence implied a quid pro quo between Martoma and Dr. Gilman.[16] In effect, the panel switched theories to understand Dr. Gilman's personal benefit: the first opinion found that developing the friendship provided the benefit and the second opinion found that the benefit arose from the quid pro quo relationship. Congress and the SEC must reform tipper-tippee liability to prevent prosecutors from substituting theories to more easily establish a tipper's personal benefit and to encourage more consistent applications of personal benefit tests.

Officials and scholars still debate how to define the relevant standards and goals for insider trading liability. The debates and uncertainties regarding the purposes of insider trading regulations complicate consistent enforcement attempts. The Exchange Act's goals include ensuring fair and honest pricing mechanisms for securities, fair dealing in securities without advantages for certain investors, economically efficient costs for securities transactions, and open and orderly markets to the extent practical.[17] Some scholars argue that limiting liability for insider trading decreases investor protection and reduces fairness in securities markets.[18] Others argue that permitting more insider trading helps promote efficient capital markets and improves the accuracy of securities prices.[19]

Judges also disagree about how to interpret and apply insider trading regulations and legislative intent. In the 1977 case *Santa Fe Industries, Inc. v. Green*,[20] the U.S Supreme Court stated that the fundamental purpose of

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11. 894 F.3d 64 (2d Cir. 2018).
12. *Id.* at 69.
13. *Id.* at 67; *see Dirks*, 463 U.S. at 663.
14. *Martoma II*, 894 F.3d at 69.
15. *Martoma I*, 869 F.3d at 73.
16. *Martoma II*, 894 F.3d at 68.
17. *See* H.R. REP. NO. 94-229, at 91–92 (1975) (Conf. Rep.), *as reprinted in* 1975 U.S.C.C.A.N. 321, 322–23.
18. *See infra* Part II.B.
19. *See infra* Part II.A.
20. 430 U.S. 462 (1977).

the Exchange Act was to promote full disclosure.[21] Three years later, in *Chiarella v. United States*,[22] the Court backtracked and stated that "neither the Congress nor the [SEC] ever has adopted a parity-of-information rule."[23] The *Chiarella* majority held that section 10(b) of the Exchange Act does not require disclosure for mere possession of MNPI.[24]

The Supreme Court in the 1980s established the foundation for much of the current jurisprudence regarding insider trading.[25] In the 1983 case *Dirks v. SEC*,[26] the Court identified when tippees must abstain from trading after receiving MNPI.[27] The Court found that a tippee only assumes a fiduciary duty to abstain from trading if: (1) the tipper breached a fiduciary duty; (2) the tippee knew or should have known that the tipper breached that duty; and (3) the tipper personally benefitted from disclosing the tip (the "personal benefit" requirement).[28] Because courts often cannot definitively determine the intent of a tipper who shares MNPI, the Supreme Court used the personal benefit requirement to help identify when tippers disclose information for improper purposes.[29]

Courts struggle to consistently apply tests involving nonpecuniary benefits to tippers, such as when the tipper gifts the information to a friend or relative or intends to benefit a particular recipient.[30] Gifting confidential information to a trading friend or relative qualifies as a personal benefit; the Supreme Court analogized this to tippers trading on the information themselves and then gifting the proceeds to the tippee.[31] "Tipping chains" best illustrate the issues for nonpecuniary personal benefits, and chains occur when the tippee who trades on the MNPI is several people removed from the insider who originally disclosed the information.

A hypothetical shows the dilemma juries face when attempting to infer the personal benefit received by a tipper. A hedge fund trader attempts to gather information to make beneficial trades for her hedge fund. The trader makes financial models and interviews professionals but also discovers information about two companies' earnings statements that have not yet been released. The trader uses this information to make profitable trades for her hedge fund. Insiders at each company previously released this earnings information to investor-relations teams, but it is unclear how the information leaked from the investor-relations teams to the trader. The information passed through several people before coming to the trader. The trader previously gave career advice to one of the insiders and went to church with another. Based on these

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21. *Id.* at 477–78.
22. 445 U.S. 222 (1980).
23. *Id.* at 233.
24. *Id.* at 235.
25. *See infra* Parts I.A.3–4. *See generally* Dirks v. SEC, 463 U.S. 646 (1983); *Chiarella*, 445 U.S. 222.
26. 463 U.S. 646 (1983).
27. *Id.* at 654, 659–60.
28. *Id.* at 660–62.
29. *Id.* at 662–63.
30. *See infra* Part I.C.
31. *Dirks*, 463 U.S. at 664.

facts, should the trader face insider trading liability because the insiders gifted the information or intended to benefit the trader?

The above hypothetical represents a similar fact pattern to that found in *United States v. Newman*.[32] In *Newman*, the Second Circuit established a heightened standard to reduce convictions in cases with more remote and tenuous tipper-tippee relationships.[33] Prior to *Newman*, prosecutors won eighty-five consecutive insider trading cases in the Second Circuit between 2009 and 2014 due to less stringent requirements necessary to infer a personal benefit from a gift.[34] The *Newman* standard used a two-element test to determine whether the prosecution successfully proved the personal benefit requirement for a gift. The first element required that the tipper and tippee develop or maintain a "meaningfully close personal relationship."[35] The second element required that the relationship cause an exchange involving a potential pecuniary gain or something similarly valuable in nature.[36]

After *Newman*, scholars began using the term "gift theory" to describe the relevant tipper personal benefit.[37] Gift theory usually describes the personal benefit received when a tipper gifts confidential information to friends or family.[38] Vague language from *Dirks* also allows courts to interpret an intention to benefit a particular recipient as a tipper personal benefit under gift theory.[39] This makes sense because when giving a gift, the giver intends to benefit the recipient, and thus any intentional benefit should also qualify as a gift. However, the distinction becomes murkier when applied. For instance, imagine that a tenant shares MNPI with a doorman. A facial review of the facts may suggest that the tenant gifted the MNPI to the doorman to help the doorman make a profitable trade. But, the tenant may have inadvertently leaked the tip.

Under *Newman*, to determine if a personal benefit exists due to a gift of MNPI, the court must first look at the relationship between the tenant and the doorman. Although the tenant and doorman maintain a relationship, the issue remains whether the relationship is meaningfully close and personal. Additional tests to determine an appropriate closeness of the relationship may draw the court's focus away from the original question of insider trading to whether the tipper shared the MNPI for an improper purpose.

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32. 773 F.3d 438 (2d Cir. 2014) (overturning the convictions of Todd Newman and Anthony Chiasson for securities fraud in the Southern District of New York).

33. *Id.* at 448; *see infra* Part I.C.1.

34. Katherine Drummonds, Note, *Resuscitating* Dirks*: How the* Salman *"Gift Theory" of Tipper-Tippee Personal Benefit Would Improve Insider Trading Law*, 53 AM. CRIM. L. REV. 833, 841–42 (2016).

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

36. *Id.*

37. Gift theory is also sometimes called tipper-tippee liability or tipper liability. *See generally* Drummonds, *supra* note 34.

38. Abigail Bush, Note, *A Friend in Need May Get You in Trouble for Insider Trading Indeed: An Argument for the Meaningfully Close Personal Relationship Definition of Friendship Under the Gift Theory*, 107 GEO. L.J. 1, 2 (2018).

39. *See infra* Part I.C.4.

The Supreme Court, the Second Circuit, and the Ninth Circuit have all heard appeals regarding the application of personal benefit tests since 2014. In *United States v. Salman*,[40] the Ninth Circuit declined to follow *Newman*'s two-element test and instead followed the *Dirks* precedent for personal benefits from gifts of MNPI.[41] The Supreme Court granted certiorari for *Salman* and agreed that *Dirks* resolved the issue easily.[42] The Court also abrogated the second element of *Newman* because its requirement of a pecuniary gain or something similarly valuable lacked consistency with *Dirks*.[43]

After *Salman*, the Second Circuit reexamined the remaining "meaningfully close personal relationship"[44] element of the *Newman* test in *Martoma I*.[45] Initially, a majority of a three-judge panel relied on the Supreme Court's reasoning in *Salman* to abrogate this element of the *Newman* test.[46] Ten months later, the same panel and two-judge majority issued an amended opinion that no longer completely rejected the *Newman* test.[47] The majority found that a jury cannot declare that a trading relative or friend received a personal benefit through a gift without finding "either that tipper and tippee shared a relationship suggesting a quid pro quo or that the tipper gifted confidential information with the intention to benefit the tippee."[48]

Insider trading jurisprudence and scholarship show that courts need reforms to more consistently apply personal benefit tests for nonpecuniary benefits. Prosecutors argue for a broad standard for gifts that applies to everyone, not just to friends or family.[49] The Supreme Court has rejected such a broad standard multiple times[50] and acted only to revert case law back to the *Dirks* precedent.[51] The Second Circuit has changed its gift theory personal benefit test three times since 2014.[52] Investors and securities professionals want a standard that more clearly defines insider trading violations and reduces reliance on circumstantial or subjective evidence showing the closeness of a relationship between tippers and tippees.[53]

The confusion over gift theory has created two questions. First, how should insider trading law define the relationship standards for gifts of MNPI? Second, how should the law distinguish between gifted tips and tips

40. 792 F.3d 1087 (9th Cir. 2015), *aff'd*, 137 S. Ct. 420 (2016).
41. *Id.* at 1092.
42. Salman v. United States, 137 S. Ct. 420, 427 (2016).
43. *Id.* at 428.
44. United States v. Newman 773 F.3d 438, 452 (2d Cir. 2014).
45. *Martoma I*, 869 F.3d 58, 67 (2d Cir. 2017), *amended by* 894 F.3d 64 (2d Cir. 2018).
46. *Id.*
47. *Martoma II*, 894 F.3d 64, 71 (2d Cir. 2018).
48. *Id.* at 68.
49. *See* Salman v. United States, 137 S. Ct. 420, 426 (2016).
50. *See id.* at 426–27; Dirks v. SEC, 463 U.S. 646, 656 (1983); Chiarella v. United States, 445 U.S. 222, 233 (1980).
51. *See Salman*, 137 S. Ct. at 427.
52. *See infra* Part I.C.
53. *See infra* Part I.C.1.

intended to benefit a particular recipient? These questions also include corollary questions of how to draw boundaries for the requisite closeness of relationships for gifts to friends and how to apply liability standards in cases involving remote tippees in tipping chains.

This Note resolves the tension regarding gift theory personal benefit tests. Part I explains the development of insider trading jurisprudence from the 1960s to the *Martoma II* decision in 2018. Part II contrasts theories that argue that insider trading promotes efficient capital markets and more accurately prices securities against theories that argue that regulations promote fairness and protect investors from harm. Part III argues that courts should distinguish personal benefits as gifts from those intended to benefit a particular recipient and suggests the creation of new and distinct personal benefit tests for each of the above categories. The new test for finding a personal benefit to be a gift would require prosecutors to prove the scienter element rather than the close relationship element. The new test for intention to benefit a particular recipient would establish a rebuttable presumption of legitimacy for disclosures.

I. THE DEVELOPMENT OF INSIDER TRADING LAWS

Enforcement and promulgation of federal securities regulations has changed significantly since the passage of the Exchange Act. Part I traces the development of insider trading jurisprudence from the passage of the Exchange Act through the *Martoma II* decision. Part I.A explains how the Supreme Court rejected an equal-access-to-information standard and instead required a breach of fiduciary duty to find nondisclosure fraudulent. The Court also added the personal benefit requirement for cases involving tippers. Part I.B describes how the SEC expanded insider trading liability by promulgating Regulation Fair Disclosure ("Reg FD") and Rule 10b-5-2 and by persuading the Supreme Court to adopt the "misappropriation theory." Part I.C shows how standards for finding that a gift conferred the personal benefit changed after the *Newman*, *Salman*, *Martoma I*, and *Martoma II* decisions. Part I.D discusses two theories about the appropriateness of a closeness requirement for friendships and how to apply tests that accurately determine a relationship's closeness.

A. Competing Theories of Equal Access and Fiduciary Duty

Part I.A details the development of insider trading jurisprudence from the Exchange Act to the *Dirks* decision. Part I.A.1 explains how the Exchange Act and Rule 10b-5 apply to insider trading. Part I.A.2 describes how the Second Circuit sided with the SEC's view that investors should have equal access to MNPI by adopting a broad rule requiring anyone to disclose or abstain from trading when they possess MNPI. Part I.A.3 then explains how the Supreme Court rejected the "equal access" rule and implemented the "fiduciary duty" rule for securities fraud. Finally, Part I.A.4 describes the Supreme Court's addition of the personal benefit requirement as an objective test for determining improper purposes for tips of MNPI.

1. Early Regulations: The Exchange Act and Rule 10b-5

Following the stock market crash in 1929, Congress established federal regulation of securities markets by passing the Securities Act of 1933[54] (the "Securities Act") and the Exchange Act in 1934.[55] The Exchange Act created the SEC and gave it broad power to prevent unscrupulous traders from manipulating the sale of securities on a national security exchange.[56] Section 10(b) of the Exchange Act bans anyone from directly or indirectly using any manipulative or deceptive device to contravene any rules the SEC prescribes to protect investors or the public interest.[57] Nothing in the original text of the Exchange Act specifically mentioned insider trading.[58] Despite this omission, legislative history supported the SEC's decision to use the broad language and delegation of authority in section 10(b) to develop a flexible standard for securities fraud that applies to any developments in the securities industry and to new forms of manipulation or deceit.[59] Using this flexible standard, the SEC originally interpreted section 10(b) to require traders to fully disclose any MNPI in an effort to promote fairness in the securities industry.[60]

The SEC first exercised its rulemaking authority under section 10(b) in 1942 by promulgating Rule 10b-5.[61] Similar to the language in section 10(b), the SEC enacted Rule 10b-5 as a broad rule to protect investors and combat securities fraud.[62] Rule 10b-5 specifically prohibits anyone from using any device or scheme to defraud, make untrue statements or omit statements of material fact, or engage in acts of fraud or deceit regarding the purchase or sale of securities.[63] Despite the general provisions of Rule 10b-5, only eleven people were convicted of insider trading from 1942 to 1984.[64] However, the SEC waited until 1961 to categorize insider trading as a violation of Rule 10b-5, which likely limited the number of criminal convictions for insider trading.[65]

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54. Pub. L. No. 73-22, 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. § 77 (2012)).
55. Pub. L. No. 73-110, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. § 78 (2012)); *see also* Bainbridge, *supra* note 2, at 1.
56. *See* Bainbridge, *supra* note 2*,* at 1–2.
57. 15 U.S.C. § 78j (2012).
58. *See* Bainbridge, *supra* note 2, at 2; Eisenberg, *supra* note 2.
59. *See* H.R. REP. NO. 98-355, at 13 (1983), *as reprinted in* 1984 U.S.C.C.A.N. 2274, 2286.
60. *The Securities Exchange Act of 1934—Principles of Full Disclosure*, SEC. & EXCHANGE COMMISSION HIST. SOC'Y, http://www.sechistorical.org/museum/galleries/it/fullDisclosure_a.php [https:// perma.cc/H866-SRVT] (last visited Aug. 22, 2019).
61. Bainbridge, *supra* note 2, at 2; *see* 17 C.F.R. § 240.10b-5 (2019).
62. *See* Lewis D. Lowenfels, *Codification and Rule 10b-5*, 23 VAND. L. REV. 591, 596 (1970).
63. 17 C.F.R. § 240.10b-5.
64. 134 Cong. Rec. 23,601 (1988) (statement of Rep. Eckart).
65. *See* Bainbridge, *supra* note 2, at 3.

2. *Texas Gulf Sulphur*'s Equal-Access Rule

In the 1968 case *SEC v. Texas Gulf Sulphur Co.*,[66] the Second Circuit adopted a rule from the earlier SEC decision *Cady, Roberts & Co.*[67] and established a broad standard for insider trading liability.[68] Texas Gulf Sulphur (TGS), a drilling company, discovered a mine in early November 1963.[69] TGS verified the drilling find in early April after completing a land acquisition program in the find area.[70] Between November and the middle of April 1964, defendants' ownership of TGS stock and call options increased dramatically and TGS issued stock options to $26 of its officers and employees.[71] TGS's stock price rose from $17 on November 15 to $36 on April 16 (the day the find was announced) and to over $58 on May 15.[72] The SEC filed a complaint against certain TGS officers, directors, and employees and alleged violations of Rule 10b-5 because the defendants either purchased TGS stock or options on the basis of MNPI, shared the MNPI with other traders, or recommended the purchase of TGS stock to other traders.[73] TGS also issued a deceptive press release on April 12.[74]

Hearing two defendants' appeals of their convictions and the SEC's appeals of the other dismissals, the Second Circuit interpreted the purpose of the Exchange Act to be the promotion of fairness in securities transactions and prevention of inequitable and unfair practices.[75] The court adopted the *Cady, Roberts & Co.* rule that anyone in possession of MNPI must disclose the information before trading on it or abstain from trading.[76] The court defined "materiality" as any information that a reasonable person would deem important in deciding a course of action for the transaction in question.[77] The court held that Rule 10b-5 requires that all investors should have equal access to rewards and face identical market risks in securities transactions.[78]

Although the Second Circuit established a broad "disclose or abstain" rule in *Texas Gulf Sulphur*, the Supreme Court in *Santa Fe Industries, Inc. v. Green* clarified that Rule 10b-5 violations still require manipulation or

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66. 401 F.2d 833 (2d Cir. 1968) (en banc).
67. 40 S.E.C. 907 (1961).
68. Donald C. Langevoort, *From* Texas Gulf Sulphur *to* Chiarella*: A Tale of Two Duties*, 71 SMU L. REV. 835, 836 (2018); *see also Cady, Roberts & Co.*, 40 S.E.C. at 911 (finding that the SEC and courts "have consistently held that insiders must disclose material facts which are known to them by virtue of their position but which are not known to persons with whom they deal and which, if known, would affect their investment judgment").
69. *Texas Gulf Sulphur Co.*, 401 F.2d at 843.
70. *Id.* at 843–44.
71. *See id.* at 844.
72. *Id.* at 847.
73. *Id.* at 839–42.
74. *Id.*
75. *Id.* at 848.
76. *Id.*
77. *Id.* at 849.
78. *Id.* at 851–52.

deception.[79] Santa Fe Industries attempted to complete a merger with Kirby Lumber Corp.[80] After Morgan Stanley appraised the Kirby stock at $125 per share, Santa Fe offered Kirby stockholders $150 per share.[81] The Kirby shareholders sued and claimed that the stock was worth $772 per share based on physical assets and that Santa Fe violated Rule 10b-5 with its offer.[82]

In evaluating the claim for fraud under Rule 10b-5, the Court defined manipulation as engaging in practices "that are intended to mislead investors by artificially affecting market activity."[83] The Court held that section 10(b) only regulates conduct involving manipulation or deception, and if neither are present, a claim of fraud or fiduciary breach does not state a cause of action under Rule 10b-5.[84] Because Santa Fe's offer lacked the necessary manipulation or deception, the Court dismissed the alleged Rule 10b-5 violations and remanded for application of state law.[85] Nothing in the Court's opinion, however, addressed the Second Circuit's equal access rule.

3. *Chiarella*'s Fiduciary Duty Rule

In the 1980 case *Chiarella v. United States*, the Supreme Court considered issues of equal access and the necessity of a fiduciary duty to clarify the scope for insider trading liability.[86] The defendant in the case, Vincent Chiarella, worked for a financial printer; his duties included handling announcements of corporate takeover bids.[87] Although clients concealed the names of the takeover companies before sending documents to his employer, Chiarella still "deduce[d] the names of the target companies."[88] Chiarella never publicly disclosed his knowledge; instead, he bought stock in the target companies and sold the stock after the takeover attempts were announced.[89] After an SEC investigation, the Second Circuit upheld Chiarella's conviction for violating section 10(b) and Rule 10b-5.[90] The Second Circuit held that anyone who regularly receives MNPI incurs an affirmative duty to disclose before using the information to trade securities.[91]

The Supreme Court granted certiorari and reversed Chiarella's conviction.[92] In a strategic decision, the Justice Department chose not to present an argument in support of the Second Circuit's holding regarding an affirmative duty to disclose.[93] Instead, the government argued that Chiarella

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79. *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 473 (1977).
80. *Id.* at 465.
81. *Id.* at 466.
82. *Id.* at 467.
83. *Id.* at 476.
84. *Id.* at 473–74.
85. *See id.* at 476–80.
86. *See* Chiarella v. United States, 445 U.S. 222, 231–33 (1980).
87. *Id.* at 224.
88. *Id.*
89. *Id.*
90. *Id.* at 224–25.
91. *Id.* at 231.
92. *Id.* at 225.
93. Langevoort, *supra* note 68, at 846.

misappropriated the information and "deceived the source of the information . . . because misappropriation itself triggers a duty to disclose."[94] Because the government failed to submit the misappropriation argument to the jury during trial, the Supreme Court declined to review the argument on procedural grounds.[95]

In its decision, the Supreme Court focused its discussion on the prerequisite fiduciary duty required to prove fraud through nondisclosure under section 10(b) of the Exchange Act.[96] Although the majority agreed with Justice Harry Blackmun's dissent that section 10(b) acts as a flexible "catchall" provision,[97] they found that fraud must be present to establish a section 10(b) violation.[98] Chiarella did not owe a fiduciary duty to the sellers of the target company because he lacked any prior relationship with that company.[99] Chiarella, therefore, owed no duty to disclose before trading: a necessary element to make his silence fraudulent.[100]

Upon examination of the language and legislative history of section 10(b), the Court found no evidence of congressional intent to create a general duty to forgo any actions based on MNPI.[101] Accordingly, the Court held that mere possession of MNPI does not create a duty to disclose under section 10(b).[102] Because the trial judge only instructed the jury on Chiarella's failure to disclose and not on his duty to anyone other than the selling company, the Court reversed his conviction.[103] The Court also found that "not every instance of financial unfairness constitutes fraudulent activity under § 10(b)."[104] An insider unfairly trading on a corporation's MNPI in violation of a duty owed to that corporation became the basis for the "traditional" or "classical" theory of insider trading liability.[105]

4. *Dirks* Introduces the Personal Benefit Element

In the 1983 case *Dirks v. SEC*, the SEC again attempted to expand the definition of insider trading to encompass situations that leave traders with unequal information, regardless of fiduciary duty.[106] The SEC argued to affirm its censure of the defendant for aiding and abetting insider trading.[107] Raymond Dirks, a broker-dealer, received information from Ronald Secrist

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94. *Id.*
95. *Chiarella*, 445 U.S. at 236–37. The misappropriation argument became the basis for the "misappropriation theory" that the Supreme Court adopted in *United States v. O'Hagan*, 521 U.S. 642, 650 (1997).
96. *See Chiarella*, 445 U.S. at 227–29.
97. *Id.* at 226, 246.
98. *Id.* at 234–35.
99. *Id.* at 232–33.
100. *Id.* at 232.
101. *Id.* at 233.
102. *Id.* at 235.
103. *Id.* at 236–37.
104. *Id.* at 232.
105. *See* United States v. O'Hagan, 521 U.S. 642, 651–52 (1997).
106. *See* Dirks v. SEC, 463 U.S. 646, 657–58 (1983).
107. *Id.* at 650–52.

who alleged that his former employer, Equity Funding of America, was engaging in fraudulent corporate practices.[108] Secrist wanted Dirks to verify and disclose the allegations of fraud.[109] Dirks corroborated the fraud and shared this information with several of his clients, who then sold their holdings of Equity Funding securities.[110] Dirks also urged the *Wall Street Journal* to write a story and hoped that it would expose the fraud allegations.[111] Using what has been criticized as terrible enforcement discretion,[112] the SEC investigated Dirks and censured him for aiding and abetting securities fraud.[113]

The Supreme Court reversed the D.C. Circuit's affirmation of Dirks's censure.[114] To support its censure, the SEC argued that anyone in possession of MNPI has a duty to disclose or abstain from trading on that information because tippees "inherit" the same duty as insiders for trading on MNPI.[115] The Court rejected the SEC's broad view of insider trading liability and duty.[116] The Court reaffirmed the principle from *Chiarella* that a duty to disclose only arises from a relationship between parties and not from a marketplace position that enables the acquisition of MNPI.[117] The Court also reaffirmed that liability for Rule 10b-5 violations derives from unfairly using information intended only for corporate purposes and not for personal benefit.[118] A tippee's duty to disclose or abstain derives from an insider's duty to disclose or abstain.[119]

To help courts identify when a tippee unfairly trades and violates a duty to disclose, the Court added the personal benefit element for tippee insider trading liability as an objective requirement.[120] The Court noted that to preserve a healthy market, the SEC recognizes that securities analysts must "ferret out" nonpublic information to make analytical judgments.[121] Nevertheless, the Court stated that analyst tippees cannot always trade on information received.[122] In its attempt to draw a line between permissible and impermissible trades, the Court focused on whether tippers disclosed the information for an improper purpose.[123] An improper purpose for the disclosure occurs when the tipper exploits the information for personal gain.[124] The Court also provided examples of tipper personal benefits,

108. *Id.* at 648–49.
109. *Id.* at 649.
110. *Id.*
111. *See id.*
112. *See* Eisenberg, *supra* note 2.
113. *Dirks*, 463 U.S. at 650–52.
114. *Id.* at 652.
115. *Id.* at 651, 655–56.
116. *See id.* at 656–57.
117. *Id.* at 657–58.
118. *Id.* at 654.
119. *Id.* at 659.
120. *Id.* at 663.
121. *Id.* at 658–59.
122. *Id.* at 659.
123. *See id.* at 659–62.
124. *Id.* at 659.

including pecuniary gain and reputational benefit.[125] The Court listed certain circumstances that may create the inference of a personal benefit to the insider: a relationship that suggests quid pro quo from the recipient or an intention to benefit a particular recipient.[126] "The elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend."[127]

Applying the personal benefit test to the case, the Supreme Court determined that Secrist disclosed the information to Dirks to expose corporate fraud.[128] The Court found that Secrist "received no monetary or personal benefit for revealing Equity Funding's secrets, nor was their purpose to make a gift of valuable information to Dirks."[129] The Court brushed aside the SEC's fears that defendants could manufacture proper purposes for improper trades because the personal benefit test provides objective criteria to determine the scienter element for securities fraud.[130] Not only did the Supreme Court again reject the SEC's equal access theory, but it also instituted the personal benefit requirement as an additional obstacle for the SEC to secure insider trading convictions.[131]

B. The SEC Wins the Long Game

With its equal access theory now twice rebuffed by the Supreme Court, the SEC lobbied Congress, promulgated three new rules (10b-5-1, 10b-5-2, and Reg FD), and argued Supreme Court cases to expand insider trading liability.[132] In response to public outrage from securities scandals in the 1980s, Congress passed the Insider Trading Sanctions Act[133] (ITSA) in 1984 and the Insider Trading and Securities Fraud Enforcement Act[134] (ITSFEA) in 1988. ITSA allowed treble damages and increased the maximum criminal fine for violations of the Exchange Act to $100,000.[135] ITSFEA established a private cause of action for insider trading victims, created a bounty system

125. *Id.* at 663.
126. *Id.* at 664.
127. *Id.*
128. *Id.* at 667.
129. *Id.*
130. *Id.* at 663.
131. *Id.* at 657–58, 664.
132. *See SEC Historical Society 1980s Scandals*, *supra* note 3; *Power of SEC Resilience:* United States v. O'Hagan, SEC. & EXCHANGE COMMISSION HIST. SOC'Y, http://www.sechistorical.org/museum/galleries/it/resilience_b.php [https://perma.cc/59Q3-XVMQ] (last visited Aug. 22, 2019); *Old Debate and New Rules: SEC Regulation of Insider Trading in the Global Marketplace*, SEC. & EXCHANGE COMMISSION HIST. SOC'Y, http://www.sechistorical.org/museum/galleries/it/regulation_a.php [https://perma.cc/X4UX-6PNS] (last visited Aug. 22, 2019) [hereinafter *SEC Historical Society New Rules*].
133. Pub. L. No. 98-376, 98 Stat. 1264 (1984) (codified at 15 U.S.C. § 78 (2012)).
134. Pub. L. No. 100-704, 102 Stat. 4677 (1988) (codified at 15 U.S.C. § 78 (2012)); *see also Congressional Deference to SEC Enforcement*, SEC. & EXCHANGE COMMISSION HIST. SOC'Y, http://www.sechistorical.org/museum/galleries/it/raisingStakes_b.php [https://perma.cc/39TG-TY58] (last visited Aug. 22, 2019) [hereinafter *SEC Historical Society Congressional Deference*]; *SEC Historical Society 1980s Scandals*, *supra* note 3.
135. *See SEC Historical Society 1980s Scandals*, *supra* note 3.

to reward informants with a percentage recovery of insider trading profits, increased the maximum fine to $1 million, and set the maximum jail term at ten years for insider trading.[136]

Despite these expansions of liability, Congress refused to adopt the "misappropriation theory" that the Justice Department first argued in *Chiarella*.[137] This theory, referenced by the dissent in *Chiarella*, proposes that because misappropriation triggers a duty to disclose, anyone who misappropriates MNPI deceives the source of the information.[138] Instead, Congress largely deferred to the courts to continue developing insider trading law.[139]

Part I.B.1 describes how the Supreme Court adopted the misappropriation theory. Part I.B.2 analyzes how the SEC promulgated Reg FD to limit the practice of selective disclosure. Part I.B.2 also explains how the SEC promulgated Rule 10b-5-2 to define relationships in situations where duties of trust or confidence exist to help guide application of the misappropriation theory.

1. *O'Hagan* Adopts Misappropriation Theory

In the 1997 case *United States v. O'Hagan*,[140] the SEC finally convinced the Supreme Court to adopt the misappropriation theory.[141] The defendant, James O'Hagan, worked as a partner at a law firm.[142] His firm briefly represented Grand Metropolitan PLC in 1988 in a potential tender offer for the Pillsbury Company.[143] O'Hagan did not work on the Pillsbury matter, but he purchased call options and shares of Pillsbury stock beginning in August and September, respectively, before his firm withdrew from representing Grand Metropolitan in September.[144] When Grand Metropolitan announced the tender offer in October, O'Hagan sold his call options and shares and made more than $4.3 million.[145]

A jury convicted O'Hagan of seventeen counts of securities fraud, twenty counts of mail fraud, seventeen counts of fraudulent trading in connection with a tender offer, and three counts of violating federal money laundering

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136. *See SEC Historical Society Congressional Deference*, *supra* note 134.

137. *See* Langevoort, *supra* note 68, at 846; *SEC Historical Society Congressional Deference*, *supra* note 134.

138. *See* Chiarella v. United States, 445 U.S. 222, 240 (1980) (Burger, C.J., dissenting); *infra* Part I.B.1 (discussing the misappropriation theory in more depth). *See generally* Carpenter v. United States, 484 U.S. 19 (1987) (affirming the conviction of a journalist who misappropriated information from his employer, the *Wall Street Journal*).

139. *See* H.R. REP. NO. 98-355, at 14 (1983), *as reprinted in* 1984 U.S.C.C.A.N. 2274, 2287 (stating that misappropriation as a potential fraudulent act should "be left to further judicial development"); 134 Cong. Rec. 23,600 (1988) (statement of Rep. Lent) (stating that ITSFEA makes no change to substantive insider trading law).

140. 521 U.S. 642 (1997).

141. *Id.* at 647.

142. *Id.*

143. *Id.*

144. *Id.*

145. *Id.* at 648.

statutes.[146] In a divided opinion, an Eighth Circuit panel reversed all of O'Hagan's convictions.[147] The Supreme Court reversed the Eighth Circuit's decision.[148]

In reinstating O'Hagan's convictions, the Court distinguished between the classical theory and the misappropriation theory for insider trading liability.[149] Per *Chiarella*, a violation of section 10(b) and Rule 10b-5 occurs under the classical theory "when a corporate insider trades in the securities of his corporation on the basis of [MNPI]."[150] The classical theory applies to anyone who receives confidential information through a positional relationship with a corporation, including temporary fiduciaries such as attorneys.[151] A violation of section 10(b) and Rule 10b-5 occurs under the misappropriation theory when someone "misappropriates confidential information for securities trading purposes, in breach of a fiduciary duty owed to the source of the information."[152] The Court stated that the two theories are complementary because the classical theory protects shareholders from corporate insider abuse and the misappropriation theory protects against abuse from outsiders with access to confidential information—but no fiduciary duty.[153]

The Court found that misappropriation satisfies the deception requirement under section 10(b) because "[a] fiduciary who '[pretends] loyalty to the principal while secretly converting the principal's information for personal gain,' 'dupes' or defrauds the principal."[154] A corporation has the exclusive right to use confidential information and undisclosed misappropriations of this information constitute fraud similar to embezzlement.[155] The Court limited the scope of liability and noted that "full disclosure forecloses liability under the misappropriation theory" because it eliminates deception of the information's source.[156] The Court found that O'Hagan's failure to disclose his trades using the misappropriated information violated section 10(b) and breached his duty to his firm and its client, Grand Metropolitan.[157]

2. Regulations Limit Disclosures and Define Duties of Trust or Confidence

In August 2000, over three years after the *O'Hagan* decision, the SEC promulgated several regulations regarding disclosure, transactions involving

146. *Id.* at 648–49.
147. *Id.* at 649.
148. *Id.*
149. *See id.* at 651–52.
150. *Id.*
151. *Id.*
152. *Id.* at 643.
153. *Id.* at 652–53.
154. *Id.* at 653–54 (citation omitted) (quoting Brief for the United States at 17, United States v. O'Hagan, 521 U.S. 642 (1997) (No. 96-842), 1997 WL 86306, at *17).
155. *Id.* at 654.
156. *Id.* at 655.
157. *Id.* at 660.

MNPI, and the applicability of the misappropriation theory.[158] The SEC promulgated Reg FD to stop the practice of selective disclosure.[159] Selective disclosure occurs when a corporation discloses information to certain traders, often institutional investors, who are likely to transact using that information without disclosing it to the general public.[160] Reg FD requires that whenever issuers or their agents disclose MNPI to certain parties, they must publicly disclose the information simultaneously for intentional disclosures and promptly for unintentional disclosures.[161] Reg FD attempted to strike a balance that minimized informed trading on intentionally disclosed material information without chilling securities analysts' ability to perform information-seeking interviews.[162]

The SEC promulgated Rule 10b5-2 to clarify to whom, and to which duties, the misappropriation theory applies.[163] Paragraph b specifies when "duties of trust or confidence" exist, such as when the recipient of information agrees to keep information confidential, knows or reasonably should know that the disclosing party expects the recipient to maintain confidentiality, or receives the information from a spouse, parent, child, or sibling.[164] Rule 10b5-2(b)(3), which covers information received from a spouse, parent, child, or sibling, includes a presumption for liability unless the receiver did not know or reasonably should not have known that the source expected the information to be kept confidential.[165] Like *Dirks*'s list of personal benefits, this is a nonexhaustive list intended to help courts apply insider trading liability under the misappropriation theory.[166]

C. *New Judicial Developments for Gift Theory*

Part I.C discusses the cases that the Supreme Court, Second Circuit, and Ninth Circuit have heard since 2014 regarding the necessary closeness of a tipper-tippee relationship to find a gift of MNPI to be personal benefit.

1. *Newman* Attempts a Heightened Standard

After the 2008 recession, the SEC increased its focus on prosecuting hedge fund managers and employees.[167] In *United States v. Newman*, the

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158. *See* 17 C.F.R. § 240.10b5-1 (2019) (providing that any person with a direct, indirect, or derivative duty of trust or confidence to an issuer, shareholder, or source of MNPI may not buy or sell securities "on the basis of material nonpublic information" and outlining the affirmative defenses available for eliminating insider trading liability); 17 C.F.R. § 240.10b5-2 (2019); 17 C.F.R. § 243.100 (2019).

159. Merritt B. Fox et al., *Informed Trading and Its Regulation*, 43 J. CORP. L. 817, 893 (2018).

160. *Id.*

161. 17 C.F.R. § 243.100(a)(1)–(2).

162. Fox et al., *supra* note 159, at 893; *see infra* Part II.B.1 (discussing the societal benefits and drawbacks of different types of informed trading).

163. *See* Eisenberg, *supra* note 2; *SEC Historical Society New Rules*, *supra* note 132.

164. 17 C.F.R. § 240.10b5-2(b).

165. *Id.*

166. *See* Bainbridge, *supra* note 2, at 13.

167. *See* Eisenberg, *supra* note 2.

government presented evidence that Todd Newman and Anthony Chiasson employed analysts who directly or indirectly exchanged information about companies' earnings statements after obtaining the information from corporate insiders.[168] Newman and Chiasson then traded on this information and earned $4 million for Newman's managed funds and $68 million for Chiasson's managed funds.[169] Newman and Chiasson were several levels removed from the corporate insider tippers and each argued that the government presented no evidence that any tipper received a personal benefit.[170] The district court rejected the defendants' argument and proposed jury instructions that claimed that the Second Circuit's decision in *SEC v. Obus*[171] did not require explanation of a personal benefit to the tipper as a separate element for insider trading liability.[172]

On appeal, the defendants raised multiple challenges to their convictions, including claims of insufficient evidence and erroneous jury instructions.[173] Clarifying the elements of tippee liability articulated in *Dirks*, the Second Circuit stated that "even in the presence of a tippers' breach, a tippee is liable only if he knows or should have known of the breach."[174] The Second Circuit noted that the government did not identify any prior case where defendants were as remote as Newman and Chiasson and were held criminally liable.[175] While several people in the tipping chains previously knew each other and even exchanged career advice or went to church together, the Second Circuit found that these people were only casual acquaintances and that the circumstantial evidence did not permit the court to infer a personal benefit.[176] Furthermore, the prosecution presented no testimony that Newman and Chiasson knew or consciously avoided knowing that they had traded on information from insiders or that the insiders benefited from the disclosures.[177] When combined with the defendants' evidence showing that they had accurately modeled the earnings statements, the Second Circuit found that the government did not prove beyond a reasonable doubt that the defendants had the intent to commit insider trading.[178]

The Second Circuit worried that if it accepted the government's evidence of a personal benefit, then "practically anything would qualify" as a personal benefit, which would nullify that element for liability.[179] Instead, the Second Circuit attempted to clarify the gift example of a personal benefit from *Dirks*.[180] The court held that a jury cannot infer a personal benefit from a

168. United States v. Newman, 773 F.3d 438, 443 (2d Cir. 2014).
169. *Id.*
170. *Id.* at 443–44.
171. 693 F.3d 276 (2d Cir. 2012).
172. *Newman*, 773 F.3d at 444.
173. *Id.* at 445.
174. *Id.* at 447.
175. *Id.* at 448.
176. *See id.* at 451–53.
177. *Id.* at 453.
178. *Id.* at 455.
179. *Id.* at 452.
180. *See id.*

gift to a trading friend or relative "in the absence of proof of a meaningfully close personal relationship that generates an exchange that . . . represents at least a potential gain of a pecuniary or similarly valuable nature."[181] This two-element test established a heightened requirement for finding a personal benefit from a gift and spawned later appeals in *Salman* and *Martoma II*.[182]

2. *Salman* Restores *Dirks*

In 2016, the Supreme Court in *Salman v. United States*[183] accepted its first insider trading case in almost two decades.[184] Maher Kara worked as an investment banker at Citigroup and his brother, Mounir "Michael" Kara, began trading on information that Maher shared with him.[185] Michael even declined an offer from Maher for cash and preferred instead to receive the lucrative trading information.[186] Michael then shared the tips with his brother-in-law, Bassam Salman.[187] Using another relative who traded on his behalf, Salman made over $1.5 million on trades using Maher's information.[188] During Salman's trial, the evidence at trial showed that Maher and Michael had a close relationship and that Salman knew Maher was supplying the information.[189] The jury convicted Salman on all counts and the Ninth Circuit affirmed the conviction despite Salman's argument that the Ninth Circuit should adopt the heightened *Newman* personal benefit standard.[190]

The Supreme Court granted certiorari to resolve the tension between the Second Circuit and the Ninth Circuit that stemmed from the *Newman* decision.[191] The Supreme Court held that Salman's actions were "in the heartland of *Dirks*'s rule concerning gifts" and adhered to the *Dirks* personal benefit precedent.[192] Because Salman conceded that the original disclosure from Maher to Michael constituted a gift, the Court implied that this made everyone in the tipping chain liable and provided enough evidence to sustain Salman's conviction.[193] The Court also repudiated the second element of the *Newman* test and held that requiring a tipper to receive something pecuniary or similarly valuable in nature was inconsistent with *Dirks*.[194]

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181. *Id.*
182. *See generally* Salman v. United States, 137 S. Ct. 420 (2016); *Martoma II*, 894 F.3d 64 (2d Cir. 2018).
183. 137 S. Ct. 420 (2016).
184. *See* Austin J. Green, Note, *(Beyond) Family Ties: Remote Tippees in a Post-*Salman *Era*, 85 FORDHAM L. REV. 2769, 2771 (2017).
185. *Salman*, 137 S. Ct. at 424.
186. *Id.* at 428.
187. *Id.* at 423–24.
188. *Id.* at 424.
189. *Id.* at 424–25.
190. *Id.* at 425; *see* United States v. Newman, 773 F.3d 438, 452 (2d Cir. 2014).
191. *Salman*, 137 S. Ct. at 425.
192. *Id.* at 429.
193. *Id.*
194. *Id.* at 428.

3. *Martoma I*: Abrogating *Newman* Entirely

After the Supreme Court in *Salman* partially abrogated the *Newman* holding without substantially changing insider trading law, the Second Circuit was given another opportunity to revise its standard for inferring personal benefits from gifts in *Martoma I*.[195] Mathew Martoma managed an investment portfolio focused on pharmaceutical and health-care companies and paid Dr. Sidney Gilman, the chair of a safety committee monitoring the clinical trials of a new drug, approximately $1000 per hour for approximately forty-three consulting sessions.[196] Martoma made trades in advance of the announcement of the results of the trials that resulted in gains of approximately $80 million and averted losses of over $194 million.[197] The jury convicted Martoma of two counts of securities fraud;[198] he appealed, claiming insufficient evidence and inadequate jury instructions under the *Newman* standard.[199]

A three-judge panel heard Martoma's appeal and issued a majority opinion affirming his convictions in August 2017.[200] The majority rejected Martoma's claim that there was insufficient evidence of Dr. Gilman's pecuniary gain even though Dr. Gilman did not charge Martoma for the two sessions in which Dr. Gilman released the study data.[201] The court determined that the ongoing quid pro quo theory—that "Dr. Gilman regularly disclosed confidential information in exchange for fees"—could lead a rational trier of fact to find proof of all insider trading liability elements "under a pecuniary *quid pro quo* theory."[202]

The majority relied on the Supreme Court's reasoning in *Salman* to reject Martoma's inadequate jury instructions claim and abrogate *Newman*'s first element that required a "meaningfully close personal relationship."[203] The majority argued that *Dirks* never limited personal benefits to gifts from "meaningfully close" friends and family members.[204] The majority held that *Salman* allowed an inference of a personal benefit from a gift whenever an insider discloses information with the expectation that the tippee will trade using the information.[205] The majority found that the new rule would not apply to all disclosures, such as inadvertent or whistleblowing disclosures, and did not eliminate the personal benefit rule.[206] The majority concluded

195. *Martoma I*, 869 F.3d 58, 61 (2d Cir. 2017), *amended by* 894 F.3d 64 (2d Cir. 2018); *see also* Peter J. Henning, *Making Up Insider Trading Law as You Go*, 56 WASH. U. J.L. & POL'Y 101, 119 (2018).
196. *Martoma I*, 869 F.3d at 61.
197. *Id.* at 62.
198. *Id.* at 61.
199. *Id.* at 64.
200. *Id.* at 61.
201. *Id.* at 67.
202. *Id.*
203. *Id.*
204. *Id.* at 68.
205. *Id.* at 69–70.
206. *Id.* at 71.

that "the district court's instruction on gifts with the goal of developing friendships . . . did not constitute 'obvious' error."[207] Even if the instruction created an obvious error, the court held that the evidence of Dr. Gilman's financial benefit from his relationship with Martoma did not impair Martoma's substantial rights.[208]

In her dissent, Judge Rosemary S. Pooler contended that the jury instructions were erroneous and that *Newman* could be abrogated without an en banc hearing.[209] Judge Pooler claimed that the majority's holding exceeded the "friends and family" limitation on finding a personal benefit from a gift—established by *Dirks*—and instead applied gift theory to any person.[210] The dissent also argued that "[w]hat counts as a 'gift' is vague and subjective,"[211] and that the majority provided no further guidance on the matter.[212] Judge Pooler argued that the lack of guidance for juries to find that a disclosure is a gift forces juries to make arbitrary and subjective decisions.[213] This undermines the objective intent element of the personal benefit requirement.[214] The dissent worried that the new rule would allow the government to rely exclusively on circumstantial evidence rather than objective facts in insider trading prosecutions.[215] The dissent held that if construed broadly, "the term 'gift' could cover nearly any disclosure, and thus eliminate the personal benefit rule entirely."[216] Because the dissent argued that the first element of the *Newman* test still applied, it concluded that the jury instructions were plainly erroneous and not harmless.[217]

4. *Martoma II*: *Newman* Lives

Ten months after the initial opinion, the three-judge panel issued an amended opinion and agreed that the jury instructions were inconsistent with *Newman* but for different reasons than Mathew Martoma proposed.[218] The majority no longer rejected the "meaningfully close personal relationship" element from *Newman*.[219] Instead, the majority found that the jury instructions were erroneous because they allowed the jury to find a personal benefit from a gift without finding "either that tipper and tippee shared a relationship suggesting *quid pro quo* or that the tipper gifted confidential information with the intention to benefit the tippee."[220] The majority nevertheless upheld Martoma's conviction because the government

207. *Id.* at 73 (quoting United States v. Marcus, 560 U.S. 258, 262 (2010)).
208. *Id.*
209. *Id.* at 74 (Pooler, J., dissenting).
210. *Id.* at 75.
211. *Id.*
212. *Id.* at 82.
213. *Id.*
214. *Id.*
215. *Id.*
216. *Id.* at 86.
217. *See id.* at 87–91.
218. *Martoma II*, 894 F.3d 64, 68 (2d Cir. 2018).
219. *See id.*
220. *Id.*

presented sufficient evidence that Dr. Gilman benefited through his quid pro quo relationship with Martoma and through his intention to benefit Martoma with the disclosure.[221]

The majority's amended decision resulted primarily from a new interpretation of the language in *Dirks* describing personal benefits. The majority argued that the comma separating the "intention to benefit a particular recipient" phrase from the "relationship suggesting quid pro quo" phrase in *Dirks* severs any connection between them.[222] Therefore, the court held that the language regarding an intention to benefit should be read independently from the language regarding relationships.[223] The majority's holding allows proof of "a personal benefit with objective evidence of the tipper's intent, without requiring in every case some additional evidence of the tipper-tippee relationship."[224]

The *Martoma II* majority argued that *Newman* provided substantial guidance for defining a "meaningfully close personal relationship" as requiring that an insider intend to benefit the tippee or have a relationship that suggests a quid pro quo.[225] The majority interpreted *Newman* as limiting the application of gift theory to only situations where one of the freestanding personal benefits described above also applied.[226] Using the above interpretation, the majority agreed that Martoma received erroneous jury instructions regarding the application of the personal benefit test; however, the error did not impact Martoma's substantial rights.[227] The majority argued that the district court properly instructed the jury on both of the freestanding personal benefits necessary to satisfy the new personal benefit test.[228] The Second Circuit majority found that a rational trier of fact would have found either the quid pro quo relationship or Dr. Gilman's intent to benefit Martoma sufficient.[229]

Judge Pooler again dissented, arguing that the majority redefined *Newman* in subjective terms in derogation of circuit precedent.[230] Judge Pooler interpreted the personal benefit language from *Dirks* differently than the majority and claimed that an intention to benefit a particular recipient also requires evidence suggesting a quid pro quo relationship.[231] In contrast, gifts of MNPI operate as a distinct type of personal benefit because evidence that suggests a quid pro quo relationship is not necessary for certain friendships

221. *Id.* at 71.
222. *Id.* at 74 ("The sentence, so understood, effectively reads, 'there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or there may be an intention to benefit the particular recipient.'").
223. *Id.*
224. *Id.* at 75.
225. *Id.* at 77.
226. *Id.*
227. *Id.* at 78.
228. *Id.* at 79–80.
229. *Id.*
230. *Id.* at 80 (Pooler, J., dissenting).
231. *See id.* at 82–83.

and familial relationships.[232] According to Judge Pooler, the majority's interpretation of *Dirks* limits proof of necessary objective facts to the disclosure of MNPI but not to facts indicating that the tipper benefitted from the relationship with the tippee.[233]

The dissent also argued that the majority's interpretation conflicted with a reading of *Dirks* as a whole and that a tipper's intention to benefit a tippee does not qualify as a personal benefit for the tipper.[234] As in her dissent in *Martoma I*, Judge Pooler believed that the majority's amended opinion replaced an objective test with a test that requires a subjective determination of an intention to benefit.[235] The personal benefit test purports to determine the tipper's purpose for the tip; however, the prosecution must only prove the personal benefit, not the purpose.[236] Focusing on the closeness of the relationship between tipper and tippee provides better objective evidence that disclosures to friends and relatives are gifts than attempting to determine the tipper's intentions.[237] Because the instructions did not ask the jury whether Dr. Gilman and Martoma shared a likely quid pro quo relationship or were close enough friends that the information could be a gift, the dissent found that the instructions were erroneous and not harmless.[238]

*D. Post-*Newman *Relationship Personal Benefit Theories*

Legal scholars continue to debate how courts should interpret the closeness of the relationship between tipper and tippee in the personal benefit analysis. Abigail Bush argues in favor of keeping the "meaningfully close personal relationship" element from *Newman* as the correct definition of friendship for personal benefits derived from gifts.[239] Bush argues that a close relationship provides indirect benefits to the tipper because it creates a reasonable assumption that the tippee will share prosperity with the tipper and because the relationship creates a feeling of obligation for the tipper to provide for the tippee's security and stability.[240] Without such a relationship, no reason exists to assume that either of the above benefits exist.[241] Forcing juries to determine if tippers reasonably expect tippees to trade on information establishes a subjective, rather than objective, standard.[242]

Bush claims that personal benefits derived from gifts represent "the minimum benefit that a tipper must gain to even be considered to have personally benefitted from his disclosure of inside information."[243] Because

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232. *Id.* at 83.
233. *See id.* at 84.
234. *Id.* at 84–85.
235. *Id.* at 85.
236. *Id.* at 86.
237. *Id.*
238. *Id.* at 87.
239. Bush, *supra* note 38, at 3.
240. *Id.* at 6.
241. *Id.*
242. *Id.* at 7.
243. *Id.* at 15.

gift theory under *Dirks* represents the floor for personal benefits, Bush argues for interpreting the friendship requirement to confine liability to a narrower set of relationships.[244] Bush identifies factors which help determine whether an appropriately close friendship exists: a history of engaging in social activities directly together, a history of assisting one another with personal issues, and the length of the relationship and frequency of interactions.[245] Bush believes that courts can use prior case law to determine the sufficiency of friendship through specific social activities as well as actions that show a history of support.[246] Prior cases also indicate that a higher frequency of interactions over a longer period of time will support a finding of friendship.[247] These factors limit inferences for gift theory application and help prevent the eradication of boundaries for disclosures established by *Dirks*.[248]

Similar to Bush, Sara Almousa believes that courts must clarify the relationships in which liability should attach for a personal benefit.[249] Almousa identifies two ways to determine appropriately close relationships that satisfy the personal benefit requirement: either the tipper must receive an objective gain from disclosing the tip or the information must strengthen the tipper's relationship with any tippee who gains from using the information.[250] Almousa claims that her proposed standard shifts the focus away from a relationship benefit between the original tipper and tippee and instead focuses on whether any tippee in the chain benefitted.[251] Almousa concedes that her new standard would not resolve the *Newman* issue of remoteness from the original tipper and may even make convicting remote tippees more difficult.[252] Nevertheless, Almousa argues that her standard satisfies the objective purpose for the personal benefit requirement and "potentially eliminates the need for prosecutors to prove that tippees knew the information came from corporate insiders."[253]

II. APPLYING INSIDER TRADING LAW AND PERSONAL BENEFIT TESTS

As the cases and theories discussed in Parts I.C and I.D demonstrate, courts struggle to consistently define and apply tests for nonpecuniary personal benefits. This struggle stems at least in part from attempts to create objective criteria for liability standards and limit what juries may infer from circumstantial evidence.[254] Additionally, courts must attempt to balance the

244. *Id.*
245. *Id.* at 10–13.
246. *Id.* at 11.
247. *Id.* at 13.
248. *See id.* at 15–16.
249. Almousa, *supra* note 5, at 1274.
250. *Id.* at 1274–75.
251. *Id.* at 1275.
252. *Id.* at 1276.
253. *Id.* at 1277.
254. *See* Dirks v. SEC, 463 U.S. 646, 663 (1983); United States v. Newman, 773 F.3d 438, 451–52 (2d Cir. 2014).

potentially conflicting goals of the Exchange Act.[255] Scholars on one side argue that insider trading regulations that promote efficiency in capital markets and allow more forms of informed trading best accomplish the goals of the Exchange Act.[256] Those on the other side argue that regulations that protect investors from harm and promote fair and beneficial securities activities best accomplish the Exchange Act's goals.[257]

To determine how to establish the best insider trading liability standards, this Note reviews rationales and theories regarding economic efficiency, accurate pricing, market fairness, and investor harm. Part II.A focuses on theories arguing that insider trading prohibitions regulate securities transactions inefficiently. Part II.B reviews theories that identify the harm from insider trading and distinguish fair and beneficial securities activities from harmful uses of MNPI.

A. "Efficient Capital Markets" Theories

Even prior to the Second Circuit's decision in *Texas Gulf Sulphur*, Henry Manne, a legal and economic scholar, suggested that prohibitions on insider trading restrict the development of efficient capital markets.[258] Specifically, Manne makes two economic arguments against enforcement of insider trading laws.[259] First, insider trading helps price securities more efficiently so markets reflect the true value of the securities more accurately.[260] Second, insider trading does not significantly harm long-term securities investors.[261] Manne's two arguments combine to suggest that permitting more insider trading benefits long-term investors because investors receive more accurate prices, which reduces market unfairness for securities transactions. Part II.A.1 reviews claims that insider trading helps to more accurately price securities. Part II.A.2 presents arguments that insider trading does not harm long-term investors.

1. Accurate Pricing

Manne's first argument that insider trading helps to more accurately price securities finds widespread support; Manne himself claims that almost nobody disagrees "that insider trading does always push the price of a stock

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255. *See* H.R. REP. NO. 94-229, at 91–92 (1975) (Conf. Rep.), *as reprinted in* 1975 U.S.C.C.A.N. 321, 323–24.

256. *See infra* Part II.A.

257. *See infra* Part II.B.

258. *See generally* HENRY MANNE, INSIDER TRADING AND THE STOCK MARKET (1966).

259. *See* Henry G. Manne, *Insider Trading: Hayek, Virtual Markets, and the Dog That Did Not Bark*, 31 J. CORP. L. 167, 168 (2005). Manne also argues that insider trading better compensates innovative employees; however, this Note does not review that argument. For a counterargument to Manne's compensation claim, see Stephen M. Bainbridge, *Regulating Insider Trading in the Post-Fiduciary Duty Era: Equal Access or Property Rights?*, *in* RESEARCH HANDBOOK ON INSIDER TRADING, *supra* note 2, at 80, 95–96.

260. Manne, *supra* note 259, at 168.

261. *Id.*

in the correct direction."[262] Matt Levine, a columnist for Bloomberg, agrees that insider trading helps markets function more efficiently and better informs prices.[263] Stephen Bainbridge believes that when a corporation withholds material information, "the market can no longer accurately price its securities."[264] Merritt Fox, Lawrence Glosten, and Gabriel Rauterberg agree that "informed trading leads to more accurate share prices," which increases efficient economic allocation of resources.[265] However, these experts also argue that informed trading reduces market liquidity, which creates inefficiencies and increases costs for securities transactions.[266]

In accord with views of the scholars above, the Supreme Court in *Basic Inc. v. Levinson*[267] adopted the "fraud-on-the-market" theory, which believes that securities markets should accurately reflect all material public information in the price of the security.[268] Any material misstatement that creates investor reliance and inaccurately affects the price of a security allows a cause of action under Rule 10b-5.[269] The fraud-on-the-market theory allows investors to rely on the accuracy of stock prices, which corresponds with the goals of the Exchange Act to ensure fair pricing mechanisms for securities, fair dealing among all investors, and open and orderly securities markets.[270]

In *Basic*, Combustion Engineering, Inc. discussed a possible merger with Basic Inc.[271] Between 1977 and 1978, Basic made three separate public statements denying any merger negotiations.[272] Basic finally suspended trading on its stock and announced the merger and price in December 1978.[273] Basic shareholders who sold their shares after the first denial but before the merger announcement filed a class-action suit and claimed the misstatements violated section 10(b) and Rule 10b-5.[274]

The Supreme Court granted certiorari to resolve circuit splits regarding the standard of materiality and the presumption of reliance for the shareholder class.[275] The Court found that requiring shareholder plaintiffs to prove a change of action due to the material misstatements "would place an unnecessarily unrealistic evidentiary burden on the Rule 10b–5 plaintiff who

262. *Id.* at 169.
263. Matt Levine, *Insider Trading Isn't So Simple*, BLOOMBERG OPINION (Oct. 15, 2018, 11:37 AM), https://www.bloomberg.com/opinion/articles/2018-10-15/insider trading-isn-t-so-simple [https://perma.cc/FN9F-THMY].
264. Bainbridge, *supra* note 2, at 20.
265. Fox et al., *supra* note 159, at 822.
266. *Id.*
267. 485 U.S. 224 (1988).
268. *Id.* at 244–47.
269. *Id.* at 247.
270. *See* H.R. REP. NO. 94-229, at 91–92 (1975) (Conf. Rep.), *as reprinted in* 1975 U.S.C.C.A.N. 321, 323–24.
271. *Basic*, 485 U.S. at 227.
272. *Id.*
273. *Id.* at 227–28.
274. *Id.* at 228.
275. *Id.* at 230.

has traded on an impersonal market."[276] The Court noted that market professionals usually consider most material public information—and this affects stock prices.[277] The Court further believed that all investors rely on market integrity because an opposite presumption would lead to no public investments in the stock market due to fears of rigged stock prices.[278] Because announcements of material public information often affect stock prices, the fraud-on-the-market theory presumes reliance on the misstatements and posits that market prices should reflect the integrity and accuracy of a security's value.[279]

In *Halliburton Co. v. Erica P. John Fund, Inc.*,[280] the Supreme Court denied another challenge to investor reliance on stock price accuracy and reaffirmed the fraud-on-the-market theory.[281] Erica P. John Fund shareholders filed a class action suit alleging that Halliburton misrepresented its potential liability in asbestos litigation.[282] Halliburton pushed to overturn *Basic*'s presumption of reliance, but the Supreme Court rejected this argument and found that Halliburton relied on the economic arguments rejected in *Basic*.[283] The Court also found that *Basic* did not presume complete efficiency in capital markets and the rebuttable presumption of reliance accounted for the degree of market efficiency.[284]

Halliburton argued that value investors, who attempt to purchase undervalued stocks or sell overvalued stocks, provide a counterexample to the fraud-on-the-market theory and rebut the presumption that investors rely on stock prices that accurately reflect the value of securities.[285] While the Court acknowledged that value investors exist, most uninformed investors still rely on the presumption that the stock price of a security will reflect all material public information.[286]

By preserving the fraud-on-the-market theory in the above cases, the Supreme Court emphasized the importance of stock price accuracy for uninformed investors. As noted above, a regulatory system that encourages the most accurate pricing of securities corresponds with the goals of the Exchange Act.[287] Fraud-on-the-market depends on material public announcements before the stock price adjusts and current jurisprudence does not require companies to disclose all material information.[288]

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276. *Id.* at 245.
277. *Id.* at 246–47 n.24.
278. *Id.* at 246–47.
279. *Id.*
280. 134 S. Ct. 2398 (2014).
281. *Id.* at 2414.
282. *Id.* at 2405–06.
283. *Id.* at 2406–07, 2409–10, 2413.
284. *Id.* at 2409–10.
285. *Id.* at 2410–11.
286. *Id.*
287. *See* H.R. REP. NO. 94-229, at 91–92 (1975) (Conf. Rep.), *as reprinted in* 1975 U.S.C.C.A.N. 321, 323–24.
288. *See* Bainbridge, *supra* note 2, at 20.

Allowing more insider trading would accelerate the accurate reporting of securities prices. In contrast with rapid price changes following public announcements of material information, allowing insider trading requires no public announcement, and each trade gradually moves the price closer to the correct value of the security.[289] Insider trading may also reduce agency costs by giving more market information to investors faster than regulated disclosures.[290] A return to the *Texas Gulf Sulphur* equal access rule for MNPI may not increase disclosure because insiders can still refrain from trading to avoid making negative disclosures.[291] Investors prefer to obtain as much accurate information as soon as possible because more information can help investors make better trades.[292] Allowing more insider trading by creating heightened tests for finding a tipper personal benefit could increase perceptions of rigged stock markets, but the information and accurate pricing benefits may outweigh these investor fears.

2. Investor Harm

Manne's second argument relies on a belief that a long-term investor suffers no immediate damage when trading anonymously with an insider who has MNPI.[293] Bainbridge supports this argument because in an impersonal market, the investor makes an independent decision to buy or sell the security regardless of the fact that an insider acts on the other side of the transaction.[294] Bainbridge concedes that the investor may not transact if given access to the same information that the insider possesses, but securities lawmakers have been unwilling to require immediate disclosure of material information in all circumstances.[295] In Stuart Green and Matthew Kugler's study of the general public,[296] the authors found that the subjects "were unable to isolate the victim in one case from the victim in another."[297] The authors concluded that rationales for banning insider trading cause confusion for both lay people and legal professionals.[298] If damage from insider trading cannot be consistently identified, then this could cause issues for consistently applying insider trading standards. Manne believes that harm from insider trading occurs more frequently in theoretical literature than in the actual market and this renders investor-protection benefits irrelevant for insider trading regulations.[299] Furthermore, diversified portfolios reduce risks to

289. *Id.*
290. Manne, *supra* note 259, at 180–81.
291. Kenneth E. Scott, *Insider Trading: Rule 10b-5, Disclosure and Corporate Privacy*, 9 J. LEGAL STUD. 801, 811 (1980).
292. Manne, *supra* note 259, at 181.
293. *Id.* at 168.
294. *See* Bainbridge, *supra* note 2, at 23–24.
295. *Id.* at 24.
296. Stuart P. Green & Matthew B. Kugler, *When Is It Wrong to Trade Stocks on the Basis of Non-Public Information?: Public Views of the Morality of Insider Trading*, 39 FORDHAM URB. L.J. 445, 446 (2011).
297. *Id.* at 484.
298. *Id.*
299. Manne, *supra* note 259, at 169.

individual investors and efficient capital markets establish rates of return that reflect risk of investment.[300]

Even if insider trading harms individual investors, the current insider trading jurisprudence still leaves gaps that do not benefit or protect investors.[301] Donald Langevoort believes that insider trading "is not deceptive in the way we today insist on for 10b-5 liability."[302] He notes that *Chiarella* overrules *Texas Gulf Sulphur*'s equal access principle but still ignores the deception requirement problem for Rule 10b-5 liability.[303] Donna Nagy claims that the personal benefit element does not include or define many deceptive breaches of the duty of loyalty as illegal forms of tipping.[304] One wrongful type of permissible trade occurs when a fiduciary discloses his intention to trade on the MNPI to the source.[305] Similar to Nagy, Matthew Guttentag argues that a personal benefit test is underinclusive because situations may arise where deceptive conduct occurs but no personal benefit or breach of fiduciary duty exists.[306] Current insider trading jurisprudence represents a complex patchwork approach that does not cover all types of insider trading or MNPI tipping.[307] Attempts to establish a system that prevents all types of improper trades or requires blanket disclosures would cause huge issues for the administration and enforcement of regulations.[308] Investors may face more harm from increased tax expenditures for broader enforcement of regulations than from damages due to insider trading.

If investors perceive harm from insider trading while conducting securities transactions, members of the general public may lose confidence in securities markets and withdraw participation altogether.[309] John P. Anderson argues against claims that a loss of confidence in securities markets produces a chilling effect on investors' willingness to participate because these claims must be proven rather than assumed.[310] Anderson cites a poll conducted in 1986 after an insider trading scandal; the poll's responses showed that although 67 percent of respondents believed that Wall Street commonly engaged in insider trading, 55 percent stated that they would trade on an inside tip.[311] This suggests that while a majority of the general public

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300. Scott, *supra* note 291, at 809.

301. *See generally* Michael D. Guttentag, *Selective Disclosure and Insider Trading*, 69 FLA. L. REV. 519 (2017); Langevoort, *supra* note 68; Donna M. Nagy, *Beyond* Dirks*: Gratuitous Tipping and Insider Trading*, 42 J. CORP. L. 1 (2016).

302. Langevoort, *supra* note 68, at 840.

303. *Id.* at 848.

304. Nagy, *supra* note 301, at 48.

305. *Id.* at 52.

306. Guttentag, *supra* note 301, at 565.

307. William K. S. Wang, *Stock Market Insider Trading: Victims, Violators and Remedies—Including an Analogy to Fraud in the Sale of a Used Car with a Generic Defect*, 45 VILL. L. REV. 27, 66 (2000).

308. Scott, *supra* note 291, at 812.

309. John P. Anderson, *Insider Trading and the Myth of Market Confidence*, 56 WASH. U. J.L. & POL'Y 1, 1 (2018).

310. *Id.* at 2.

311. *Id.* at 5–6.

believes insider trading occurs frequently, this will not stop most people from participating in securities markets.

Bainbridge argues that without proof of investor injury, insider trading should not undermine investor confidence in securities markets.[312] Anderson claims that empirical data does not support market confidence rationales for insider trading bans.[313] Anderson also anecdotally refers to Japan, which enacted insider trading regulations in the 1980s and subsequently suffered a market collapse and decrease in market liquidity.[314] Anderson acknowledges that a myriad of causes led to the collapse but uses this as a counterexample to the suggestion that insider trading regulations inspire market confidence and encourage individual investment.[315]

Instead of protecting investors, establishing fair markets, and encouraging public participation in securities transactions, insider trading regulations may have the opposite effect. Regulations that ban insider trading may reduce the amount of accurate information available for investors, thereby reducing investors' desire to invest and, in turn, reducing available capital for efficient market allocation.[316] Although allowing insider trading may unfairly benefit traders using MNPI to transact with uninformed investors, all investors would still receive more information sooner and would trade using more accurate pricing. Further, allowing insider trading might not change investors' perceptions of market unfairness. As a result, insider trading regulations with tests that more easily find a personal benefit for a tipper may negatively impact the development of open and efficient capital markets.

B. Beneficial Regulation and Protection Theories

Contrary to the potential benefits identified above of permitting insider trading, insider trading can potentially harm individual investors and negatively impact securities markets by increasing price spreads and reducing liquidity. Part II.B.1 describes socially desirable and undesirable forms of informed trading, the economic impact of desirable and undesirable trading, and how current regulations work to prohibit undesirable or permit desirable types of trading. Part II.B.1 also analyzes a proposal to reverse the evidentiary burden, which requires the defendant to prove that no personal benefit came from disclosure in order to prohibit more undesirable trades. Part II.B.2 reviews William Wang's analogy that compares insider trading to a generic car defect for one make and model and argues that insider trading causes harm to specific but anonymous individuals.

312. *See* Bainbridge, *supra* note 2, at 24.
313. Anderson, *supra* note 309, at 2.
314. *Id.* at 10.
315. *Id.*
316. *See supra* Part II.A.1.

1. Market Fairness and Desirable Informed Trading

While ITSA was under consideration in Congress in 1983, the House Committee on Energy and Commerce submitted a report that stated that unlawful use of MNPI is distinguishable from legitimate and beneficial actions of securities professionals.[317] New regulations should not inhibit any legitimate analytical activities.[318] Modeling earnings, ferreting out information, and interviewing corporate officers and insiders represent legitimate analytical activities conducted by securities professionals, and the SEC agrees that these types of analyses help preserve a healthy market.[319] Courts, the SEC, and Congress face a continuing challenge to create a regulatory and enforcement system that prevents unlawful uses of MNPI for securities transactions while still preserving analysts' ability to conduct legitimate and beneficial activities.

Fox, Glosten, and Rauterberg suggest that the real injury from insider trading occurs from reduced liquidity, and such injury occurs regardless of whether a tipper receives a personal benefit.[320] Fox and his coauthors support "fundamental value trading" as socially desirable, and they define fundamental value trading as gathering and analyzing pieces of public information to make a superior pricing assessment, which increases economic efficiency.[321] Fundamental value trading helps incentivize new information through stock profits and improves stock price accuracy over time.[322] However, the authors conclude that other forms of informed trading, such as announcement trading and insider trading, are socially undesirable because they reduce liquidity, reduce fundamental value trading, allocate resources inefficiently, and misallocate risks.[323] The authors distinguish undesirable trades based on issuer-generated material information from socially desirable trades based on information from non-issuers.[324]

Based on these desirable goals, Fox, Glosten, and Rauterberg analyzed current insider trading regulations and determined that Rule 10b-5 does not prohibit fundamental value trading.[325] For insider trading, the authors agree that a personal benefit test combined with Reg FD operates as the best way to convert "an anti-fraud rule into a policy-based regulation of informed trading capable of protecting analyst interviews."[326] However, the authors also believe that this test too often protects indirect tippees who execute undesirable trades.[327] To resolve this problem, the authors propose that

317. H.R. REP. NO. 98-355, at 5 (1983), *as reprinted in* 1984 U.S.C.C.A.N. 2274, 2278.
318. *Id.*
319. Dirks v. SEC, 463 U.S. 646, 658–59 (1983).
320. Fox et al., *supra* note 159, at 824.
321. *Id.* at 836.
322. *See id.* at 842–43.
323. *See id.* at 847–56.
324. *Id.* at 859.
325. *See id.* at 861, 869.
326. *See id.* at 871.
327. *Id.*

tippers and tippees must provide persuasive evidence that the disclosure was not for a *Dirks*-style personal benefit.[328]

The purpose for reversing the evidentiary burden onto the defendants stems from obstacles in proving a personal benefit through a quid pro quo relationship.[329] Fox and his coauthors argue that evidence establishing a quid pro quo benefit is hard to obtain.[330] Tipping chains complicate the issue because the government must then prove the indirect tippee knew of the quid pro quo relationship.[331] By contrast, proving a personal benefit through a gift does not present a significant obstacle.[332] For most gift cases, the prosecution usually must only prove that a relationship exists in order to show a personal benefit and, as in *Salman*, indirect tippees will be liable if they knew of the relationship.[333] The authors' proposed burden reversal would aid prosecutions for insider trading and deter more undesirable trades from occurring while still protecting analysts' ability to conduct interviews for fundamental value trading.[334] However, others argue against easing liability requirements and protest that the elements of insider trading liability should not cater to prosecutorial goals.[335]

2. Investor Protection

Although Manne and other scholars believe that individual investors suffer no harm from insider trading,[336] William Wang argues that a general harm exists.[337] Each act of insider trading causes harm to at least one individual trader, but the victims are anonymous and cannot be identified.[338]

Wang analogizes the injury from insider trading to a generic car defect for all cars of a certain model, like a 2019 Sedan sold by the Car Company.[339] In such a scenario, an insider at the Car Company knows about the generic defect (thus possessing MNPI) and sells her 2019 Sedan to a car dealer at the existing market rate before the generic defect becomes publicly known and causes the price for the 2019 Sedan to drop.[340] The dealer may also sell a 2019 Sedan to another buyer before the defect becomes known.[341] After the announcement of the defect, the market price for all 2019 Sedans drops and

328. *Id.* at 876.
329. *Id.* at 875–76.
330. *See id.* at 876.
331. *Id.*
332. *Id.* at 875.
333. *Id*.
334. *Id*. at 876.
335. Almousa, *supra* note 5, at 1276.
336. *See supra* Part II.A.2.
337. *See* Wang, *supra* note 307, at 48–49 (arguing that the Supreme Court can claim that victims of insider trading are harmed by the nondisclosure of MNPI under the classical theory of insider trading).
338. *Id.* at 31.
339. *Id.*
340. *Id.* at 32.
341. *Id.*

the buyer now possesses less valuable property.[342] The buyer appears to be the victim as the transaction harms the buyer because the purchase price did not reflect the value of the car, but the buyer is not definitively the victim.[343] The buyer might have purchased a 2019 Sedan even if the Car Company insider never sold her 2019 Sedan upon learning the MNPI about the defect.[344] As a result, the buyer may have been stuck with a less valuable car regardless of the insider's nondisclosure and insider trading violation.[345]

Alternatively, assume that the dealer buys the car from the insider before the defect becomes known.[346] The dealer chooses to lower the price on all 2019 Sedans to increase sales and decrease inventory.[347] Although a buyer of a 2019 Sedan may not purchase the insider's car, the dealer's decreased prices to reduce inventory may have incentivized the buyer to purchase a 2019 Sedan.[348] Because all 2019 Sedans have the same defect, the induced buyer becomes the victim of the insider's sale.[349] Instead of inducing a buyer, the dealer's lower price for 2019 Sedans may preempt a potential seller from selling her 2019 Sedan.[350] This delay in selling may cause the preempted seller to keep her 2019 Sedan until the defect becomes publicly known, which makes the seller the victim.[351] If the dealer's price reductions do not induce a buyer or preempt a seller, then the dealer holds a greater inventory of 2019 Sedans than anticipated, and the dealer becomes the victim after public announcement of the defect.[352]

In the final hypothetical, the dealer, an induced buyer, or a preempted seller may all be victims depending on how they act and react to each other, but only one victim actually exists from the sale of the insider's car.[353] To determine the actual victim, one must know the price the dealer would have charged for 2019 Sedans without buying the insider's car and "how the public would have reacted to these prices."[354] Such information is merely speculative rather than known with certainty.[355]

This hypothetical translates to securities trades involving insider trading.[356] Each instance of insider trading affects the trading price for the securities and creates at least one induced buyer or preempted seller.[357] General knowledge that insider trading occurs in markets may cause stock prices to decrease to help compensate buyers for the risk of being victims of

342. *Id.*
343. *Id.*
344. *Id.*
345. *Id.*
346. *Id.* at 33–34.
347. *Id.* at 33.
348. *Id.*
349. *Id.*
350. *Id.* at 34.
351. *Id.*
352. *Id.* at 35.
353. *Id.*
354. *Id.* at 34.
355. *Id.*
356. *Id.* at 35.
357. *Id.*

insider trading for each trade.[358] Despite this potential reduction in stock prices, investors do not share insider trading losses equally and an insider trading victim bears a disproportionate harm from the trade.[359] This corresponds to the last car hypothetical where the property of just one of the parties (the dealer, induced buyer, or preempted seller) loses value after announcement of the public defect.[360]

Although specific yet anonymous victims exist for each instance of insider trading, investors who trade more frequently face disproportionate risks from insider trading.[361] The risk of becoming a victim of insider trading correlates to the frequency at which one trades.[362] Securities professionals and market-makers who trade more frequently may pass these risks onto other investors by widening their spreads for trades.[363] The increased spreads reduce the general public's potential profit and may deter people from investing, which reduces market liquidity for securities.[364]

Because insider trading can harm anonymous investors, increase investing costs for all investors through larger transaction spreads, and deter investments in securities, regulations that limit insider trading can help curb these negative effects. Increased price spreads to offload risks of insider trading may make securities prices less accurate compared to the value of the securities.[365] Although decreased prices for securities or increased spreads can limit risk or partially compensate victims, victims still disproportionately bear the costs and these measures can interfere with the efficient function of capital markets.[366] Because of the negative effects of insider trading noted above, securities investors need regulations to limit the harm from insider trading transactions. Tests that more easily find a tipper's personal benefit can accomplish this goal.

The contrast between the efficient capital markets theories and the investor protection and market fairness theories shows the disagreement among scholars over how to implement the most efficient and fair insider trading regulatory system. The type of regulatory system affects how courts should apply personal benefit tests for tippee insider trading liability. Tests that make it harder to find a tipper's personal benefit may help increase stock price accuracy, give more information to investors faster, and encourage public participation in capital markets without harming specific investors.[367] However, this may also increase perceptions of rigged securities markets.[368] By contrast, tests that use parameters that more easily show a personal benefit can reduce the general market harm from insider trading, encourage socially

358. *Id.* at 37.
359. *Id.*
360. *See id.* at 35.
361. *Id.* at 37.
362. *Id.*
363. *Id.* at 38.
364. *Id.* at 40.
365. *See supra* Part II.B.
366. *See supra* Part II.B.
367. *See supra* Part II.A.
368. *See supra* Part II.B.

desirable securities transactions, and prevent trades that reduce market liquidity while still improving stock price accuracy by allowing fundamental value trading.[369] However, more liberal personal benefit tests may establish underinclusive or overinclusive standards for insider trading liability and enforcement, and administration costs may exceed any benefits of reduced insider trading.[370] This Note's solution maintains much of the existing jurisprudence, including the *Dirks* personal benefit requirement, while harmonizing the applications of tests used for personal benefits involving a gift or an intention to benefit a particular recipient.[371]

III. New Tests for Nonpecuniary Personal Benefits

This Note argues that different factual situations support the need for two distinct tests for nonpecuniary personal benefits: one test for gifts and one test for an intention to benefit a particular recipient. The two tests would operate as complementary theories of liability, similar to the classical and misappropriation theories. The new test for finding a personal benefit from a gift of MNPI would apply to all people, not just close friends or family, and would require prosecutors to show evidence of the tipper's intention to gift the MNPI. The new test for intention to benefit a particular recipient establishes a rebuttable presumption of legitimacy for any disclosure. This Note also recommends that courts should instruct juries that tipper personal benefits are a separate and necessary element of insider trading liability.

Currently, the Second Circuit requires a meaningfully close personal relationship for tippee liability under gift theory, but this creates an underinclusive test.[372] For example, if an insider shares MNPI with a stranger on the street who then trades on that information, the stranger likely would not face criminal liability under *Newman* because no meaningfully close personal relationship exists. In this example, arguing that the tip intended to benefit the stranger provides more support for liability than arguing that the tipper shared the MNPI as a gift. By invoking the two distinct tests proposed in this Note, prosecutors would be able to pursue more instances of improper disclosures that result in insider trading.

Part III.A identifies and explains the new test for finding a personal benefit from a gift. Part III.B identifies and explains the new test for finding an intention to benefit a particular recipient. Part III.C then analyzes how each of the new tests promotes economic efficiency and stock price accuracy while still protecting investors and fairness in securities markets.

A. Focusing on Scienter for Gifts

Starting with gifts of MNPI, this Note argues that a new test for finding that a gift conferred a personal benefit should focus on a scienter element—

369. *See supra* Part II.B.
370. *See supra* Part II.A.
371. *See infra* Parts III.A–B.
372. *See Martoma II*, 894 F.3d 64, 77 (2d Cir. 2018).

that the tipper intended to give a gift—and not on the closeness of the relationship between tipper and tippee. The *Dirks* personal benefit test intended to establish objective criteria for improper disclosures.[373] Standards that focus on either the tipper's intent to give a gift or on finding a sufficiently close relationship between tipper and tippee both involve subjective determinations of fact. Determining the tipper's intent to give a gift requires a subjective finding of the tipper's state of mind. A determination regarding the closeness of the tipper-tippee relationship to infer a gift is also subjective. Because both standards require subjective findings, this Note makes no attempt to evaluate which standard operates more objectively. However, determining a tipper's intent to gift information more closely aligns with *Dirks*'s overall goal of distinguishing between improper and proper disclosures. This new test extends liability beyond just close friends and family and applies to any tippees who receive MNPI as a gift from a tipper.

Many criminal statutes require mens rea determinations and juries can usually infer the defendant's intent from her actions. Insider trading laws should also allow juries to weigh evidence and infer intent. Juries must weigh the evidence presented and evaluate arguments to determine their credibility. To help a jury find the tipper's intent, the following list provides some examples of actions that suggest an intent to gift the MNPI.

If the tippee requests the information in lieu of cash, as happened in *Salman* between Michael and Maher, then the jury should infer the tipper's intent to give a gift.[374] If shortly after completing the trade and realizing the profit, the tippee loans or gives the tipper more than 10 percent of the profits from the trade, the jury should infer an intent to gift the MNPI. If the tippee sends the tipper any nonmonetary item in exchange for the information, then the jury should infer the tipper's intent to give a gift. If the tipper discloses the information close to the recipient's birthday or a holiday known for gift exchanges, then the jury may infer the tipper's intent to gift.

Although the Supreme Court on multiple occasions rejected the idea that liability for gifting MNPI should apply to all people and not just friends and family,[375] the above examples also suggest that a friendship exists between the tipper and the tippee. This Note generally agrees with Abigail Bush's claim that the current application of gift theory represents the minimum personal benefit for the tipper.[376] However, this Note disagrees that the "meaningfully close personal relationship" element from *Newman* represents the best available test to narrow the applicable relationships.[377] The examples listed above provide evidence that the tipper intended the disclosure as a gift or that the tippee intended the tipper to share the proceeds

373. *See supra* Part I.A.4.
374. *See supra* Part I.C.2. *See generally* Salman v. United States, 137 S. Ct. 420 (2016).
375. *See supra* Parts I.A.3–4.
376. *See supra* Part I.D.
377. *See supra* Part I.D.

of the tip, both of which satisfy the intent component of *Dirks*'s personal benefit requirement.[378]

Despite broadening liability for the personal benefit requirement for gifts to all people, this Note disagrees with the Supreme Court's implication from *Salman* that finding a gift between the original tipper and tippee should taint the entire tipping chain.[379] Nevertheless, the prosecution can still satisfy the burden of proof through evidence that the original tipper intended to gift the MNPI to a remote tippee or that the original tippee then intended to gift the information to a remote tippee.[380] Requiring evidence proving an intent to give a gift helps solve the scienter problem for tipping chains where the remote tippee may not know the identity of the original tipper. If the prosecution cannot produce evidence showing an intent to gift the MNPI, then it must use the complementary test to argue that the tipper intended to benefit a particular recipient in order to convict the defendant.[381] In cases like *Salman*, the government could raise alternative theories of liability under both the gift and intention-to-benefit tests. Allowing the government to raise alternative theories for finding a personal benefit would avoid the liability substitution issue that arose between the *Martoma I* and *Martoma II* decisions.

A hypothetical concerning two former coworkers illustrates the application of the new personal benefit test for gifts. Imagine that two coworkers used to work for the same employer, but one leaves and becomes a corporate insider for a different employer. Because of her corporate position, the insider obtains MNPI which she then shares with her former coworker. In addition to tipping the information, the insider sends an email to her former coworker stating that she hopes that the information will benefit the coworker's career. The email provides evidence of the insider's intent to gift the MNPI. The insider benefitted because she helped the coworker's career prospects. A prosecutor would not have to prove a close relationship between the insider and the coworker. Alternatively, if the insider did not send an email to the coworker and no other evidence exists showing the insider's intent to gift the MNPI, the prosecutor could still convict the coworker using an argument that the insider intended to benefit the coworker.

B. A Presumption of Legitimacy for Benefiting a Particular Recipient

This Note believes that insider trading jurisprudence should support the general principle that prosecutors must prove charges beyond a reasonable doubt. Although Fox, Glosten, and Rauterberg argue that the evidentiary burden should be reversed to more effectively deter and prosecute

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378. *See supra* Part I.A.4.

379. *See supra* Part I.C.2.

380. *See supra* Part I.D (taking a position similar to Almousa's argument that a personal benefit should be found when the tip strengthens the original tipper's relationship with the remote tippee).

381. *See infra* Part III.B.

economically harmful insider trading transactions,[382] this Note agrees with Almousa that insider trading regulations should not cater to prosecutorial goals.[383] Although this may enable some liable traders to escape punishment, this also conforms with constitutional protections for criminal defendants.

Instead, this Note proposes a new test that establishes a rebuttable presumption of legitimacy for disclosures prosecuted under an "intention to benefit a particular recipient" theory. Under this test, all prosecutions begin with the presumption that the tipper disclosed the MNPI for a legitimate or proper purpose. The prosecution must then introduce evidence that the tipper disclosed the MNPI for an illegitimate or improper purpose. If the prosecution fails to provide any evidence at an evidentiary hearing before trial, the judge must dismiss the charges. If the judge finds that the prosecution presented sufficient evidence, the case will proceed to trial. At trial, if the defense produces no evidence supporting the legitimacy of the disclosure, then the judge should recommend that the jury convict the defendant. If the defense produces such evidence, the issue becomes a matter of fact for the jury to decide. Similar to the new test for gifts of MNPI, this test aligns with *Dirks*'s goal of distinguishing proper from improper disclosures.[384]

Proper disclosures include any circumstances where the tipper discloses the information for a corporate benefit, the disclosure exposes fraudulent activity, or an inadvertent disclosure occurred and the corporation subsequently complied with Reg FD.[385] Disclosure for a corporate benefit occurs, for example, when an insider discloses the information to an investor-relations team. The insider expects that the investor-relations team will not trade on the information or share the information with other traders. Instead the insider discloses the information so that once the information becomes public, the investor-relations team can help to soften stock price drops when earnings statements fail to meet quarterly expectations or help to increase stock prices if earnings exceed expectations. This corresponds with goals of achieving accurate pricing and efficient allocation of resources for securities offerings.[386] However, if the investor-relations team discloses the information to other tippees who trade before the information becomes public, then those tippees become liable because the investor-relations team intended for those tippees to benefit. If a tipping chain discloses the information to several recipients for a corporate benefit, a remote tippee remains liable once the disclosure no longer occurs for a corporate benefit. The improper purpose test helps resolve the issue from *Newman* where the trading tippees were several levels removed from the original tippers.[387] Disclosure to expose corporate frauds should follow the *Dirks* line of

382. *See supra* Part II.B.1.
383. *See supra* Part II.B.1.
384. *See supra* Part I.A.4.
385. *See supra* Parts I.A.4, I.B.2.
386. *See supra* Part II.A.
387. *See supra* Part I.C.1.

reasoning.[388] The protection for inadvertent disclosures avoids chilling analyst interviews and additionally helps enforcement of Reg FD.

Some examples of improper disclosures include giving tips to institutional investors to curry favor, telling people they can make a lot of money trading on the information, and tipping a sad-looking stranger to help improve that stranger's day. Repeated disclosures to the same investor also support an inference of impropriety. While some of these examples could arguably create liability if the tips were intended as gifts, the intention-to-benefit test, operating as an alternative liability theory, corresponds with the Supreme Court's limitation that tippee liability for gifts should only apply to close friends and family.[389] The intention-to-benefit test ensures a pathway for prosecutors to hold such traders liable for these economically harmful types of trades, reduces the focus on the scienter necessary for gift convictions, and still protects traders' constitutional rights. Treating a gift and an intention to benefit a particular recipient as complementary liability theories corresponds with the complementary treatment of the classical and misappropriation theories.[390] Additionally, this eliminates the requirement that the prosecution prove that remote tippees knew or should have known that the original corporate insider tipped the MNPI, if the prosecution can show that the trading tippee knew or should have known that the immediate tipper improperly disclosed the information. Finally, the rebuttable presumption test helps alleviate evidentiary problems that occur from requiring evidence suggesting a quid pro quo relationship.[391]

C. The New Standards Would Promote Fairness and Efficiency in Capital Markets

The new personal benefit test for gifts would help improve the accuracy of securities prices. Even though the new test broadens gift theory liability beyond just close friends and family members, it would also require prosecutors to introduce more evidence to prove the intent of the tipper to give a gift rather than just showing evidence of a close relationship. Requiring more evidence makes it harder for prosecutors to show a personal benefit and will likely reduce insider trading convictions under a gift liability theory. Fewer convictions will mean that more insider trades will escape punishment, which will deter fewer people from engaging in insider trading. This, in turn, means that more trading will likely occur and this will gradually push the stock price closer to the value of the securities.[392] The benefit derived from the higher evidentiary burden placed on prosecutors seeking convictions under this new gift theory liability will be limited, however, because the separate intention-to-benefit test still provides an alternative

388. *See supra* Part I.A.4.
389. *See supra* Part I.C.2.
390. *See supra* Part II.B.
391. *See supra* Part II.B.1.
392. *See supra* Part II.A.1.

liability theory that prevents inside trades and punishes people who conduct transactions using improper disclosures.

Although the new personal benefit for gifts standard may reduce convictions for insider trading, it does not reduce protections for investors or encourage more types of harmful trades. The new test still aligns with *Dirks*'s goal of preventing gifts of MNPI to trading friends or relatives, despite broadening gift theory beyond just these individuals. The new test merely removes the easiest pathway for prosecutors to prove that a tipper personally benefits and increases the evidentiary burden for liability, as suggested in *Newman*.[393]

The separate test for intending to benefit a particular recipient will also help improve the accuracy of securities prices. Although a separate "intention-to-benefit" test may further limit pricing benefits, it also reduces the risk of becoming a victim of insider trading. The reduced risk benefits high-frequency traders and should reduce spreads when general investors transact with these professionals.[394] Lower spreads increase the accuracy of stock prices and help securities markets to function more efficiently.

The new intention-to-benefit test would also protect investors and promotes fairness in securities markets. The test would require proof of an improper purpose for any disclosure of MNPI. Like the new personal benefit test for gifts, the intention-to-benefit test will align with the *Dirks*'s goals because it does not impose liability on people who disclose MNPI for a proper purpose. The intention-to-benefit test also recognizes the general market harm caused by improper disclosures of MNPI, and criminal liability should dissuade investors from engaging in these harmful transactions.[395] Although the intention-to-benefit test should deter harmful transactions, it still permits beneficial transactions.[396]

Neither the new gift test nor intention-to-benefit test would add new restrictions that limit securities professionals' ability to conduct legitimate and beneficial activities. The new tests would not ban or limit fundamental value trading.[397] The new tests would still allow securities analysts to conduct research, model financial statements, interview corporate officers, and make analytical judgments. These beneficial activities help maintain healthy stock markets.[398] Lastly, the new personal benefit tests would follow the principle articulated in *Chiarella* and *Dirks* that securities regulations do not require equal access to information and that laws should encourage traders to piece information together to make superior analytical judgments.[399]

393. *See supra* Part I.C.1.
394. *See supra* Part II.B.2.
395. *See supra* Part II.B.2.
396. *See supra* Part II.B.1.
397. *See supra* Part II.B.1.
398. *See supra* Parts I.A.4, II.B.1.
399. *See supra* Parts I.A.2–3.

CONCLUSION

This Note supports the *Dirks* elements for insider trading convictions but proposes two new and distinct tests for determining nonpecuniary personal benefits. The new test for finding a personal benefit from a gift of MNPI would require prosecutors to show evidence of the tipper's intention to gift the MNPI. This test would apply to all people, rather than only to people with a meaningfully close personal relationship with the tipper. The new test for intending to benefit a particular recipient would establish a rebuttable presumption of legitimacy for any disclosure.

Tests that more easily find that a tipper received a personal benefit expand liability for insider trading. More liberal personal benefit tests can protect individual investors from harm, reduce price spreads for securities transactions, deter socially undesirable trades (and encourage socially desirable trades), and increase liquidity for securities and capital market investments. By contrast, tests that make tipper personal benefits harder to find limit insider trading liability and permit more legal insider trading. More permissible insider trading can improve stock price accuracy, give investors more information sooner, and reduce enforcement and administration costs while not causing any perceptible harm to investors or reducing public confidence in securities markets.

The two complementary nonpecuniary personal benefit tests correspond with the goals of insider trading jurisprudence. Requiring evidence that shows an intent to gift MNPI or an intent to benefit a particular recipient aligns with *Dirks*'s goal of separating improper from proper disclosures. The new tests would also align with *Chiarella*'s principle that securities laws do not require equal access to information. The new tests would still permit and encourage analytical activities that benefit securities markets, such as interviewing corporate officers and discovering information to make better analytical judgments. Finally, the new tests would still protect investors from becoming victims of insider trading, which should reduce transaction spreads for high-frequency traders and improve the price accuracy of securities. Because of the benefits identified above, complementary tests of liability for gifts of MNPI and an intention to benefit a particular recipient would resolve courts' recent struggles in applying nonpecuniary personal benefit tests.