Insider Trading

Insider Trading: Inside the Quagmire

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ABSTRACT

By most accounts, insider trading regulation ranks as perhaps the most confusing, incoherent, and inconsistent body of federal law. Criticism of the prevailing insider trading doctrine is pervasive and enduring. Fundamentally, this can be traced to a flawed predicate dating to the very inception of the prohibition. As originally enunciated, insider trading constituted deception and fraud under Section 10(b) of the Securities Act of 1934. This rule emerged not from the language of the statute, which contains no explicit definition of the conduct constituting unlawful insider trading, but from ad hoc interpretations and applications of Section 10(b) by courts, regulators, and prosecutors. But, doctrinally, the notion of insider trading as deception and fraud, as those terms were understood and enforced under the common law as recognized and practiced at the time, was a flawed, uncomfortable fit. In the statutory void, law enforcers and capital markets struggled with the confusion and anomalies the faulty insider trading regulation engendered. To deal with these difficulties, fictional or constructive doctrines were engrafted onto the existing legal structure in the form of further regulations, prosecutions, and case law. As insider trading law struggled to evolve, it became burdened by ever more complexity.

The ensuing muddle cries out for reform, through judicial, regulatory, or legislative means. But, to be effective, the change cannot be grounded on the deficient underpinnings of prevailing insider trading law, nor can it be piecemeal. Rather, meaningful reform demands a fundamental overhaul. This Article argues that the fraud-based theory which still governs insider trading law should be scrapped, along with the entire structure of constructive doctrines that developed with it. To this end, a statutory framework prohibiting insider trading on the basis of knowing possession of material nonpublic information, and situated under the strict liability principle embodied in Section 16 of the 1934 Act, would sufficiently furnish the needed renewal. Instances of such a model exist in other jurisdictions, the European Union and Australia in particular.

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INTRODUCTION

As highly improbable and hard to imagine as it seems, insider trading law recently became even more baffling and anomalous – at least in the Second
Circuit. The Court of Appeals, seeking to correct an error and clarify a standard articulated in a decision it rendered ten months earlier in Martoma I, issued an amended opinion in Martoma II. Rather than clarifying the murky legal standard created by Martoma I, Martoma II left significant questions unresolved, raised new concerns, and, ultimately, provoked more legal discord than resolution. The Martoma controversy involved an issue that has been the subject of much litigation, case law, and academic debate – tipper-tippee liability – and exemplifies the critically flawed insider trading regulatory regime in the United States today.

Specifically, the Martoma litigation concerned the standard to apply in assessing insider trading liability where (1) securities transactions are executed by outside traders (“tippees”) on the basis of confidential information obtained from corporate insiders (“tippers”), (2) the tipper and tippee share a relationship as relatives or friends, and (3) the tipper derives some type of personal benefit from wrongfully divulging such nonpublic information. In Martoma II, the Second Circuit’s analysis and ultimate ruling aggravated a chronic confusion that has long undermined insider trading law as it relates to tipper-tippee liability, as well as to insider trading law in its entirety.

In light of this, the Martoma litigation bears greater importance and larger implications beyond the Second Circuit. The case is likely to animate strong interest and vigorous commentary as courts and scholars, as well as regulators, prosecutors, and practitioners pour over the opinions, parse their fine points of the analysis, and struggle to understand the meaning of the concepts at issue as reinterpreted. Much mental energy will be spent to assess whether Martoma I or Martoma II’s view of the personal benefit rule in tipper-tippee liability analysis better aligns with controlling Supreme Court jurisprudence, and to determine who – the Martoma majority or the dissent – got it right.

That debate is pointless. Under an unusual approach suggested in this Article, any evaluation of which decision more accurately expresses controlling Supreme Court jurisprudence fails to focus on the most far-reaching inquiry the Martoma controversy presents: the failures of insider trading regulation as a whole. The decisions are a microcosm embodying all that is wrong and all that has failed concerning insider trading regulation. The case represents the latest

1. United States v. Martoma, 869 F.3d 58 (2d Cir. 2017) [hereinafter “Martoma I”].
2. United States v. Martoma, 894 F.3d 64 (2d Cir. 2018) [hereinafter “Martoma II”].
3. Id.
4. See Martoma I, 869 F.3d at 63 (citing Dirks v. S.E.C., 463 U.S. 646 (1983)).
manifestation of what critics have been saying for decades – from the very inception of the prohibition of insider trading – that, from the standpoint of historical development, legal concept, and practical effects, existing insider trading regulation as defined and enforced is not only hopelessly flawed but irreparably broken. The doctrine warrants scrapping entirely. Accordingly, perhaps the time has come to formally acknowledge that reality and start from square one. If that prospect came to pass, should the existing regime be replaced? If so, with what? And by whom?

This Article endeavors to analyze these issues and suggest answers to the searching questions they pose. It also develops a comprehensive design for an effective reform of insider trading regulation. Specifically, as an approach to devising reforms, it proposes supplanting the prevailing prohibition with an enforcement system developed by (1) identifying the historical, doctrinal, practical, and policy shortcomings responsible for the failures of today’s governing insider trading doctrine; and (2) devising reforms specifically designed and targeted to avoid those failures. To this end, the Martoma opinions, together with the case law they are grounded on, serve as instructive prototypes. They outline the large dimensions of the insider trading regulation muddle, underscore the multiple challenges it presents, and highlight the origins of those deficiencies. Against that backdrop, this Article describes reform measures that follow logically from the analysis and explains how the proposed reforms would produce a simpler, fairer, and more efficient insider trading regulatory scheme. To these ends, this Article proceeds in five parts.

Part I depicts the extent of the complexity and confusion surrounding insider trading regulation. The Martoma litigation sets the stage to illustrate this point. The discussion reviews the factual and procedural background of Martoma and related cases, and the varying interpretations that were the subject of the Second Circuit’s conflicting opinions. For this purpose, the analysis focuses on the intense disagreement and downright perplexity the Martoma cases engendered. In full context, however, that controversy relates to only one subset of the multifaceted principles that govern assessments of insider trading liability that, as elaborated below, are equally baffling.

Part II explains how and why insider trading regulation has become such a doctrinal quagmire. In part, this development may be attributed to the absence of a satisfactory theory of liability to ground the prohibition and compellingly explain why such conduct is wrongful. The analysis highlights the many logical irregularities and contradictory results today’s doctrine generates for lack of a coherent and consistent theoretical basis.

Part III provides an overview of the statutory and regulatory foundation of insider trading regulation that are a key source of the flaws that the prevailing

doctrine embodies. In particular, the discussion focuses on the fictional elements the prohibition incorporates, and touches upon another prominent derivation of the problem: the Supreme Court’s vague and often conflicting jurisprudence as it evolved from the Court’s initial insider trading case\(^7\) to its most recent pronouncement in this body of law.\(^8\)

Part IV, as groundwork for detailing the elements essential to the reform plan that emerges from the preceding analysis, considers the leading theories courts and scholars have advanced to describe the primary purpose and justification for prohibiting insider trading. It rejects as ill-conceived the fraud-based doctrine upon which prevailing law is based, as well as other models advocating various approaches such as property rights, contractual obligations, and deregulation.

Part V outlines the overarching purpose and vital components that a comprehensive reform of insider trading regulation should incorporate. As a starting point, a new insider trading regime should strip away the multiple fictions that complicate current law. The reform proposal would achieve this goal by removing the prohibition of deception and fraud grounding Section 10(b) of the Securities Exchange Act of 1934 (“Section 10(b)”)\(^9\) and Rule 10b-5 (“Rule 10b-5”)\(^10\) promulgated by the Securities and Exchange Commission (“SEC” or the “Commission”). Instead, the reformed approach would base regulation on the simpler structure of a strict liability regime. It would also require a clear declaration of the prohibition’s public policy ends. To this end, the proposal suggests two points. First, substantive reform should be designed to promote fairness for investors and capital markets in securities transactions. Second, structural reform should be framed to connect insider trading rules integrally to the overarching purpose and interests that the securities laws were enacted to protect.

Part V assesses the likely effectiveness of several legislative proposals advanced to reform insider trading law. It concludes that these efforts are faulty and would fall short of achieving the level of reform demanded because they fail to address the structural defects rooted in the fictional elements of existing doctrine. Those proposals also fail to express the fairness-based public policy goals of protecting investors and capital markets. This Article, in support of an alternative regulatory model, points to the approach adopted in Australia as best incorporating the essentials of an effective reform reflecting the analysis and principles advanced here.

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8. See Salman v. United States, 137 S. Ct. 420 (2016). See also infra Parts III.B and III.C.
10. 17 C.F.R. 240.10b-5.
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I. MARTOMA’S REVENGE

A. Personal Benefit in the Beginning: Dirks

Martoma I concerned the conviction of Mathew Martoma, a hedge fund manager at S.A.C. Capital Advisors, LLC (“SAC”), for violations of securities laws arising from his role in an insider trading scheme. Martoma’s offense involved trading in shares of Elan Corporation and Wyeth, two pharmaceutical companies working jointly in the development of bipineuzumab, an experimental drug intended as a treatment for Alzheimer’s disease. Martoma managed a large portfolio of investments concentrated in the healthcare industry. He obtained nonpublic information about the results of the clinical trials of bipineuzumab from Dr. Sidney Gilman, who chaired the committee monitoring the safety of the drug’s tests. In connection with many private consultations with Martoma, Gilman provided confidential updates about the results of the drug’s experimental use, for which Gilman was paid $1,000 per hour.

Based largely on that information, Martoma bought and sold Elan and Wyeth securities. On the occasion that gave rise to Martoma’s prosecution, he and SAC engaged in large trades of Elan and Wyeth shares just prior to a public presentation, made by Gilman, releasing data about the clinical trials. Gilman’s report disclosed weaknesses in the medical results and cast doubt on the drug’s effectiveness. On that day, the value of Elan and Wyeth shares dropped sharply and the trades Martoma and SAC had executed in those securities netted them about $280 million in profits as well as losses avoided.

The Government prosecuted Martoma for violations of Section 10(b) and Rule 10b-5. As substantive ground for its enforcement action against Gilman and Martoma, the Government invoked the theory of securities fraud liability applicable to tippers and tippees. The Supreme Court established the controlling standard for tipper-tippee liability in Section 10(b) and Rule 10b-5 causes of action in Dirks v. S.E.C. There, the Court endorsed the doctrine, which had been promulgated by the SEC, that an outsider/tippee who obtains

12. Id.
13. Id.
14. Id.
15. Id. at 67.
16. Id. at 62.
17. Id.
18. Id.
19. Id.
20. See id. at 61.
21. See id. at 63-64.
material nonpublic information concerning a corporation or its transactions from a company insider and purchases or sells shares of that issuer on the basis of such confidential knowledge commits deception and fraud in violation of Section 10(b) and Rule 10b-5. The tippee’s anti-fraud liability under those circumstances arises derivatively from the tipper’s actions. Specifically, the tippee is liable if there is evidence demonstrating that: (1) a corporate insider revealed material nonpublic information to the tippee; (2) by such conduct, the tipper breached a fiduciary duty arising from a relationship of trust and confidence that the insider owes to the corporation or its shareholders; and (3) the tippee knew or should have known about the tipper’s breach, and traded in securities on the basis of such nonpublic information without disclosing that inside knowledge to the party on the other side of the transaction.

The Dirks Court held that the standard to establish whether a breach of fiduciary duty has occurred is whether the insider will, directly or indirectly, derive a personal benefit from revealing the confidential information to the tippee. In making such a determination, courts may take into account “objective criteria” proved by circumstantial evidence. The Court then specified several examples of such considerations. In the Dirks decision’s central passage – which was subsequently pivotal to the Martoma decision – the Court remarked that a finding of personal benefit could include:

[P]ecuniary gain or a reputational benefit that will translate into future earnings . . . [T]here may be a relationship between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the particular recipient. 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. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.

B. Lower Court Twists and Turns: Newman

Interpreting this language in United States v. Newman, the Second Circuit read the personal benefit doctrine narrowly. Newman involved securities trading by hedge fund managers who received confidential information from corporate tippers they knew as co-workers and former classmates or as family friends who attended services at the same church and occasionally socialized

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24. See Dirks, 463 U.S. at 653.
25. See id. at 662.
26. See id. at 660.
27. See id. at 663.
28. Id. at 662.
29. See id. at 663-664.
30. Id.; see also Martoma I, 869 F.3d 58, 69-71 (2d Cir. 2017).
32. See id. at 450, 452.
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together.33 The question before the Newman court was whether those relationships were sufficient to satisfy the inferential test of personal benefit, as articulated by Dirks, entailing an insider trading violation when a corporate tipper makes “a gift of confidential information to a trading relative or friend.”34 In Newman, the court held that it was impermissible to support an inference that an insider derived personal benefit from a gift of information from “the mere fact of a friendship . . . of a casual or social nature,”35 thus making the standard more rigorous. Establishing liability in circumstances involving an information gift to a relative or friend, the Second Circuit declared, required proof of a “meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.”36 Based on its strict reading of the Dirks personal benefit rule, the Newman court ruled that the Government had not produced sufficient evidence to prove the existence of a meaningfully close personal relationship between the insiders and tippees, and reversed Newman’s conviction.37

The Newman construction of the Dirks personal benefit standard and its application formed the basis of the Second Circuit’s conflicting opinions in Martoma I and Martoma II.38 Relying on the argument that Newman had successfully advanced, Martoma claimed that his business connection with Gilman did not qualify as a “meaningfully close personal relationship” from which Gilman, by giving Martoma confidential information, had derived any consequential personal benefit representing at least a “potential gain of a pecuniary or similarly valuable nature.”39 Thus, according to Martoma, the Government had failed to satisfy the requirement as elaborated in Newman.40

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33. See id. at 452.


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

36. Id.

37. See id. at 455.

38. See Martoma I, 869 F.3d 58, 68-70 (2d Cir. 2017); Martoma II, 894 F.3d 64, 75-77 (2d Cir. 2018).

39. Martoma I, 869 F.3d at 73; Newman, 773 F.3d at 452.

40. See Newman, 773 F.3d at 455. The case also raised a question regarding the knowledge prong of the Dirks standard, which focuses on the extent of the tippee’s awareness of the tipper’s breach of duty, and any personal benefit that the insider obtained by virtue of the improper disclosure. The Newman court held that proof of such knowledge by the tippee constituted a prerequisite for liability, and that the Government had not satisfied that element because, in the scheme involved in the action, the tippees were several tiers removed from the original inside source of the confidential disclosure and had no knowledge of the insiders’ breach of duty or of any personal benefit they obtained by virtue of the misconduct. See id. at 453-54.
C. Reaffirmation: Salman

While Martoma I was pending, the Supreme Court decided Salman v. United States.41 There, the Court affirmed the insider trading conviction of a corporate employee who disclosed material nonpublic information about his company’s transactions to his brother.42 In turn, the brother revealed the confidences to another relative, who traded in the corporation’s securities on the basis of that information.43 In upholding the conviction, the Supreme Court promulgated a broad reading of the Dirks personal benefit requirement as applied to gifts of confidential information to a relative or friend.44 The Salman Court rejected the defendant’s argument advancing the stricter Newman test requiring tangible value.45 Instead, it interpreted Dirks to mean that when a tipper gives confidential information to a relative or friend, the tipper benefits personally because such a gift is equivalent to “trading by the tipper followed by a gift of the proceeds.”46 In reaching this conclusion, the Supreme Court expressly abrogated Newman, stating that “to the extent the Second Circuit held that the tipper must also receive something of a ‘pecuniary or similarly valuable nature’ in exchange for a gift to family or friends . . . this requirement is inconsistent with Dirks.”47

D. Gyrations, Again: Martoma I

In the light of Salman’s reaffirmation of Dirks and explicit rejection of Newman’s torturous construction of the personal benefit doctrine, the Second Circuit panel in Martoma I, by a divided opinion written by Chief Judge Robert Katzmann, overruled Newman.48 The majority concluded that “Salman fundamentally altered the analysis underlying Newman’s ‘meaningfully close personal relationship’ requirement.”49 According to the majority, that standard could not be sustained, and “is no longer good law.”50 To explain its reasoning, the Martoma I court invoked the “straightforward logic” of the gift of information analysis that flowed from Dirks and Salman.51 Thus, it held that an insider tipper derives a personal benefit from revealing material nonpublic information to a tippee when the disclosure is made “with the expectation that [the recipient] would trade on it’ . . . and the disclosure ‘resemble[s] trading by the insider followed by a gift of the profits to the recipient’ . . . whether or not

42. See id. at 428.
43. See id.
44. See id.
45. See id.
46. Id.
47. Id.
48. See Martoma I, 869 F.3d 58, 69 (2d Cir. 2017).
49. Id.
50. Id.
51. Id.
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there was a ‘meaningfully close personal relationship’ between the tipper and the tippee.” As the majority put it, this proposition means that it is “possible” for a corporate insider to personally benefit from revealing confidential information to a tippee with whom the tipper does not maintain a “meaningfully close personal relationship.” In a vigorous dissent, Judge Rosemary Pooler maintained that the majority had improperly overturned Newman.

E. Full Circle: Martoma II

But in Martoma II, a majority of the same panel, on its own motion, issued an amended opinion superseding its earlier opinion. Acknowledging that Judge Pooler’s dissent offered a plausible reading of Dirks bearing on the Supreme Court’s treatment of Newman, the majority endeavored to put Newman’s pieces together again. It modified and abrogated, or at least revoked in part, its abrogation of Newman, breathing new, but perhaps uncertain, life into the case.

On further analysis that elicited a faint concession, the majority concluded that while Newman’s “novel standard” expressed by the term “meaningfully close personal relationship” is “new to our insider trading jurisprudence,” and might be the subject of various constructions if viewed in isolation, Newman itself offered substantial guidance that defined the term by reference to other freestanding personal benefits that Dirks and Second Circuit jurisprudence had previously recognized. In particular, the Newman court had noted that the standard “requires evidence of ‘a relationship between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the [latter].’” This construction reduced the conceptual differences between Martoma I’s majority and dissent to a niche, technical dispute: the semantic difference in Dirks’s textual meaning based on the comma placement in the central Dirks passage.

52. Id. at 70 (quoting Salman v. United States, 137 S. Ct. 420, 428 (2016) and Dirks v. S.E.C., 463 U.S. 646, 664 (1983)).
53. Id. at 71.
54. Id. at 80.
55. See id. at 74, 80. Judge Pooler stressed that an appellate panel’s overruling a prior panel’s decision could be taken only by the Circuit Court sitting en banc. Moreover, Pooler read Salman to mean that the Supreme Court had abrogated Newman only to the extent it required the tipper’s personal benefit to comprise something of pecuniary or similar value, and thus that the Supreme Court had left Newman’s “meaningfully close personal relationship” standard undisturbed.
56. See Martoma II, 894 F.3d 64, 65 (2d Cir. 2018).
57. See id. at 77.
58. See id.
59. See id.
60. See id.
61. Id. (quoting U.S. v. Newman, 773 F.3d 438, 452 (2d Cir. 2014)).
62. Id. (quoting Dirks v. S.E.C, 463 U.S. 646, 664 (1983)). In the passage at issue, a comma separates the phrases “suggests a quid pro quo from the [latter]” and “or an intention to benefit . . .” Judge Pooler read this language as stating “a relationship . . . that suggests . . . an intent to benefit. See id. at 74. In this view, a finding of liability would thus require evidence of a sufficient relationship between tipper and
Having found in Newman two other standalone instances of sufficient personal benefits, at least one of which that did not require proof of any kind of meaningfully close personal relationship between Martoma and Gilman, the Martoma II majority applied the reconstructed standard to reassess Martoma’s conviction.\(^{63}\) Under its reconstructed analysis, the majority concluded that the district court’s instructions to the jury were inconsistent with Newman.\(^ {64}\) Judge Pooler, though acknowledging the substantial shift in the majority’s position concerning Newman, continued to dissent, declaring that “Newman remains good law,”\(^ {65}\) even if the majority opinion rendered it “a relic.”\(^ {66}\)

In fact, by restoring Newman’s personal benefit concept in a new guise, Martoma II left some issues unresolved and some terms undefined, opening new lines of uncertainty and further complicating at least this aspect of the insider trading regulation debate.\(^ {67}\) What constitutes a relationship that “suggests a quid pro quo”\(^ {68}\) from tippee to tipper? What forms of exchange from an insider to a trading relative or friend are sufficient to create a personal benefit for the tipper? What remains of Newman’s “meaningfully close personal relationship” standard, and what relationships are sufficiently meaningful and close to satisfy the test? Is there a fundamental significance in the insider’s intention to benefit the tippee by means of divulging confidential information, as opposed to the tipper engaging in such conduct to express some other intent or motive? These questions comprise but a few of a host of controversies relating to the personal benefit requirement that were unresolved by courts and regulators pre-Salman and Martoma, and that remain equally convoluted and no better understood following those decisions.

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63. See id. at 77-78.

64. Id. The district court’s jury instructions were incomplete and thus erroneous insofar as it allowed the jury to determine that the personal benefit element was met based only on a finding that Gilman disclosed confidential information to Martoma because he sought to develop or maintain a friendship, thus omitting reference to any of the other evidentiary indicators of personal benefit that Newman had endorsed. Nonetheless, the majority found the error harmless. It concluded that the Government had produced enough evidence at trial to support a conviction under either of the two other theories of personal benefit Newman recognized: that Martoma and Gilman maintained a relationship of quid pro quo, or that Gilman personally benefited by revealing confidential information to Martoma with the intention to benefit him. See id.

65. Id. at 87.

66. Id. at 80. Judge Pooler charged that the majority’s redefinition of Newman’s formulation of the personal benefit principle, as it relates to a meaningfully close personal relationship, represented “apparent concessions . . . semantic rather than substantial, specifically in that the reconstruction of the term is subjective rather than objective.” Id.

67. See supra note 4 and accompanying text.

68. Martoma II, 894 F.3d at 74.
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F. Back to Basics

The saga of Newman’s lateral journey to the Supreme Court, and its later demise in Martoma I and revival in Martoma II, effectively reaffirms the central point this Article endeavors to convey. The Newman controversy unexpectedly entered the Salman litigation through a side door, by way of the Court’s review of a Ninth Circuit ruling that conflicted with the Second Circuit’s in Newman. The Salman Court’s subsequent repudiation of Newman’s conception of the personal benefit rule, followed by Newman’s further tribulations on its return to the Second Circuit, first in the court’s divided Martoma I decision overturning Newman’s “meaningfully close personal relationship” doctrine, and later by the same panel’s modification of its Martoma I opinion – potentially reinstating Newman’s personal benefit standard as redefined – are conceptually dizzying and mystifying.

This doctrinal circumlocution, however, sheds light on a larger issue. That in the wake of the sharp divisions that Martoma I and Martoma II engendered, disagreement within the Second Circuit would still persist as to whether Newman remains good law. And, if it does, whatever aspect of its core doctrine survived rejection by the Supreme Court in Salman is revealing and symptomatic.

In fact, the labyrinthian trek from Dirks to Newman, Salman, and Martoma detailed above, insofar as it relates specifically to the personal benefit standard, provides merely a glimpse of the virtually hopeless state of confusion that envelops insider trading law in its entirety. For, more fundamentally, as elaborated on below, the same state of legal disarray characterizes every one of the other controlling principles that comprises current insider trading doctrine. Against this chaotic backdrop, therefore, the greater significance of Martoma’s baffling opinions, which purport to clarify the personal benefit doctrine, emerges from another direction: what the bewilderment says about the bigger picture, the dysfunction and futility of the prevailing model of insider trading law as a whole. The large-scale unworkability of the current system manifests the fundamental problems that ill-conceived and misguided profoundly flawed insider trading jurisprudence presents. Such deficiencies are now entrenched. They defy

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70. See Spacone, supra note 5; see also Murdock, supra note 5.
71. See Martoma II, 894 F.3d at 69-71.
72. See infra Part III-A.
73. See infra note 436 and accompanying text. In concrete terms, evidence of the problem abounds in the case law. There it takes expression in several forms of asymmetries. In some instances, evidence of a predicate required to establish insider trading liability is demanded in one case but ignored or explained away in another similar application. In others, an element is required to prove an insider trading violation under one theory or statutory regime of liability but is not necessary for a finding of liability pursuant to an alternate approach that could apply to the same set of facts but ultimately yield the same result. See, e.g., United States v. Blaszczak, No. 17 Cr. 357 (S.D.N.Y. May 18, 2018) (jury verdict finding defendant guilty of insider trading fraud under the Sarbanes-Oxley Act of 2002, 18 U.S.C. § 1348, but not guilty of insider fraud under Section 10(b) and Rule 10b-5, even though the crimes charged under both statues arose
inadequate piecemeal measures of reform because they took root at the prohibition’s creation, with its ungainly classification as deception and fraud under Section 10(b) and Rule 10b-5, and that formative tenet has not been detached and discarded. Accordingly, nothing short of total reconstruction from the ground up is likely to work well enough to relieve the underlying difficulties as long as insider trading law remains predicated on the roundly discredited theory of fraud encompassed as a violation of Section 10(b) and Rule 10b-5. This primal dimension of the problem raises a basic question: Should a prohibition and the complex regulatory system and case law developed to enforce it that generate such intense theoretical disputes, muddled doctrine, and eccentric results, continue as established law, or do these circumstances justify its abolition and total restructuring?

A point to consider in responding to the preceding question is that the complexities and pervasive confusion associated with insider trading regulation may be largely unnecessary and avoidable. For instance, the entire maze of factual issues and open legal disputes raised by the Martoma litigation – the closeness of Martoma’s relationship with Gilman, whether or not Gilman received a valuable personal benefit from tipping Martoma and in turn intended to benefit Martoma by divulging confidential information, and whether Martoma knew about any gain Gilman would derive from that conduct – are all beside the point. Such conceptual difficulties are needless because alternative legal theories can be drawn from the evolution of insider trading regulation in case law and significant statutory reform in some jurisdictions that would allow for prohibition and prosecution of the offense without implicating the multiplicity of practical and doctrinal shortcomings prevailing doctrine embodies. These developments thus suggest a critical need for a more robust response to mitigate insider trading law’s perplexities. The improvement this Article advances, by tearing down the existing regulatory framework and discarding its components altogether, would do away with the basic conceptual and practical anomalies rife in governing insider trading rules.

Bluntly stated, almost sixty years of jurisprudence and scholarship have failed to devise a coherent doctrine from a patchwork of applicable rules that in principle lack internal coherence and are often contradictory. No compelling explanation has been articulated for the myriad of deep-rooted flaws at the core.

out of the same transactions and entailed the same fraudulent conduct by the same defendants. See Elkan Abramowitz & Jonathan Sack, Back to the Future: Criminal Insider Trading Under Title 18, N.Y.L.J. (July 2, 2018), at 3. Much of the attendant jurisprudence continues to defy principled justification, thus bedeviling courts, legislators, regulators, commentators, and practitioners alike. See infra notes 94-97 and accompanying text.

74. See infra notes 324 -31 and accompanying text.
75. See Martoma I, 869 F.3d 58, 64 (2d Cir. 2017).
76. See infra Parts V.A. and V.C.
77. See id.
78. See infra notes 94-97 and accompanying text.
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of the fraud-based insider trading prohibition.\textsuperscript{79} To name a few prominent examples: the doctrinal misbranding of the offense as fraud and deception, which perhaps disproportionately overstates its moral gravity;\textsuperscript{80} its distortions in determining the victims of the wrongful conduct, as well as the beneficiaries and interests the securities laws were meant to protect;\textsuperscript{81} and the upended focus of the analysis of liability on insiders’ relationships, duties, benefits, and motives rather than the losses the victims or the marketplace suffered.\textsuperscript{82}

G. Shortcomings of Reforms

Despite the manifest failings of insider trading law, much of the commentary addressing the need for reform of the system suffers from a narrow scope and an acceptance of the current regime as the baseline for reform.\textsuperscript{83} Many evaluations fall short of the comprehensive inquiry needed for improvement to be fully effective by taking a piecemeal approach – formulating theories to explain or remedy particular components of the current doctrine.\textsuperscript{84} Such analyses require awkward straining to reconcile theories and reforms for select components with the broader, broken regime.\textsuperscript{85} This approach is fatal because the flawed doctrinal elements of existing insider trading law are closely interlinked, each integral to the overall framework of the regulatory regime.\textsuperscript{86} The problem, as this Article contends, is not due to a singular defective standard that can be readily separated and corrected, but of several unworkable principles functioning in tandem.\textsuperscript{87} As such, disposing of one defective element while enabling the others to remain in

\textsuperscript{79} See id.
\textsuperscript{80} See infra notes 324-325 and accompanying text.
\textsuperscript{81} See infra notes 392-395 and accompanying text.
\textsuperscript{82} See infra notes 211-217 and accompanying text.
\textsuperscript{83} See, e.g., Donna M. Nagy, Insider Trading and the Gradual Demise of Fiduciary Principles, 94 IOWA L. REV. 1315, 1373-78 (2009) (proposing a fraud on investors theory as a basis for an insider trading prohibition that would disregard breach of duty principles as a requirement of liability, but the system would remain grounded on the fictional notion of fraud and deception under Section 10(b) and Rule 10b-5); Jill E. Fisch, Start Making Sense: An Analysis and Proposal for Insider Trading Regulation, 26 GA. L. REV. 179, 235-251 (1991) (proposal to remove fiduciary duty and fraud doctrines from insider trading regulation, but would develop a regulatory system founded on the definition of an insider, a concept also bearing constructive aspects raising related difficulties under the analysis elaborated here). For instance, it would do little to advance insider trading law reform by discarding the fiduciary principle underpinning the prevailing regulatory structure, but leave the interrelated fraud predicate undisturbed, as the SEC did in adopting Rule 14e-3 to address misrepresentation in connection with tender offers. See infra note 185 and accompanying text. Similarly, it makes little sense to require strict adherence to the personal benefit standard in a case prosecuted under the classical theory of insider trading law, but not, as some courts have indicated, if the same case were brought under the misappropriation theory. See infra notes 314-315, 436 and accompanying text.
\textsuperscript{84} See id.
\textsuperscript{85} See id.
\textsuperscript{86} See Dirks v. S.E.C., 463 U.S. 646, 653-63 (1983) (explaining interrelationships among various elements of the insider trading prohibition, in particular the concept of insider trading as fraud in violation of Section 10(b) and Rule 10b-5, the duty of disclosure, the definition of insider, the fiduciary duty principle, and the personal benefit requirement for tipper/tippee liability).
\textsuperscript{87} See supra Part III.A.
effect would do little or nothing to resolve the core issues. That approach would be akin to rebuilding a faulty edifice on its original crumbling pillars and cracking foundation.

A complete renovation of the existing insider trading doctrine is also essential to address certain prevalent normative concerns.\textsuperscript{88} In reaction to the shortcomings of the current prohibition, regulators and prosecutors tend to ignore or creatively work around established prerequisites of liability when it is at odds with demands of other doctrinal directions, enforcement objectives, or public policies.\textsuperscript{89} Consequently, a de facto insider trading regime has gradually developed in which some of the traditional standards such as fiduciary duty principles and relationships of trust and confidence play no clear role in the analysis of an insider trading charge or determination of liability.\textsuperscript{90} This essentially deems the requirements in some cases as a doctrinal formality to be duly avowed but distinguished, rather than as recognized legal mandates to be faithfully observed.\textsuperscript{91} Dispensing with principles in some cases but not others presents obvious challenges in the proper administration of justice and the efficient operation of financial markets.\textsuperscript{92} The official existence of the rules on paper, especially when they emanate from the Supreme Court, coupled with sometimes wavering or lip service adherence to them, enhance the legal confusion and deepen the quagmire engulfing insider trading regulation.\textsuperscript{93}

A value judgment calling for such drastic upheaval of legal doctrine demands a detailed and rigorous justification. The best way to gain full appreciation of why such a seemingly extreme remedy is warranted is to break down the origins and manifestations of the problems the current system presents. To do so, this Article considers several essential questions. Precisely what makes prevailing insider trading law so bewildering, as critics universally complain? Can the complexity and confusion be traced to a particular origin? Is the existing regime so irremediable to justify repeal? If abolished, should insider trading regulation

\textsuperscript{88} See, e.g. Fisch, supra note 83, at 179-82 (noting that uncertainty in the absence of clear insider trading rules encourages regulators and prosecutors to pursue an overly aggressive litigation course, sending traders to prison on the basis of vague standards, raising due process concerns, and hindering the efficient operation of capital markets). See also infra notes 435-49 and accompanying text.

\textsuperscript{89} See, e.g. Nagy, supra note 83, at 1321 (noting the tension that has developed in the application of Supreme Court insider trading jurisprudence, which is “unique in the liberties taken by courts and the SEC to simply ignore such dictates whenever their application would produce outcomes inconsistent with overarching policy objectives”).

\textsuperscript{90} See id. at 1319-20, 1340-47 (noting that the SEC and some federal courts have tended to disregard application of the fiduciary principles that the Supreme Court in Dirks prescribed as prerequisites of insider trading liability, leading to its “gradual demise”, and having found tippee liability in the absence of a personal benefit).

\textsuperscript{91} See id. at 1340-1347 (discussing cases involving insider trading liability of thieves, hackers, and “brazen fiduciaries” charging insider trading violations despite the absence of fiduciary principles or relationships of trust and confidence between the offending trader and the source of the confidential nonpublic information).

\textsuperscript{92} See id at 1319-20, 1340-47 and accompanying text.

\textsuperscript{93} See id.; see also infra Parts III.B. and III.C.
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be replaced in some other form? How does the historical development of the current doctrine shed light on pitfalls to avoid in drafting an alternative plan?

Guided by this inquiry, the ensuing analysis suggests that a reconstituted insider trading system should feature two vital principles. First, insider trading violations should be based on violation of Section 16 of the Exchange Act ("Section 16") rather than Section 10(b) and Rule 10b-5. This would replace the current fraud-based doctrine under Section 10 with Section 16’s strict liability governing regulatory filing requirements. Second, the revised scheme should reaffirm that the overarching policy objective of insider trading regulation is to promote fairness for investors and capital markets through equality of access to material information. To that end, the reformed system should contain protections from exploitation and manipulation by outlawing the unfair advantage gained by any person who knowingly trades securities on the basis of confidential inside information.

The perspective this Article advocates may seem unorthodox. Unlike traditional legal scholarship, this study does not purport to reconcile the apparent conflicts that the underlying jurisprudence poses. Nor does it synthesize and pronounce a unified theory of insider trading law seeking to explicate a reasoned application of the personal benefit standard or of any of the other essential elements of insider trading liability. Instead, perhaps uniquely, this Article carries the argument farther. Based on a granular review of the prohibition’s historical development, doctrinal foundation, and statutory policy goals, the analysis seeks to demonstrate that not only the personal benefit principle but none of the other central doctrines on which modern insider trading regulation is grounded makes any sense, thus accounting for the troubling inconsistencies and aberrations the prohibition produces conceptually and in practice, and therefore justifying that those other rules be similarly dispatched.

Conceptual support and empirical precedent for this complete overhaul may be drawn from three sources: (1) legislative proposals, both longstanding and more recent; (2) constructive principles devised by law enforcers that fundamentally depart from controlling standards, cast doubt upon their application, and create a de facto regime divested of the legal fictions that encumber the administration and efficiency of insider trading law today; and (3) insider trading laws adopted in other jurisdictions.

A streamlined model of insider trading regulation would eradicate the constructive fictions encrusted onto insider trading jurisprudence through its

95. See infra note 462 and accompanying text.
96. See infra Part V.A.
98. See infra notes 191-95 and accompanying text.
99. See infra notes 503-14 and accompanying text.
evolution and realign it with the fairness-based objective of equality of access to material information that insider trading regulation originally envisioned. In these respects, historically, insider trading law, as one commentator remarked, would “shift[] almost full circle.”

II. THE QUAGMIRE

Insider trading regulation is among the most bewildering bodies of American law. Widespread and longstanding criticism attests to this perception. Complaints uniformly voiced by scholars, legislators and market professionals, practitioners and columnists, and even courts, underscore a common theme: the pervasive confusion and uncertainty associated both with the doctrinal requirements and the practical application of modern insider trading.

100. See infra notes 450-62 and accompanying text.

101. See Nagy, supra note 83, at 1364-65 (”[I]nsider trading jurisprudence . . . has shifted almost full circle: starting as one where unequal access to information triggered a disclosure obligation under Rule 10b-5; then to one where the disclosure obligation was predicated on a fiduciary relationship between the parties to the transaction; next to one where the disclosure obligation was predicated either on a fiduciary relations between the trading parties or between the trader-tipper and the source of the information; and finally, to one where the Rule 10b-5 violation now often turns on the wrongful use of material information, regardless of whether a fiduciary-like duty has been breached”) (emphasis in original).

102. See infra notes 94-97 and accompanying text.

103. Insider trading regulation has generated voluminous academic literature sharply divided regarding the doctrinal foundation and purposes of the rules, but uniformly critical of their substance and application. For an overview of common legal issues and strongly-worded concerns scholars have raised, see, e.g., DONALD C. LANGEVOORT, 18 INSIDER TRADING: REGULATION, ENFORCEMENT, & PREVENTION § 1.6 (Westlaw Online ed. 2019 update) [hereinafter “LANGEVOORT, INSIDER TRADING”) (explaining that much of the complexity of insider trading law results from a conflict between two forces: the wish for expansiveness and flexibility in the scope of the prohibition so as to remedy wrongdoing effectively, and the importance of clear and predictable law, a tension that produces “quixotic attempts” by courts to resolve it as well as “awkward” resistance that “make this body of judge-made [law] all the more incoherent”); Donald C. Langevoort, “Fine Distinctions” in the Contemporary Law of Insider Trading, 2013 COLUM. BUS. L. REV. 429, 431, 434 (2013) (hereinafter “Langevoort, Fine Distinctions”) (stating that “no one has ever been able to articulate a robust theory of marketplace deception arising from insider trading”); Nagy, supra note 83, at 1321 (noting the tension that has developed in the application of Supreme Court insider trading jurisprudence, which is “unique in the liberties taken by courts and the SEC to simply ignore such dictates whenever their application would produce outcomes inconsistent with overarching policy objectives”); Fisch, supra note 83, at 179 (“When Charles Dickens wrote ‘the law is a[n] ass,’ he might well have been describing the law governing insider trading. [R]estrictions on [insider trading] are confused and confusing”); Stephen M. Bainbridge, Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud, 52 SMU L. REV. 1589, 1591 (1999); Richard W. Painter, Kimberly D. Kwawiec & Cynthia A. Williams, Don’t Ask, Just Tell: Insider Trading After United States v. O’Hagan, 84 VA. L. REV. 153, 157 (1998) [hereinafter “Painter et al.”].

104. See, e.g., Painter et al., supra note 103, at 202 (quoting statement of Senator Alfonse D’Amato critiquing widespread uncertainties about what conduct the law of insider trading encompasses, describing it as an “I know it when I see it standard”).

105. See, e.g., James B. Stewart, Delving Into Morass of Insider Trading, N.Y. TIMES, Dec. 20, 2014, at B1 (noting that the development of insider trading through common law interpretation and precedents “has resulted in a thicket of confusing and, at times, tortured attempts to fit new insider trading cases into earlier precedents”).

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law. Such universal vilification of governing securities law should sound alarms that something has gone profoundly wrong in the justice system, implicating significant public policy concerns. Part II traces the origins of this phenomenon and evolution of the doctrine. A detailed review of the severe flaws that insider trading regulation has embodied since its inception, and how these problems have magnified as the law has evolved, is crucial for devising effective judicial, legislative, and regulatory reforms.

A. Origins: Distortion of Words

The SEC first enunciated the prohibition against insider trading classified as fraud in In the Matter of Cady, Roberts & Co. That decision promulgated the classical theory of insider trading liability and represents perhaps the most pronounced and fertile source of the confusion and practical concerns insider trading law has generated, as is evidenced by the Supreme Court’s application of the classical theory. Cady, Roberts holds that the purchasing or selling of securities while the trader possesses material nonpublic information obtained or divulged in breach of a fiduciary duty arising from a relationship of trust and confidence, constitutes a deceptive or manipulative practice, and thus fraud, in violation of Section 10(b) and Rule 10b-5. To avoid liability for violation of the securities laws under these circumstances, the insider is obligated either to disclose the confidential information to the investor on the other side of the purchase or sale or to abstain from the transaction. What these concepts mean, how regulators, prosecutors, and the courts apply them, and what effect enforcement of the underlying rules has on investors, as well as on the fair operation and efficiency of capital markets, encapsulate the intense insider trading debate. Controversy over the meaning and application of the legal

107. See supra note 79 and accompanying text.
108. See In re Cady, Roberts & Co., 40 S.E.C. 907, 1961 WL 60638, at *3-4 (S.E.C. Nov. 8, 1961) (declaring that any person who possesses knowledge of material facts that may affect the investment decisions of securities investors with whom they trade has a duty to disclose that information or refrain from the transaction, and that breach of that duty gives rise to liability for deception and fraud under the securities laws). See also notes 212-216 and accompanying text.
109. See Dirks v. S.E.C., 463 U.S. 646, 657-58 (1983); Chiarella v. United States, 445 U.S. 222, 230 (1980). In these cases the Supreme Court adopted and applied the legal theory the SEC first enunciated in Cady, Roberts, holding that insider trading constitutes deception within the meaning of the anti-fraud provisions of Section 10(b) and Rule 10b-5. Chiarella and Dirks, while embracing the SEC’s legal theory of imposing liability for insider trading in impersonal markets as deception and fraud in violation of Section 10(b) and Rules 10b-5, narrowed the application of the doctrine. The Court held that the obligation to disclose under Section 10(b) does not arise from mere possession of nonpublic market information, but from the existence and breach of a fiduciary duty arising from a relationship of trust and confidence owed to the party on the other side of the transaction. See Chiarella, 445 U.S. at 228; Dirks, 463 U.S. at 654. See also United States v. O’Hagan, 521 U.S. 642, 651-53 (1997) (declaring that the insider’s disclosure duty is owed to the source of misappropriated material nonpublic information on the basis of which the securities trade at issue is transacted). For further discussion of the role the jurisprudence these cases enunciated played in aggravating insider trading law’s conceptual puzzle, see infra Part III.B.
111. See id.
principles that constitute insider trading regulation arose and still persist because,
in practice, enforcement of the prohibition created too much incoherence and inconsistency.\footnote{See supra notes 93-102, 104-11 and accompanying text.} According to one commentator, “the prevailing state of the law is confusing, difficult to apply, and seriously out of sync with the reasons that lead people to want to prohibit insider trading.”\footnote{LANGEVOORT, INSIDER TRADING, supra note 103, at § 13.11; see also Fisch, supra note 83, at 184 (“[T]he doctrine under which insider trading is regulated is seriously flawed. Many of the flaws can be attributed to the fact that insider trading regulation has been developed on an ad hoc basis, with insufficient thought given to its rationale.”); Nagy, supra note 83, at 1320 (“[A] coherent and consistent theory of insider trading has yet to emerge”).} Echoing these charges, other commentators have remarked that the method for assessing insider trading liability under existing doctrine leads to a “quagmire,”\footnote{Fisch, supra note 83, at 236. These difficulties arise in part because in its practical application case by case, the prohibition becomes, Proteus-like, “a target of different size and shape.” Painter et al., supra note 103, at 188.} and constitutes a “legal and economic enigma.”\footnote{Stephen M. Bainbridge, The Insider Trading Prohibition: A Legal and Economic Enigma, 38 U. FLA. L. REV. 35 (1986).} In practice, considerable divergence over two elemental points sheds light on the perplexities generated by insider trading regulation. These observations not only illustrate the dimensions of the problem but also offer instructive guidance essential to designing any improvements. First is the controversy over what conduct insider trading regulation prohibits and how to describe the legal prerequisites to establish violations and impose liability.\footnote{See supra notes 99-107 and accompanying text.} The second relates to varying legal theories regarding the central public purposes the prohibition is meant to accomplish and the interests it intends to protect.\footnote{See infra notes 199-214 and accompanying text.} Courts, regulators, prosecutors, academics, and practitioners are sharply divided over both the conceptual underpinnings and the public policy goals that justify insider trading regulation.\footnote{See generally supra notes 94-105 and accompanying text.} These authorities have long struggled, unsuccessfully, to devise a coherent unifying principle to conceptualize the prohibition and give it doctrinal legitimacy and practical operation.\footnote{See supra notes 94-106 and accompanying text.}

In fact, a longstanding legal theory developed to bolster insider trading regulation does exist. The doctrine rests on the principle equating insider trading to deception and fraud in violation of Section 10(b) and Rule 10b-5 that the SEC promulgated in \textit{Cady, Roberts}.\footnote{See In re Cady, Roberts & Co., 40 S.E.C. 907, 1961 WL 60638, at *3-4 (S.E.C. Nov. 8, 1961).} But that designation is severely flawed on multiple grounds.\footnote{See infra notes 158-165.} It did not derive from clear and explicit text in applicable statutes or regulations.\footnote{See Chiarella v. United States, 445 U.S. 222, 226 (1980) (noting that neither the language of Section 10(b) nor its legislative history offered specific guidance in resolving whether insider trading by
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from references to “deceit” and “manipulative device” declared unlawful under Section 10(b) and Rule 10b-5. Premising insider trading liability on a theory of fraud, however, was conceptually strained and inherently defective from the start. As detailed in Part III.A.5 below, it ran counter to both the historically recognized common law concept of fraud and the ordinary sense of the term. Much of the underlying confusion and uncertainty permeating insider trading law today can be traced to these formative weaknesses. The fundamentally defective classification of insider trading as fraud gave rise to a multitude of unsustainable attempts by regulators, prosecutors, and courts to apply the doctrine. Often, they did so by further twisting concepts, contorting words, creating legal fictions, or stretching the rules so as to accommodate particular circumstances – however awkward and ill-fitting – within a constructive framework of insider trading constituting fraud and deceit.

This phenomenon is a pivotal component of the insider trading debate. It represents perhaps the most central cause of the conceptual faults burdening modern insider trading law and amounts to a significant source of the confusion the prohibition has spawned. Yet, it has not received the close attention and searching inquiry that such a consequential development warrants in the case law or commentary.

B. Through the Looking Glass: Distortions of Theory and Purpose

Grounding the insider trading prohibition on a legal theory of fraud provoked widespread discontent and reaction largely for two reasons. First, the premise entails conceptual distortions of legal theory and public policy, creating far-

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123. The original references to “fraud” and “deceit” expressed in the securities laws derive from Section 17(a) [hereinafter “Section 17(a)”] of the Securities Act of 1933 (the “Securities Act”), 15 U.S.C. § 77q.

124. See infra notes 324-330, 342-345; see also Michael P. Dooley, Enforcement of Insider Trading Restrictions, 66 VA. L. REV. 1, 59 (1980) (“Insider trading in no way resembles deceit. No representation is made, nor is there any reliance, change of position, or causal connection between the defendant’s acts and the plaintiff’s losses”).

125. See, e.g., Stewart, supra note 105 (remarking that “It’s always a problem to gerrymander insider trading into fraud”) (quoting Stephen M. Bainbridge). The same point has been made through various other imageries. See, e.g., John R. Beeson, Rounding the Peg to Fit the Hole: A Proposed Regulatory Reform of the Misappropriation Theory, 144 U. PA. L. REV. 1078 (1996) (referring to the phenomenon in terms of the proverbial square peg and round hole); Saiskrishna Prakash, Our Dysfunctional Insider Trading Regime, 99 COLUM. L. REV. 1491, 1498 (1999) (using the analogy of Cinderella’s stepsisters stuffing their oversized feet into the small glass slipper). The Procrustean bed would also fit as a suitable metaphor.

126. See supra notes 115-17 and accompanying text.
reaching implications for the justice system.\textsuperscript{128} Second, in some applications, insider trading regulation’s constructive elements produce discrepant or unjust results.\textsuperscript{129} In practice, several consequences have ensued from those developments. Absent a doctrinally sound justification, insider trading law became encrusted with even greater complications and uncertainty as courts, regulators, and scholars long struggled in an unproductive search for a more fitting conceptual foundation to support enforcement of the prohibition.\textsuperscript{130} Those endeavors improvised a large body of disparate theories.\textsuperscript{131} Manifesting the extent to which even authorities on the subject are unable to articulate a compelling legal theory of what insider trading is and why the conduct it encompasses should be declared unlawful, a large body of case law and commentary, for instance, variously portrays insider trading doctrine as based on principles drawn from or analogous to the law of fraud,\textsuperscript{132} breach of fiduciary

\begin{footnotesize}
\begin{itemize}
  \item[128] See, e.g., Fisch, supra note 83, at 179-82.
  \item[129] See e.g., infra note 199 and accompanying text.
  \item[130] See infra Part III.
  \item[131] See id.
\end{itemize}
\end{footnotesize}
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duty, agency, theft, conversion, embezzlement, trusts, property, contracts, corporations, confidential relationships, unjust enrichment, lying, trade secrets, and corruption.

133. See, e.g., supra note 100; see also infra Part III.A.2.


135. See, e.g., Fisch, supra note 83, at 207 (“The burglar who breaks into an office in order to obtain confidential corporate information for trading is stealing as well as engaging in insider trading”); S.E.C. v. Cherif, 933 F.2d 403, 417 (7th Cir. 1991) (affirming injunction based on Rule 10b-5 charges against former bank employee who entered a bank building and obtained confidential information using a key he had improperly kept).

136. See, e.g., Fisch, supra note 83, at 207 (stating that theft of confidential information by means other than burglary may also qualify as conversion); S.E.C. v. Wilson, Litigation Release No. 18496, 03 CV 2938G (N.D. Tex. 2003) (consent judgment settling SEC action charging violations of Section 10(b) and Rule 10b-5 against defendant who traded on confidential information about a corporation that he obtained from documents he found in the home of his daughter and son-in-law, an employee of the issuer, while the defendant was alone in the house and searching for supplies in the pantry).

137. See, e.g., United States v. O’Hagan, 521 U.S. 653, 654 (1997) (stating that the “undisclosed misappropriation of [corporate] information constitutes fraud akin to embezzlement”) (citing Carpenter v. United States, 484 U.S. 19, 27 (1987); United States v. Thomaz, No. 18-cr-579, at *1 (S.D.N.Y. Dec. 6, 2018) (noting that insider trading is “a variation of a species of fraud known as embezzlement which is defined as “ ‘[t]he fraudulent taking of personal property with which one has been entrusted, especially as a fiduciary.’ ” (quoting Black’s Law Dictionary (10th ed. 2014)). The case of the thief or the hacker who obtains nonpublic information by wrongful means and uses it to purchase or sell securities lays bare the doctrinal fallacy of the insider-trading-as-embezzlement theory. The analogy collapses of its manifest flaw insofar as it would suggest that the thief or hacker has been “entrusted” by the lawful owner to possess and use the stolen property, or that any “fiduciary” relationship exists between them providing access to the inside nonpublic information. Equally defective is the notion that the thief has “defrauded” the rightful owner of the information by the wrongful taking and use. See also Fisch, supra note 83, at 207.

138. See, e.g., Fisch, supra note 83, at 193 (noting that the law of trusts serves as a legal source of a heightened disclosure duty) (citing GEORGE G. BOGERT, TRUSTS § 96, at 348 (6th ed. 1987)).

139. See, e.g., O’Hagan, 521 U.S. at 654 (stating that “[a] company’s confidential information . . . qualifies as property to which the company has a right to exclusive use”) (citing Carpenter, 484 U.S. at 27); United States v. Libera, 989 F.2d 596, 600 (2d Cir. 1993) (stating that the purpose of the insider trading misappropriation theory is “to protect property rights in information”).

140. See, e.g., Jonathan R. Macey, From Fairness to Contract: The New Direction of the Rules Against Insider Trading, 13 HOFSTRA L. REV. 9, 11 (1984) (arguing that concerns about fairness expressed in insider trading jurisprudence “are better analyzed in contractual terms,” and that the Supreme Court’s prevailing analysis of Rule 10b-5 “evinces a new understanding of the fact that privileged corporate information is a valuable asset in the nature of a property interest”); Richard A. Epstein, Returning to Common-Law Principles of Insider Trading After United States v. Newman, 125 YALE L.J. 1482, 1492 (2016) (arguing that contractual solutions would be more effective at addressing insider trading concerns, and that “it is . . . possible that consensual arrangements would reach the same position that the law requires today—namely, that the insider must live with the choice to either disclose or abstain from trading”).

141. See, e.g., In re Cady, Roberts & Co., 40 S.E.C. 907, 1961 WL 60638, at *3 (S.E.C. Nov. 8, 1961) (noting that “the securities acts may be said to have generated a wholly new and far-reaching body of Federal corporation law”).

142. See, e.g., Painter et al., supra note 103, at 176 n.101 (noting distinctions between “fiduciaries” and “confidential” relationships, one of which attaches to particular offices as a matter of law, and the other stemming from the behaviors and expectations of the parties in their relationships with each other) (citing George G. Bogert, Confidential Relations and Unenforceable Express Trusts, 13 CORNELL L. Q. 237, 248 (1948)).
Thus, on these variable depictions, insider trading regulation assumes the mimicking trait of a chameleon, tactically changing shade to suit its surroundings. In one case, the doctrine may be perceived as a design against theft; in another, the same concept is portrayed as promoting corporate honesty and loyalty; in a third, as designed for protection of business property.\textsuperscript{147} A different perspective goes further by wiping the slate clean and explaining insider trading law as none of the above, but as “sui generis.”\textsuperscript{148} Such widely varying conceptualizations of the same conduct is important because it comes with legal consequences with seemingly conflicting, irreconcilable, or unjustifiable outcomes.\textsuperscript{149} This is because each of these conceptualizations of conduct comes with its own standards necessary to prove a violation of established norms, the distinct relationships that must exist, and the different types and quality of evidence that must be shown.\textsuperscript{150} It is no wonder that such diverging legal theories underpinning insider trading would produce legal confusion.

Why and how insider trading law became so baffling is manifest as well in the confounding paradoxes and fundamental absurdities that insider trading law theories produce in some contexts. For instance, twists of insider trading jargon have upended the meaning of certain legal terms to produce a doublespeak by which certain words articulate contradictions and legal chimera.\textsuperscript{151} Specifically, over time, insider trading restrictions have mutated to hold that: an insider may

\textsuperscript{147} See, e.g., Fisch, supra note 83, at 190 (explaining that under agency principles a corporate insider is “unjustly enriched by making use of corporate information for his personal benefit, and that any trading profits are rightfully the property of the owner of the information—the corporation,” though arguing also that “unjust enrichment is not the legal equivalent of deception”); Donald C. Langevoort: Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement, 70 CALIF. L. REV. 1, 6-7 (1983) (stating that “the duty of affirmative disclosure rests heavily on an unjust enrichment principle and blends into the broader doctrine of constructive fraud”).

\textsuperscript{148} See, e.g., Fisch, supra note 83, at 237 (discussing insider trading by omission to disclose material facts as analogous to lying, but concluding that insider trading “is not the moral equivalent of lying”).


\textsuperscript{150} See, e.g., Sung Hui Kim, The Last Temptation of Congress, 98 CORNELL L.R. 845, 893, 903 (2013) (arguing that deterrence of corruption is a central objective of the common law governing fiduciaries, and that because legislators should be recognized as fiduciaries who owe a duty to society not to use public office for personal gain, the prohibition of insider trading should be imposed upon them).

\textsuperscript{147} See Painter et al., supra note 103, at 219-20 (describing various purposes attributed to insider trading regulation, including objectives of promoting information symmetries, market confidence, disclosure, fraud prevention, protection of proprietary material, and enforcement of fiduciary obligations).

\textsuperscript{148} Langevoort, Fine Distinctions, supra note 103, at 440 (stating that “insider trading law is indeed sui generis. It is not really fraud, even though we have chosen to call it fraud in order to preserve and embellish the useful message of investor protection”).

\textsuperscript{149} See, e.g. infra note 436 and accompanying text.

\textsuperscript{150} See, e.g., Ernst & Ernst v. Hochfelder, 425 U.S 185, 208 (1976) (discussing the difference in the evidentiary standard of intent in criminal actions charging fraud under Section 10(b) and civil actions alleging negligence under Section 11 of the 1934 Act); U.S. v. Newman, 773 F.3d 438, 447 (2d Cir. 2014) (discussing the requirement of willfulness to establish a criminal violation of the securities laws.). See also Langevoort, Fine Distinctions, supra note 103, at 435–47.

\textsuperscript{151} See infra notes 143-48 and accompanying text.
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be an outsider; disclosure may not be disclosable; deception is not deceptive; a tippee may have no tipper; the investor victimized may not be the victim; and a fiduciary duty may not be necessary to find fraud committed by breach of a fiduciary duty.

Finally, clashing perspectives concerning the conceptual grounding for insider trading regulation produced substantive disagreement not only about what unlawful conduct should be classified within which legal theory, but about the public purpose and primary beneficiaries of the prohibition. In this regard, varying philosophies advance diametric approaches pointing to regulation pressing in different directions with different objectives, and encompassing different vital interests that the rules should and were intended to protect. Among numerous conflicting notions, the most prominent advocate for protection of investors and capital markets, property rights in information, honest and open corporate management, and efficient markets.

This theoretical debate and the distinctions and disparities it implicates is not merely academic. After decades of intense discourse, the most knowledgeable and experienced authorities in the field remain in disarray about insider trading regulation. They have been unable to reach even a general consensus to describe what the prohibition is, what comprises its substance and structure, what


154. See, e.g., S.E.C. v. Obus, 693 F.3d 276, 286 (2d Cir. 2012) (holding that the knowledge and deceptive intent elements of Rule 10b-5 liability may be met by defendant’s reckless conduct in communicating confidential information in violation of company rules). See also infra Part III.A.5.

155. See, e.g., United States v. Evans, 486 F.3d 315, 323 (7th Cir. 2007) (affirming the conviction of defendant-tippee of insider trading charges, even though his tipper was acquitted of charges of Rule 10b-5 violations stemming from the same transaction, where the Circuit Court reasoned that when the parties maintain a relationship of trust and confidence, a tippee who induces a breach and trades on the basis of nonpublic information obtained from the tipper may be held liable for violation of Rule 10b-5 and that “it is not essential that the tipper knew that his disclosure was improper”). See also infra Part III.A.2.

156. See, e.g., Carpenter v. United States, 484 U.S. 19, 24 (1987) (affirming, by an equally divided Court, the insider trading convictions of a Wall Street Journal columnist tipper and tippees who bought and sold securities based on the columnist’s pre-publication disclosure of stock analysis information, and declaring that the victim of the fraud was the Wall Street Journal, even though the newspaper was not a purchaser or seller of the securities traded). See also infra Part III.A.5.

157. See, e.g., S.E.C. v. Dorozhko, 542 F.3d 42, 45, 49 (2d Cir. 2009) (finding that a trader’s acquisition of confidential records through computer hacking of a company’s files and purchasing and selling securities based on such nonpublic information may constitute a deceptive device for the purposes of Rule 10b-5 liability even though the defendant was “a corporate outsider who owed no fiduciary duties to the source of the information”). See also infra Part III.A.2.

158. See infra notes 436-38 and accompanying text.

159. See id.

160. See, e.g., Painter et al., supra note 103, at 219-20.

161. See, e.g., supra notes 94-97 and accompanying text.
it intends to do, or what interests it is designed to protect. The results such an amorphous concept produces are not surprising. Inevitably, it gives rise to precisely the circumstances the legal community today continues struggling to overcome: not only fomenting confusion and unpredictability in the law, creating instability in the marketplace, and complicating the task of devising effective improvements. Moreover, uncertainty regarding elemental legal principles translates into material difficulties in practice. In the world of litigation and adjudication of actual controversies, shifting ground under the legal theory and overarching public policy goals underlying a legal action may be decisive in determining how a case is resolved. For these reasons, the failure of courts, regulators, and scholars to formulate and recognize a clear legal theory as a unifying principle for assessing insider trading liability has been momentous. Coupled with the application of several legal fictions engrafted onto the doctrine as constructive principles, and the large array of clashing philosophies about the public justification for the prohibition, these developments have multiplied the incoherence of the jurisprudence and distorted its results in practice.

C. End of the Line: Congress and the Supreme Court

Though widespread differences regarding the theoretical basis and public policy aims supporting insider trading regulation continue to divide the legal community, agreement about some essential points does emerge from the debate. First, there is virtual unanimity among commentators and practitioners that a fundamental problem exists, that insider trading regulation is seriously defective, and that the doctrine needs major overhaul. But no consensus has developed on what should be done, or where or how to go about it. Numerous proposals have been advanced in Congress to address the problem. Generally, these

162. See id. See also infra notes 436-438 and accompanying text.
163. See, e.g., infra notes 436-449 and accompanying text.
164. See, e.g., Painter et al., supra note 103, at 188 (“Fines, lost careers, and even jail terms rest on an uncertain articulation of when fiduciary relationships exist and which parties to those relationships have a duty to disclose before trading on the basis of material, nonpublic information.”).
165. See infra note 436 and accompanying text.
166. See infra notes 436-449 and accompanying text.
167. See supra notes 94-97 and accompanying text.
168. See id.
169. See supra notes 46-48 and accompanying text.
170. In fact, on two occasions during the 1980s Congress considered bills to enact a statutory prohibition of insider trading. See LANGEVOORT, INSIDER TRADING, supra note 103, at §§ 13.1–13.5 (providing legislative history regarding those measures). That legislative effort was unsuccessful in both instances. Ironically, while failing to proscribe insider trading directly and define its elements and the specific conduct to which the prohibition would apply, Congress adopted provisions expanding the remedies that may be ordered for violations of Section 10(b) and Rule 10b-5 based on the regulatory framework established by existing rules promulgated by the SEC and the courts. See also infra note 188 and accompanying text.
Efforts have failed. Yet, the experience reflects recognition that, given the critical stakes on the line, the need to resolve widespread divergence about legal theory remains critical. Not the least of those concerns is that treating insider trading regulation under one particular legal theory rather than another could be outcome-determinative. Different conceptions of unlawful conduct, different legal standards applied in assessing liability, and different perspectives about the public goals that regulation seeks to achieve could alter the way any particular case is decided. Moreover, the disparity and “twisted logical basis” on which insider trading law is founded does not provide a recognized and reliable standard by which individuals and institutions can guide permissible business and personal behavior, nor one which the government can employ to achieve recognized public policy and enforce established norms. Equally vital, the existence of inordinate ambiguity about the meaning of legally binding rules, and about where the law’s definitional lines are drawn, carry far-reaching significance implicating the fairness and efficiency of the justice system, as well as the integrity and stability of capital markets.

Second, a measure of agreement within the legal community exists regarding where ultimate responsibility for the rise and continuation of the concerns insider trading regulation raises rests: on the absence of express guidance from Congress, and on the Supreme Court’s murky insider trading jurisprudence. A primary reason for the intolerable doctrinal vagueness and inconsistencies prevalent in insider trading rules may be traced to Congress’s doorsteps, not through statutory action, but more because of failure to act. Congress, while aware of the problem for many years, has not legislated a solution, thus declining to prescribe a definition of the insider trading offense or its elements, or to articulate the explicit public policy warranting regulation. The void created by the lack of congressional direction enabled the insider trading doctrine to evolve as ad hoc regulatory and judge-made law, a development that raises particularly

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171.  See Painter et al., supra note 103, at 203 (remarking that Congress’ unsuccessful efforts in 1984 and 1988 to address deficiencies in insider trading law by statute “not only failed to define insider trading, but also provided no persuasive guidance on the issue for the courts”).
172.  See, e.g., infra note 436 and accompanying text.
173.  See id.
175.  See infra notes 438-449 and accompanying text.
176.  See Fisch, supra note 83, at 182-84 (noting that the lack of clear guidance defining the conduct insider trading rules prohibit hinders efficient operation of capital markets, fails to provide adequate notice of violations, and “present issues of interpretation that are simply unacceptable in a criminal statute.”).
177.  See infra notes 169-170 and accompanying text.
178.  See infra note 186 and accompanying text.
179.  See Fisch, supra note 83, at 179-80 (“The legal uncertainty has been attributed to the absence of a statute defining the prohibited conduct.”) (citing other sources).
180.  See supra notes 161-62 and accompanying text.
acute concerns in connection with enforcement of the securities laws through 
criminal proceedings.  

The courts have not done any better filling in the gaps, with several Supreme 
Court interventions responsible for making conditions worse. Rather than 
remedying the elemental weaknesses embedded in the jurisprudence originating 
with Cady, Roberts’s legal concept of classifying insider trading as fraud in 
violation of Section 10(b) and Rule 10b-5, the Supreme Court’s successive 
interpretations of the doctrine have aggravated the problem. In three opinions 
rendered from 1980 to 1997, Chiarella v. United States, S.E.C. v. Dirks, and 
United States v. O’Hagan, the Court not only failed to establish a coherent and 
consistent jurisprudence to govern insider trading, but also left more questions 
open than resolved through the legal holdings in its decisions.

Recently, Salman presented the Court with another occasion to review 
insider trading law and potentially enunciate a coherent doctrine clarifying some 
of the intricacies that continued to vex its jurisprudence during the twenty years 
since O’Hagan. On the narrowest terms, it essentially reaffirmed the personal 
benefit and knowledge principles governing tipper/tippee liability that the Court 
had adopted in Dirks in 1983, the same rules that were the source of intense 
conflict again in the Martoma opinions. Beyond reaffirming Dirks, faults and 
all, Salman achieved little else. In brief, after Salman, as evident in the Martoma 
I and Martoma II opinions, the pervasive incoherence and obscurities that imbue 
insider trading law remain in force by virtue of the Court’s missed opportunities
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to clarify. Consequently, because of the likelihood that the Supreme Court will not consider insider trading jurisprudence again for years to come, Salman highlighted the compelling need to reform the prohibition through congressional action or formal SEC rulemaking.190 The lack of a unifying rationale in the Supreme Court’s insider trading doctrine, coupled with the imperative of uniform legal theory and public policy, legislative or regulatory imprint by Congress or the SEC can perhaps most effectively resolve the underlying concerns.191

The vacuum that congressional inaction and inadequate Supreme Court guidance have created in this body of law offers an opportunity to fill the gap. A statutory or regulatory model that would eliminate the existing Section 10(b) and Rule 10b-5 fraud doctrine and its fictional components, and replace it with a distinct fairness-based offense defined under Section 16, would offer responsive improvement.

III. THE MUDDELESS REALLY GETS MUDDLED

In the wake of the Great Depression of the 1930s, set in motion in part by the stock market crash in 1929 and the ensuing collapse of the country’s capital markets, Congress adopted far-reaching measures designed to protect investors from marketplace manipulation and deception, promote integrity and confidence in the marketplace, and strengthen the stability of the financial industry.192 In furtherance of those purposes, Congress enacted the Securities Act193 and the Exchange Act.194 Those statutes, along with implementing regulatory and

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190. See Donald C. Langevoort, Words from on High About Rule 10b-5: Chiarella’s History, Central Bank’s Future, 20 Del. J. Corp. L. 865, 865 (1995) (noting that “[a] securities law decision by the United States Supreme Court is an extraordinary event” and that the Court “does extremely little of the adjudicatory work in securities law”).

191. As one authority expressed this point: “with full appreciation of the advantages of the common law’s ad hoc approach, it still seems clear that [insider trading] jurisprudence . . . has developed to the point where it cries out for the kind of philosophic consistency that only studied legislation can provide.’” Painter et al., supra note 103, at 219 (quoting LOUIS LOSS & JOEL SELIGMAN, 8 SECURITIES REGULATION 3762 (3d ed. 1991)).


193. See 15 U.S.C. § 77a. Section 17(a) of the Securities Act (“Section 17(a)”), referring to “fraudulent interstate transactions,” makes it unlawful for any person, in connection with a securities transaction, to use any device, misrepresentation, or practice to mislead or to defraud. See 15 U.S.C. § 77q.

194. See 15 U.S.C. § 78a et seq. Exchange Act Section 10(b), building on the anti-fraud provisions of Section 17(a), prohibits “manipulative and deceptive devices,” to this end granting regulatory and enforcement powers to the SEC. See 15 U.S.C. § 78j(b). In an exercise of that authority, the SEC promulgated Rule 10b-5, for this purpose drawing from language of Section 17(a) specifying the fraudulent practices declared unlawful. See 17 CFR 240.10b-5. On a different track, by means of Rule 14e-3, the SEC declared insider trading in connection with tender offers to constitute a fraudulent practice. See 17 CFR 240.14e-3. The rule was adopted pursuant to the SEC’s enforcement authority under Section 14(e) of the Williams Act of 1968, 82 Stat. 454, 15 U.S.C. § 78n(e), which Congress enacted as an amendment of the Exchange Act to regulate tender offers. See United States v. O’Hagan, 521 U.S. 642, 667 (1997). But unlike the standard governing liability under Section 10(b) and Rule 10b-5, breach of
enforcement actions by the SEC, government prosecutions, and court interpretations, as well as the various legal theories that have emerged from applications of the prohibition, compose the doctrinal “hodgepodge” that characterizes insider trading regulation. In day-to-day practice, this gives rise to the morass that critics roundly decry. The substance and standards these statutes and rules embody have one central quality in common: they relate to proscription of conduct, promulgation of principles, and imposition of liability that the securities laws do not expressly define. At the same time, Congress has consciously opted not to provide legislative direction. Hence, insider trading restrictions developed in a virtual statutory blank space that the SEC and the courts have endeavored to occupy.198 But they have done so by means of doctrine that from the start was only tenuously tethered to the text of the underlying statutes. In that respect, insider trading regulation was conceptually and structurally defective.

A. Original Fault: The Five Fictions of Insider Trading Fraud

To bolster the theory that insider trading constituted a “manipulative or deceptive device,” and therefore fraud under Section 10(b) and Rule 10b-5, the SEC and subsequently the courts, developed a complex doctrine composed of five interrelated principles required to warrant imposition of insider trading liability: (1) an insider, (2) fiduciary duty, (3) disclosure, (4) personal benefit, and (5) deception. Each of these concepts embodies constructive elements which this Article refers to as “fictions of insider trading fraud.”

The bewilderment insider trading law generated from its origins to this day is best explained and understood in terms of why and how the constituent doctrines on which the prohibition is predicated are fictional. That characterization rests on two vital points. First, these components of insider trading liability, both in principle and in operation, are substantially grounded in

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196. See Bainbridge, supra note 115, at 38 (noting that the development of federal insider trading regulation “occurred not through congressional legislation but through a process of SEC rule-making and judicial interpretation under [Section 10(b)];” Nagy, supra note 83, at 1322 (“In the United States, the law of insider trading is essentially judge-made. The critical role courts plays is a function of the fact that no federal statute directly prohibits the offense of insider trading.”); Fisch, supra note 83, at 186.
197. See supra note 161-62 and accompanying text. In connection with considering amendments to the Exchange Act in 1984 and 1988, Congress declined to adopt a definition of conduct that constitutes unlawful insider trading. Instead it expressed satisfaction with leaving the matter to the development of standards by the SEC and the courts. See infra note 417 and accompanying text.
198. See supra note 187 and accompanying text.
199. See id.
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legal fictions. Specifically, they relate to constructive doctrines devised and perpetuated by the SEC and the courts to overcome obstacles that arise when controlling rules are technically and rigidly applied and produce undesirable results or conflict with another policy goal. Second, though the standards are doctrinally prescribed to establish insider trading violations under Section 10(b) and Rule 10b-5, in practice some courts, prosecutors, and regulators have tended to gloss over, distinguish, or simply disregard them as the occasion or a desired result compelled in particular circumstances; for example, by finding insider trading liability despite the conspicuous absence of one or more of the purported requirements.

Consequently, a crucial first step in framing an appropriate response to relieve the complexity of insider trading law, whether by legislative, regulatory, or judicial means, would call for a detailed analysis bearing on two inquiries: (1) the extent to which the core principles that determine insider trading violations are fictional in the sense suggested here, and (2) how the constructive rules operate in practice to bring about adverse effects for the effective administration of justice and efficient operation of capital markets. On this view, an effective streamlining of insider trading doctrine would begin by uprooting each of the fictional principles from insider trading doctrine.

1. Fiction of the Insider

Traditionally, the notion of the corporate “insider” encompassed high-ranking officers, directors, and controlling shareholders who owed fiduciary duties to the company and its shareholders by virtue of their direct relationship. This included the obligation to disclose material facts in financial dealings with the company or its shareholders. In Cady, Roberts, the SEC found an outside trader, Robert Gintel,

201. See supra notes 162, 165-66 and accompanying text.
202. See, e.g., Landgevoort, Fine Distinctions, supra note 103, at 440 (noting that insider trading is “not really fraud, even though we have chosen to call it fraud in order to preserve and embellish the useful message of investor protection,” and that the Supreme Court permitted the Cady, Roberts theory of “constructive fraud to survive the fiduciary principle” in order for the judiciary “to retain[] control over the scope of the law.”).
203. See, e.g., Nagy, supra note 83, at 1319 (“Despite the Supreme Court’s explicit dictate that fiduciary principles underlie the offense of insider trading, there have been recent repeated instances in which lower federal court and the [SEC] have disregarded these principles. On some occasions, judicial adherence to fiduciary principles would have dictated ruling in favor of defendants charged with insider trading, but courts essentially ignore those principles.”).
204. See, id.; see also id. at 1321 (noting that it would be preferable to replace current insider trading enforcement theories with a federal statute defining the prohibited conduct, “rather than allowing lower courts and the SEC to continue on a course of revisionism and results-oriented decisionmaking.”).
206. See infra notes 326-42 and accompanying text.
liable for insider trading under Rule 10b-5. Gintel was not a corporate insider in the traditional sense because he had no direct relationship to the issuer, Curtiss-Wright, whose shares were involved, nor did he owe a fiduciary duty to the company. Rather, Gintel was a brokerage firm partner of the real insider, J. Cheever Cowdin, a Curtiss-Wright director who inadvertently divulged to Gintel nonpublic information about a dividend the Curtiss-Wright board had declared.

To overcome these conceptual hurdles in a finding of Gintel’s liability for a violation of Section 10(b) and Rule 10b-5, the Commission conceived a fiction by extending the application of the term “insider” to encompass a larger universe. According to the Commission’s analysis, an insider was “any person” on whom the obligation to disclose confidential information before buying or selling securities may be imposed by virtue of two considerations: “[F]irst, the existence of a relationship giving access, directly or indirectly, to information prior to trading in securities intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.”

Applying this standard, the SEC determined that Gintel qualified as an indirect temporary insider by virtue of his relationship with Cowdin. It therefore found that Gintel’s purchases and sales of the Curtiss-Wright shares at issue violated Section 10(b) and Rule 10b-5. The Commission’s reasoning thus introduced an artifice into insider trading law. In essence, the decision opened the door for outsiders to transform into corporate insiders by virtue of some professional or personal connections, laying the groundwork for a vast body of litigation and literature about the contours of relationships which the term “insider” embraced. Following its formulation in Cady, Roberts, the test describing persons who hold “a special relationship with a company,” and thus are eligible for treatment as insiders, expanded significantly to embrace professionals such as the corporation’s lawyers, bankers, and accountants. But as insider trading law further evolved, the term became far more elastic. Its bounds stretched to outlandish lengths to classify as insiders a broad range of

209. See id. at *2.
210. Id.
211. Id. at *4.
212. Id.
213. Id.
214. See id.
215. See id.
216. See infra note 209 and accompanying text.
217. Id., at *7.
218. See Fisch, supra note 83 at 201-03; Painter et al., supra note 103, at 177, 190.
219. See Fisch, supra note 83, at 201-03.
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persons who bore scant to no connection to the corporation whose shares were the subject of the underlying transaction. That domain swelled to cover, for instance, the securities transactions of outsiders affiliated with corporate insiders through relationships as diverse and removed from the underlying legal principle as office mates, psychiatrists, plumbers, barbers, relatives, and friends. None of these connections bear even a remote link to the corporation whose shares are involved in the particular transaction. Yet, the “insider” designation is extended to them to capture those trades within the web of Section 10(b) and Rule 10b-5 deception and fraud.

The SEC discerned a “logical sequence” in its original constructive designation of a corporate outsider as an insider based on the outsider’s relationship with an actual insider. But whatever connection may have existed, logical or not, the link became more forced and attenuated somewhere along that conceptual chain. Eventually it lost all practical meaning and severed altogether as the misappropriation theory of insider trading took hold. That doctrine dispensed with the necessity for the illusory tie between an outside trader and a “real” corporate insider through whom the outsider transformed into an insider and derivatively breached a fiduciary duty, acquired the insider’s disclosure obligation, and, by omitting to disclose material nonpublic information before trading, incurred liability for fraud in violation of Section 10(b) and Rule 10b-5. In essence, under the misappropriation doctrine and for the purposes of insider trading liability, any outsider may qualify as a misappropriator by obtaining and misusing confidential corporate information to buy or sell securities, thus warranting treatment by law enforcers as an “insider.” On its terms, mere articulation of the principle underscores its incongruence. Under the curious language and conceptual distortions by which insider trading regulation evolved in theory and practice, the doctrine of “insiders” experienced transfiguration: insider trading essentially morphed into outsider trading.

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220. See id.
221. See id.
222. See id.
223. See id.
225. See id.
226. See supra notes 207-208 and accompanying text.
227. See id.
228. See id.
229. See id.
230. See id.
231. See id.
The anomalous conversion of any outsider into a corporate insider for the purposes of insider trading liability analysis triggered related conceptual oddities. Constructive outsiders-turned-insiders who misappropriate and trade in securities based on confidential information have no relationship of trust and confidence with the corporation whose shares they buy or sell, and hence owe no fiduciary duty to it. Nonetheless, by reason of their insider securities transactions, they acquire a fiduciary obligation to disclose to the source any nonpublic information they possess relating to securities transactions. This is not based on deception of the corporation or counterparty with whom they trade, as is the case in relation to direct securities purchases or sales by real insiders, but deception of the source of the information. The additional levels of complications and aberrations that principle introduced into insider trading law is examined further in the following section and Part III.B.

2. Fiction of Fiduciary Duty

Like the rules that effectuated the constructive transformation of the insider, the fiduciary principles governing the insider’s relationship of trust and confidence that created a corresponding duty to disclose material nonpublic information prior to trading also underwent substantial modification as insider trading law developed, particularly with the introduction and application of the misappropriation theory of insider trading liability. This evolution occurred in two respects. First, it took place as potential liability expanded with insider trading law’s departures from adherence to traditional common law fraud rules. Second, the phenomenon that took root as the fiduciary principle also deviated from recognized common law concepts when distinguished, explained away, or disregarded by law enforcers where doctrinal barriers stood in the way of achieving the desired result in a particular case. To this extent, the principle of a relationship of trust and confidence triggering a fiduciary duty to disclose and serving as a requirement of insider trading liability under Section 10(b) and Rule 10b-5 continues to apply in many cases as a formality, though not always in actual practice. This development presents another aspect of the “fiduciary fictions” that insider trading regulation embodies.

In Cady, Roberts, Gintel, the outsider broker-dealer that the Commission’s insider trading liability analysis derivatively converted into an indirect temporary

232. See id.
233. See Painter et al., supra note 103, at 180.
234. See id.
235. See Nagy, supra note 83, at 1317-20.
236. See supra notes 154-58 and accompanying text.
237. See supra note 194 and accompanying text.
238. See Nagy, supra note 83, at 1319.
239. Id. at 1338-39.
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insider, had no actual connection to Curtiss-Wright. According to the SEC, however, he “undoubtedly occupied a fiduciary relationship to his customers.”

That connection gave rise to a duty for the constructive insider to disclose material nonpublic information which derived from a “special relationship” with the corporation. But, in reality, Gintel had no such connection, and presumably owed no fiduciary in this regard. Yet, the Commission determined that such a tie did exist. It constructed an affiliation through Gintel’s brokerage firm partnership relationship with Cowdin, the corporate director who provided Gintel with the nonpublic information on the basis of which Gintel traded in Curtiss-Wright shares.

Gintel, by failing to inform his customers before buying or selling Curtiss-Wright securities that he possessed material nonpublic information, committed a constructive breach of fiduciary duty. Under the circumstances, the Commission’s inquiry raised several basic questions. What connections and communications does a relationship of trust and confidence embrace? Who constitutes the source from which the insider’s fiduciary duty to disclose derives, and who should be treated as its beneficiary? What obligation does the fiduciary principle entail and how is it breached or fulfilled?

As a preliminary matter, the fiduciary duty doctrine that the SEC and the courts engrafted onto the insider trading doctrine as a requirement of liability stemmed from common law fiduciary duty principles. But those standards applied to communications exchanged within particular relationships demanding special trust and confidence, such as those of attorneys, physicians, clergy, trustees, and other professionals generally governed by state privilege and fiduciary duty law. In that context, the law attached a protective privilege to confidential disclosures made within the scope of the relationship.

As it encompassed corporate insiders’ transactions, the doctrine recognized a disclosure duty that officers and directors owed to the company, rather than to...
the shareholders, and in special circumstances extended only to dealings with the corporation’s existing shareholders.251

Importantly, the rule governed face-to-face securities transactions, not those occurring in anonymous public exchanges.252 Thus, the notion that insider trading through impersonal transactions executed in open exchanges constituted fraud in violation of Section 10(b) and Rule 10b-5 required ignoring or discarding these defining principles as they were understood and applied at common law. To accomplish that doctrinal transformation necessitated the fiction that insiders were invested with a fiduciary duty to disclose material facts in connection with securities trading, even when they were not actual insiders but only constructively so, and even in the context of trading with unknown investors in impersonal public markets. In theory, those principles would presumably serve as protection for counterparties, though they were anonymous persons with whom the full extent of the inside trader’s real business connection existed only fleetingly, more as an instantaneous technical contact than as a developed relationship.253

As happened in connection with the doctrinal conversion of an actual outsider into a constructive “insider,” the requirement of a relationship of trust and confidence and corresponding fiduciary duty also underwent a fictional metamorphosis. In its original classical model crafted in Cady, Roberts, insider trading liability derived from the existence of such a special relationship between buyer and seller of securities, and it generally arose from corporate officers dealing with the company’s shareholders.254 That relationship gave rise to a double-edged fiduciary duty that the insider directly breached by trading in the corporation’s securities and failing to disclose material nonpublic information in that connection, or indirectly by divulging such confidences to outside persons who then purchased or sold the company’s shares without disclosure to the counterparty. In either event, the insider involved, real or constructive,
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appropriates information developed for corporate business and misuses it for personal gain. To that end, the insider exploits the advantage enjoyed by having access to confidential knowledge to trade securities with investors unaware of the informational gap.

With subsequent SEC regulations, iterations, and enforcement proceedings, and court interpretations of those applications, a shift occurred in the central inquiry to determine the role of the fiduciary principle in the analysis of insider trading liability. As the law evolved after Cady, Roberts, the focus of the analysis changed to determine whether a relationship of trust and confidence that triggered an obligation to disclose material nonpublic information existed, not only between the insider and the corporation, but more generally between any securities buyer and seller. The obligation even extended to a connection with trading in impersonal markets where investors on the other side of the transaction are total strangers to the insider. In that context, both the notion of a relationship of trust and confidence, and, as examined the next section, the corresponding duty to disclose nonpublic information lost all real and practical sense when imposed as aspects of insider trading liability. Thus, like the other doctrines examined above, the insider’s relationship of trust and confidence with a corresponding disclosure duty also became an unnecessary “fiduciary fiction” that experienced “gradual demise.”

This phenomenon imported three distorting concepts into insider trading analysis. First, it stretched the notion of “fiduciary” and “relationship of trust and confidence” to nonsensical lengths, encompassing circumstances in which a fiduciary obligation clearly did not exist because the supposed insider/outsider had no real connection to the corporation, nor a practical means to comply with the disclosure obligation in contemporaneous anonymous transactions executed in impersonal markets. Consequently, for the purposes of technically satisfying the doctrine, some type of relationship had to be constructively devised. Cases involving outsider thieves trading in securities on the based on their stolen information, and insiders who communicate confidential information recklessly, illustrate this point. Second, to reach a finding of

255. See Painter et al., supra note 103, at 205-09.
256. See infra notes 290-294 and accompanying text.
257. See id.
258. See id.; Painter et al., supra note 103, at 208-09.
260. Id. at 1321.
261. See Painter et al., supra note 103, at 205-09.
262. See Nagy, supra note 83, at 1336; (noting the Supreme Court’s adherence to fiduciary principles in insider trading doctrine despite its lacking sense as a matter of policy, prompting some lower courts and the SEC to disregard that element liability in some applications and to devise “fiduciary fictions” to overcome the resulting doctrinal difficulties).
263. See supra, note 126 and accompanying text.
264. See supra, note 145 and accompanying text.
liability in cases where the outside trader had no direct connection to the corporation but obtained confidential information from an insider, as in the tipper/tippee context, required constructing an oblique means to establish such a link derivatively: the fiction of the constructive fiduciary by which an insider’s communication of confidential information in breach of a fiduciary could be imputed to the trading outsider.265 Third, the reconstructed fiduciary principle expanded absurdly the range of the communications that a relationship of trust and confidence encompassed.266 It then extended to disclosures regarding securities transactions that have no link whatsoever to the reasons that justify protecting privileged confidences revealed inside the bounds of certain special relationships.267 The reasons for the law’s protection of confidential communications conveyed within the borders of those recognized relationships are not implicated in many instances when the nonpublic information divulged falls outside the scope of the parties’ business or personal relationship.268

Perhaps because of such conceptual difficulties that regulators, prosecutors, and courts encountered in applying fiduciary principles to insider trading regulation, they began to craft artful ways to maneuver around or ignore the rules altogether.269 Thus, another gap opened in insider trading law, a crack between doctrine and reality, between the technical standards prescribed to impose liability, and how those rules were or were not enforced in practice. Commenting on this development, one scholar remarked: “Despite the Supreme Court’s explicit dictate that fiduciary principles underlie the offense of insider trading, there have been recent repeated instances in which lower federal courts and the


266. See supra notes 207-213 and accompanying text (discussing expansion of the concept of insider to encompass a large array of persons and relationships to a corporation or securities transaction).

267. See Painter et al., supra note 103, at 168-69 (noting that at the time the Supreme Court decided Chiarella, “there was . . . little evidence that Section 10(b) was ever intended to regulate relations formed outside the securities market and protect newspapers from their columnists, patients from their psychiatrists, spouses from each other, parents from their children, and state lotteries from their commissioners”); Sung Hui Kim, supra note 146, at 868-69 (noting that as a result of applying a vast array of vague factors to the determination of who qualifies as a fiduciary, “the universe of fiduciaries has gradually expanded to include such strange bedfellows as marriage brokerage agencies, commercial developers of inventions, psychiatrists, life tenants of property, and private hospitals. As a consequence, experts have described fiduciary law as amorphous, intrinsically non-rational, ill-defined, messy, atomistic, slippery, protean, confused, problematic, result-oriented, and elusive” ) (internal quotation marks and citations omitted).

268. See Painter et al., note 103, at 210 n.238 (noting that lawyers’ professional responsibilities generally prohibit disclosing confidential information “relating to representation of a client,” and thus “[i]nformation that does not relate to the representation is presumably outside the reach of the prohibition”).

269. See, e.g., S.E.C. v. Dorozhko, 574 F.3d 42, 49, 51 (2d Cir. 2009) (acknowledging that the SEC’s claim involved “a corporate outsider who owed no fiduciary duties to the source of the information,” and concluding that the SEC did not need to demonstrate a breach of fiduciary duty); Nagy, supra note 83, at 1337 (noting that “a host of lower courts and the SEC have in effect concluded that the offense of insider trading focuses on a person’s wrongful use of confidential information, regardless of whether a fiduciary-like duty is breached”).

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[SEC] have disregarded these principles. Disregarding the doctrine’s grounding as a central element of insider trading jurisprudence, the fiduciary duty fiction has emerged and has been ignored, for instance, in cases involving a trader’s acquisition of material nonpublic information through unlawful means such as unauthorized entry, theft, or hacking.

Most notable to the erosion of the fiduciary duty principle, and thereby evidencing its doubtful necessity as a pivotal component of insider trading doctrine, are two points concerning the Supreme Court’s outlook towards the doctrine’s standing. First, the Court has failed to take into account the manifestly odd applications of the fiduciary principle, or even to acknowledge its apparent substantive flaws and growing irrelevance. In fact, remarkably, the Court has gone to great lengths in a contrary direction to reaffirm the fiduciary duty principle as a linchpin of its insider trading jurisprudence. In each of its insider trading opinions from Chiarella to Salman, and especially in O’Hagan, where its application made the least sense, the Court emphatically embraced the fiduciary doctrine as essential to insider trading liability analysis. Second, the disintegration of the fiduciary duty obligation requirement, largely because of its fictional role in practice, has gained ground despite its repeated explicit recognition and reaffirmation by the Supreme Court.

270. Nagy, supra note 83, at 1319. Three instances of this phenomenon set in motion by SEC regulations include Rule 14e-3, prohibiting deceptive practices in connection with tender offers, Rule 10b5-1, which governs pre-existing agreements to purchase or sell securities, and Rule 10b5-2, which provides that a violation of Rule 10b-5 may arise where a person agrees not to disclose nonpublic information and breaches that promise. See 17 CFR 240.14e-3, 17 CFR 240.10b5-1, 17 CFR 240.10b5-2. For a discussion of how these rules operate to erode the principle of breach of fiduciary duty as a doctrinal component of Rule 10b-5 liability articulated in Supreme Court jurisprudence, see Nagy, supra note 83, at 1353-64.

271. See Nagy, supra note 83, at 1340 (noting that “a growing number of courts simply disregard this fiduciary dictate when it forecloses liability against a defendant who has traded securities based on wrongfully obtained information”) (citing cases).

272. See, e.g., United States v. Cherif, 933 F.2d, 403, 404(7th Cir. 1991); S.E.C. v. Wilson, 03 Civ. 2938G, 2003 WL 22907913 (N.D. Tex. 2003); S.E.C. v. Dorozhko, 574 F.3d 42, 45 (2d Cir. 2009). Dorozhko illustrates this point. There, the Second Circuit Court of Appeals, recognizing that the defendant, a computer hacker, was a corporate outsider who owed no fiduciary obligation to the source of the information he misappropriated, explicitly cast aside the fiduciary principle, concluding that the securities laws as embodied in Supreme Court opinions do not require establishing a fiduciary relationship or a breach of a duty of confidence as an element of a securities claim under Section 10(b). See 574 F.3d at 45.

273. See Nagy, supra note 83, at 1337 (noting that “[f]rom a doctrinal perspective, the [Supreme] Court’s fiduciary foundation for insider trading liability under Rule 10b-5 was shaky from the start.”); see also id. at 1336, 1339 (noting that although the Court’s affinity for fiduciary principles “makes no sense as a matter of policy,” the Court in O’Hagan “nonetheless painted fiduciary principles with an extremely broad brush” (referencing O’Hagan v. United States, 521 U.S. 642 (1997))).

274. See id. at 1339-40 noting that “[t]aken together, Chiarella, Dirks, and O’Hagan evidence a Supreme Court willing to stretch fiduciary principles to no small degree, when doing so facilitates a desirable policy outcome.”

275. See id.; id. at 1337-40.

276. See id. at 1340 (“Although several lower courts have adhered strictly to the Supreme Court’s dictate that insider trading liability must be predicated on deception by a fiduciary, a growing number of
one commentator remarked that: “on some occasions, judicial adherence to fiduciary principles would have dictated rulings in favor or defendants charged with insider trading, but courts essentially ignored those principles. On other occasions, courts have ignored fiduciary principles where adherence to them would have established the defendant’s liability.” In consequence, on this doctrinal point as well, the break in insider trading law between rule and reality inevitably engendered substantial uncertainty and confusion in the law and potential weakening of confidence in the securities marketplace.

### 3. Fiction of Disclosure

In virtually every application of insider trading regulation to cases after *Cady, Roberts*, the SEC and the courts have declared, with mantra-like repetition and consistency, the precept that the prohibition compels an insider who knowingly possesses material nonpublic information to disclose it or abstain from trading. Typically, these pronouncements are stated in conclusory, emphatic, and formulaic terms. Yet, they contain little or no elaboration of what precisely “disclosure” means and give no thought to the consideration that in the context of anonymous impersonal markets the notion of disclosure of confidential information is nonsensical. Statements of the concept offer no rationale, but merely repeat by rote the doctrinal phrase “disclose or abstain.”

Conceptually, disclosure of nonpublic information makes most practical and business sense where the obligation stems from an exercise of a corporation’s duty to reveal material facts when it is about to enter into a transaction to purchase or sell its own securities, or to announce a significant discovery or new product, and the insider possesses knowledge of confidential information that courts simply disregard this fiduciary dictate when it forecloses liability against a defendant who has traded securities based on wrongfully obtained information.

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277. *Id.* at 1319.

278. In the original statement of the doctrine, the Commission declared that if disclosure under the circumstances “would be improper or unrealistic . . . the alternative is to forego the transaction.” In re *Cady, Roberts & Co.*, 40 S.E.C. 907, 1961 WL 60638, at *3 (S.E.C. Nov. 8, 1961). In *Chiarella*, the Supreme Court, citing *Cady, Roberts*, endorsed the SEC’s concept of “[t]he obligation to disclose or abstain.” *Chiarella v. United States*, 445 U.S. 222, 227 (1980). See also *United States v. O’Hagan*, 521 U.S. 642, 652 (1997) (reaffirming that a relationship of trust and confidence gives rise to a duty to disclose or abstain from trading); *Dirks v. S.E.C.*, 463 U.S. 646, 659 (1983) (holding that “the tippee’s duty to disclose or abstain is derivative from that of the insider’s duty”); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 848 (2d Cir. 1968) (stating that “anyone who possesses material nonpublic information “must either disclose it to the investing public, or . . . must abstain from trading” or recommending the securities).

279. See supra note 268 and accompanying text.

280. See, e.g., *Wang*, supra note 153, at 1249, 1252-1255 (discussing the impracticalities and anomalies of securities trading in anonymous markets). See *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith*, 495 F.2d 228, 238 (2d Cir. 1981) (discussing tippees’ objection to imposition of an obligation to “disclose or abstain” relating to information about a company they had no association with, in part because public disclosure to the world by, for example, calling a press conference may not have been effective if no one showed up).

281. See supra note 268 and accompanying text.
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could affect the price or economics of the transaction. Under such circumstances, a clear point in time and workable methods exist – such as public announcements to the media or the stock exchanges, filing of documents, or meetings with shareholders – for the company to provide proper public disclosure of material information that could affect the price of its securities.

The notion of a corporate insider’s obligation to reveal confidential corporate information before trading has little practical relation to transactions executed on modern securities markets. This is for the same reason that distorts the concept of insiders and fiduciary principle: the disclosure duty developed as an aspect of fraud liability by omission that arose in connection with face-to-face transactions. When extended to persons executing anonymous trades on impersonal public exchanges, such legal obligation raises formidable practical complications. In this respect, the concept embodies another doctrinal fiction that implicates numerous complex issues. Who does the inside trader disclose confidential information to so as to properly comply with this aspect of the fiduciary obligation? How can the insider disclose confidential information, which the trader typically has acquired by improper means, without incurring liability on multiple grounds if he or she does proceed with the transaction? Does the required disclosure consist of revealing the nonpublic information itself to the corporation, to its source, to the counterparty, or to the market in general? Or does the required disclosure comprise the insider’s intention to trade in the shares of the corporation while possessing knowledge of confidential facts? If the trader is a tippee, does disclosure absolve the insider of Section 10(b) and Rule 10b-5 liability? Would the disclosure by the tippee affect the tipper’s potential insider trading liability?

As the preceding questions suggest, disclosure to the inside source of the information, or to the corporation itself, may have no value or effect. Either one may already be aware of the particular circumstances, or may not care that the information is made public by an unauthorized source. Or if they do mind and object to the disclosure, the insider, having technically fulfilled the disclosure obligation, could choose to go ahead with the transaction without fear of any

282. See, e.g., Texas Gulf Sulphur, 401 F.2d at 845-48 (describing a company’s disclosure by press release of information about a major oil discovery and transactions in the corporation’s shares that company insiders executed on the basis of such knowledge before it was fully public); Cady, Roberts, 1961 WL 60658, at *2 (disclosure of company stock dividend by communication to the stock exchange and transactions by company directors before the news was published).

283. See supra note 272 and accompanying text.

284. See supra note 270 and accompanying text.

285. See infra notes 324-331 and accompanying text.

286. See Wang, supra note 153, at 1255 (noting that “[a]nomalies, practical difficulties, and theoretical problems in finding harmful deceit exist in a stock market inside trade,” and that consequently the discussion of a duty to disclose to the victims of impersonal insider trading is “academic . . . because the inside trader usually cannot identify his potential victim and therefore cannot disclose to him”); see also id. at 1252.

287. See, e.g., id. at 1249, 1252-1255.
potential liability for securities fraud or concern for any consequences to the corporation or other investors.\textsuperscript{288} That prospect is most likely to occur where the trader is an outsider with no relationship or duty of loyalty to the corporation.\textsuperscript{289} More importantly, disclosure to the corporation or to the source of the information would do nothing to satisfy the fiduciary duty that\textit{Cady, Roberts, Chiarella,} and\textit{Dirks} all mandate: disclosure to the buyers or sellers on the other side of the securities transaction as a means of protecting investors against deception and the unfairness of corporate insiders taking advantage of nonpublic information in purchasing or selling securities.\textsuperscript{290}

Disclosure to unknown counterparties in securities transactions conducted on impersonal markets is a chimeraic notion with no workable means of execution. Most incongruous, according to the odd logic the Supreme Court promulgated in\textit{O’Hagan},\textsuperscript{291} by virtue of such disclosure, and despite the trader’s commission of other offenses such as breach of duty or theft, an insider could be absolved of liability under Section 10(b) and Rule 10b-5.\textsuperscript{292} The insider’s disclosure of the confidential information followed by trading in the corporation’s shares could undermine, delay, or even wreck the underlying transaction, potentially causing the issuer to cancel the deal or pay a higher price to proceed with it.\textsuperscript{293} Such conduct could also harm other investors who purchase or sell at about the same time at a price higher or lower than they might otherwise have paid.\textsuperscript{294}

The complexities created by a disclosure requirement may also implicate difficulties for the trader and other persons to whom confidential information is divulged. If, to comply with the fiduciary principle, the insider reveals a

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\item See Painter et al.,\textit{ supra} note 103, at 180-81.
\item See\textit{O’Hagan}, United States v. O’Hagan, 521 U.S. 642 (1997). Under\textit{O’Hagan}, at odds with what the Court had declared in\textit{Chiarella and Dirks}, the constructive insider need not have any relationship with the corporation or shareholders whose securities are the subject of the transaction, or with the counterparty. The trader could be any person who, through unauthorized means, obtains nonpublic information that upon disclosure could affect the price of securities. The\textit{O’Hagan} Court stated that the disclosure duty arising from any relationship of trust and confidence within the expanded universe of outsiders-turned-insiders is “owed not to the trading parties, but to the source of the information.” Id. at 653. This formulation thus opened a new world of controversy and litigation as to whether a relationship of trust and confidence compelling disclosure exists in innumerable categories of interpersonal connections, including family, friends, and professional and business ties.
\item See Painter et al.,\textit{ supra} note 103, at 180 (noting that under\textit{O’Hagan}’s conception of insider trading doctrine, “[o]nce the intent to trade is disclosed to the principal,, the trading is legal under Section 90(b), no matter how strenuously the principal objects.”)
\item See, e.g.,\textit{SEC} v. Texas Gulf Sulphur Co., 401 F.2d 833, 845-48 (2d Cir. 1968).
\item See, e.g.,\textit{O’Hagan}, 521 U.S. at 656 (noting that inside trading by misappropriators “deceives the source of the information and simultaneously harms members of the investing public.”); Jesse M. Fried,\textit{Insider Trading Via the Corporation}, 162 U. PENN. L. REV., 801, 806 (2014) (“When insiders use private information to time their personal trades, they directly reduce public shareholders’ returns. Each dollar reaped by insiders comes at public investors’ expense. This diversion of value reduces public investors’ expected returns and increases firms’ cost of capital.”).
\end{enumerate}
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Insider Trading

confidence to the securities purchaser or seller, or alerts the corporation or the source of the information about the contemplated trade on the basis of material facts not publicly available, that action could subject the insider or other persons to potential Section 10(b) liability, for example as aiders and abettors. That dilemma poses a maze of additional incongruities at each level of the liability analysis. As one commentator described such irrationality: “[I]f the insider tips in breach of a duty of nondisclosure, it is illogical to find that this duty of nondisclosure is converted, in the hands of the tippee, into a duty to disclose.”

Relatedly, the bigger ambit of persons and relationships encompassed by the disclosure obligation under the misappropriation theory gave rise to other complications concerning the practical scope, method, and consequences of disclosure. In O’Hagan, the Supreme Court contributed to the confusion by creating a safe haven with a pronouncement that represents perhaps the most peculiar and confounding aspect of its opinion. According to the Court’s cold logic, because the person defrauded by insider trading is not the other party to the transaction but the source of the information, “if the fiduciary discloses to the source that he plans to trade on the nonpublic information, there is no ‘deceptive device’ and thus no § 10(b) violation.” Stretching the theory of this proposition to the ends of its reasoning, an outsider who discloses to the source of the nonpublic information his intent to purchase or sell the securities of an issuer would reap undeserved gains, and incur no Rule 10b-5 liability from a self-interested action, despite its demonstrably harmful consequences to the issuer of the underlying securities, to counterparties and other investors, to the marketplace, and to the general public. The meaning of the insider trading disclosure duty – and in fact of the concepts of a fiduciary relationship and fraud as well – are strained and distorted to extreme limits in cases in which the fictional insider may be a random individual who happens to acquire nonpublic information purely by accident, such as inadvertently overhearing a conversation.

295. See, e.g., Wang, supra note 153, at 1222 (discussing the quandary created by the duty to disclose and noting that if the insider “sells without disclosing to the buyer, he commits fraud. If he discloses and his buyer trades on the basis of the information, the [insider] is liable as a tipper. This dilemma is compounded when full disclosure to the world is infeasible”); see also id. at 1249 (“Ironically, each revelation to a potential party in privity might itself be grounds for rule 10b-5 liability, if the recipient of the information traded on the basis of the revelation. By attempting to avoid liability, the initial information possessor would have inured it. If the selective revelation is a per se violation even in the absence of a trade by the tippee, the initial information possessor is in violation of the rule whether or not he discloses the information”).

296. Fisch, supra note 83, at 210 (emphasis in original).


298. Id. Expressing the disparity of this escape hatch from insider trading liability, one scholar noted that “[o]nce the intent to trade is disclosed to the principal, the trading is legal under Section 10(b), no matter how strenuously the principal objects. Thus, if O’Hagan had told his law firm and its client that he was trading before he did so, he presumably would not have violated the statute.” Painter et al., supra note 103, at 180.

299. See Wang, supra note 153, at 1234-35 (“[E]ach act of inside trading does in fact harm other individuals”); see also id. at 1222, 1249-1253; Painter et al., supra note 103, at 175, 179, 187; Fried, supra note 294 at 806.
between a corporate officer and another person in a restaurant or a taxi, or by unlawful means such as an insider’s unauthorized view of private papers after an illegal entry, theft, or computer hacking.\textsuperscript{300}

To the extent the SEC and the courts have been aware of the preceding issues, they have tended either to brush them aside or turn a blind eye to the impracticality of the disclosure mandate.\textsuperscript{301} Perhaps these issues are ignored, dismissed, or minimized precisely because law enforcers, if they have considered the problem, realize that disclosure is not a feasible option, but overlook the infeasibility because the insider theoretically has a convenient alternative: to abstain from trading.\textsuperscript{302} On this point, for instance, in \textit{Cady, Roberts} the SEC acknowledged but dismissed the argument that substantial “practical difficulties” may arise in complying with the disclosure obligation in impersonal open markets transactions.\textsuperscript{303} The Commission, however, did not respond to the concern in any depth.\textsuperscript{304} It brushed the issue aside, simply stating that if disclosure prior to a securities purchase or sale “would be improper or unrealistic under the circumstances . . . the alternative is to forgo the transaction.”\textsuperscript{305} But this dismissive proposition minimizes the practical dimensions of the doctrine.\textsuperscript{306} Because in practice the disclosure option in the context of impersonal trading on a public exchange is an unworkable fiction, in reality the only alternatives available for the insider who possesses material nonpublic information and plans to purchase or sell securities are to abstain or to commit fraud by tipping or trading.\textsuperscript{307} Insofar as the disclosure principle serves no meaningful purpose in

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\item[300] See, e.g., S.E.C. v. Dorozhko, 542 F.3d 42 (2d Cir. 2009) (computer hacking by foreigner from abroad); S.E.C. v. Cherif, 933 F.2d 403, 411 (7th Cir. 1991) (unlawful entry by former bank employee); S.D.C. v. Switzer, 590 F. Supp. 756, 761-62 (W.D. Okla. 1984) (conversation between corporate executives that the fictional insider overheard from the stands of a football field). It is improbable and fanciful to expect that, according to the doctrine, a thief, before placing an order to buy or sell securities on the basis of nonpublic information obtained from stolen papers, would pause to call the owner of the documents to reveal the misappropriated confidential matters and convey his or her intent to trade. Equally unreal is the prospect that by taking this step, which is devoid of any purpose related to the stated objectives of insider trading regulation, the thief would be absolved of liability under Rule 10b-5, regardless of the havoc or harm such action may bring upon other parties affected by the transaction.
\item[301] See, e.g., supra notes 293-95 and accompanying text.
\item[302] See id.
\item[304] See id. at *5-6.
\item[305] Id. at *3.
\item[306] Under some circumstances, for instance, a person may incur Rule 10b-5 liability even if he or she does not trade. See, e.g., Shapiro v. Merrill Lynch, Pierce, Fenner & Smith 495 F. 2d 228, 236-37 (2d Cir. 1974).
\item[307] See, e.g., Shapiro, 495 F.2d at 238 (analyzing the tippee’s disclosure, abstention, and trading options and concluding that if disclosure is not feasible, the tippee’s only choice is to refrain from trading); see also Wang, \textit{supra} note 153, at 1253 (noting that “[w]ith a publicly traded security, individual disclosure to [an open market] potential victim is impossible, and public disclosure is not helpful. Even if individual disclosure were possible, this type of potential victim would not be better off because he probably could not utilize the information without violating rule 10b-5 himself. In either event, the inside trade would be objectionable not because of any harmful fraud, but because of the harmful effects of the act itself”).
\end{footnotes}
real-world securities markets, there is no justification for giving it recognition as a component of established doctrine. In a comprehensive overhaul of insider trading law, the concept would be abandoned.

4. *Fiction of Personal Benefit*

The “personal benefit”\(^{308}\) element of insider trading regulation stemmed from the expansion of Section 10(b) and Rule 10b-5 liability to encompass the tipper/tippee relationship. The *Dirks* Court endorsed the SEC’s fiduciary duty principle but constructed another fiction as a “limiting principle”\(^{309}\) intended to narrow the doctrine’s application in the tipper/tippee context. To that end, the Court devised the doctrine described above requiring that the insider tipper realize a personal benefit from divulging nonpublic information to a tippee.\(^{310}\)

The *Dirks* personal benefit standard, vague by any measure, engendered decades of legal controversy, court analyses rendering conflicting rulings, extensive scholarly discourse expressing a broad spectrum of views, and unsynchronized prosecution and SEC law enforcement policies and strategies.\(^{311}\) Combined or separately, these developments tend to sow further uncertainty in the securities industry. The *Martoma* litigation, as this Article observed above, opens but a small window into that much larger bewildering debate.\(^{312}\) In that enterprise, law enforcers have struggled with developing a coherent and principled analysis for determining each component of the personal benefit test, taking into account the many subtleties and complexities of human behavior that might motivate a person to purposefully reveal a confidence in breach of a business or personal obligation or promise not to.\(^{313}\) Specifically, that inquiry entails: what type of (1) tipper breach of duty; (2) tipper personal benefit; (3) tipper/tippee relationship; and (4) tippee knowledge of the tipper’s breach and personal benefit, would suffice to meet the requirement.\(^{314}\)

The authorities have searched high and low for direct signs and circumstantial clues to decipher the tipper’s motivation for revealing a confidence, gauging any personal benefit exchanged and weighing evidence of the tippee’s awareness that a breach of duty lay somewhere behind the tipper’s divulging of nonpublic information.\(^{315}\) At times the personal benefit inquiry has

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\(^{308}\) The term derives, like each of the other fictions examined here, derives from the SEC’s decision in *Cady, Roberts*. See *Cady, Roberts*, 1961 WL 60638, at *4.

\(^{309}\) *Dirks v. S.E.C.*, 463 U.S. 646, 664 (1983)

\(^{310}\) *See supra* notes 11-19 and accompanying text.

\(^{311}\) *See infra* notes 304-13 and accompanying text.

\(^{312}\) *See supra* notes 63-64 and accompanying text.

\(^{313}\) *See infra* notes 306-15 and accompanying text.

\(^{314}\) *See Dirks*, 463 U.S. at 662-64, 667.

\(^{315}\) *See, e.g.*, *Salman v. United States*, No. 15-628, 2016 WL 285583 at *2-3* (Appellate Brief) (May, 13, 2016), Brief of the NYU Center on the Administration of Criminal Law as Amicus Curiae in Support of Neither Party (observing that courts “have had great difficulty determining in a coherent fashion whether a given benefit to the tipper is sufficiently 'objective' or 'consequential,' or whether a
taken the search to metaphysical depths and semantic heights several levels removed from the original source of the confidence.316 Most telling for the purposes of the analysis and central argument here are the cases where the personal benefit standard was simply irrelevant to a finding of liability.317 Questions and conflicts developed over the meaning of a gift of information;318 the knowledge of a benefit;319 the closeness of the relationship from which a motive for a gift or a personal benefit could be inferred;320 and whether the benefit must be expressly pecuniary and concrete;321 or could extend to intangibles such as an unspoken psychological, reputational, or goodwill reward.322 Courts are split over whether the personal benefit standard applies in misappropriation cases,323 with some even questioning its continuing vitality altogether.324 Again, as occurred in relation to the other insider trading doctrinal fictions, the uncertainty and conceptual qualms that the personal benefit requirement generated in some cases led the SEC and lower courts to undercut or overlook its application in all cases.325 Noting this point, one commentator observed that after Dirks, “the SEC has tried to minimize its burden, and this

friendship between the tipper and the tippee is sufficiently close, to satisfy the element. As a result, courts have reached inconsistent outcomes based on arbitrary distinctions that have no basis in § 10(b) . . . and that have nothing to do with securities trading or even the disclosure of information that is material to securities trading”).

316. See id.

317. See, e.g., S.E.C. v. Obus, 693 F.3d 276, 286 (2d Cir. 2012) (holding that insider trading in violation of Rule 10b-5 may be based on the tipper’s reckless conduct, and specifying the elements of the insider trading scienter analysis that do not include reference to a tipper’s personal benefit).

318. See, e.g., Salman v. United States, 137 S. Ct. 420 (2016) (affirming a finding that confidential information provided to the tippee by his brother constituted a gift sufficient to satisfy the personal benefit test).

319. See, e.g., United States v. Evans, 486 F.3d 315, 323 (7th Cir. 2007) (finding that a violation of Rule 10b-5 may exist where the tippee receives nonpublic information knowing it is unauthorized, even if the tipper is not aware that the disclosure was improper, thus effectively discarding the personal benefit requirement).

320. See, e.g., Obus, 693 F.3d at 291; United States v. Salman, 792 F.3d 1087, 1093 (9th Cir. 2015), aff’d, Salman v. United States, 137 S. Ct. 420, 427 (2016) (finding a sufficient inference of a personal benefit from the tipper’s family relationship with the tippee).

321. See United States v. Salman, 792 F.3d 1087, 1092 (9th Cir. 2015).

322. See, e.g., Obus, 693 F.3d at 291; United States v. Cuban, 620 F.3d 551, 557 n.38 (5th Cir. 2010) (noting that the insider’s tip to a major shareholder may have generated a benefit as goodwill).

323. See, e.g., S.E.C. v. Yun, 327 F.3d 1263, 1269-70 (11th Cir. 2003) (holding that the personal benefit test applies in misappropriation cases); S.E.C. v. Libera, 989 F.2d 596, 600 (2d Cir. 1993) (stating the elements of insider trading liability under the misappropriation theory that did not specify a personal benefit requirement); David T. Cohen, Note, Old Rule, New Theory: Revising the Personal Benefit Requirement for Tipper/Tippee Liability under the Misappropriation Theory of Insider Trading, 47 B.C. L. REV. 547 (2006).

324. See, e.g., Obus, 693 F.3d at 286 (suggesting that the personal benefit element is not a requirement of the analysis of intent for insider trading liability); see also S.E.C. v. Willis, 777 F. Supp. 2d 1165, 1172 n.7 (S.D.N.Y. 1991); S.E.C. v. Mussella, 748 F. Supp. 2d 1028, 1038 n.4 (S.D.N.Y. 1989), aff’d, 898 F.2d 138 (1990). As Salman and the Martoma opinions amply demonstrate, the personal benefit requirement is very much alive and still sowing discord, even in its state of limbo. See supra notes 1-59 and accompanying text.

process has now reached a point where some might argue that the [personal benefit] requirement no longer exists in practice."

Familiar reasons underlie the controversy over the nature and application of the personal benefit standard and highlight the doctrinal concerns it raises. One of the most fundamental flaws of the personal benefit rule is that it inverts the focal point of the analysis of wrongful conduct, thus potentially distorting the outcomes in two respects. In the analysis of the personal benefit standard for tipper/tippee liability as articulated in *Dirks* and reaffirmed in *Salman*, the inquiry about the wrongdoing centers on a distorted definition of the offense insofar as it concentrates less on the tipper’s culpability in committing a wrongful act or the harm the misconduct may produce to the particular investor victim, to the corporate issuer, or to the capital marketplace, than on his relationship with the tippee and motive for conferring a potential gain on the tippee. On this reading of the personal benefit requirement, these considerations are apparently irrelevant to the analysis of a tipper/tippee insider trading offense. In other words, the test focuses on any reward the offending insiders realize by breaching a fiduciary duty, and on the trading advantage they intend to give to the recipient of the confidential disclosure because of some gain the tipper obtains by making the informational gift. In the typical case, however, nowhere in the statement of the elements of the personal benefit standard is there express reference to the losses and other wrongs the offender inflicted on the victims of the offense: the investors and shareholders harmed by the insider trading transaction, or of the detriment experienced by the corporation whose shares are improperly traded, or by the capital markets generally. Yet, as some commentators have remarked,

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326. *Id.*

327. Generally, wrongful conduct is evaluated by several legal principle that take into account and weigh the severity of the offense and culpability of the offender as well as the harm cause or threatened to the victim and the public at large. *See generally* Solem v. Helm, 463 U.S. 277, 291-92 (1983) (expressing broad principles governing assessments of wrongful conduct. *But see* Salman v. United States, 137 S. Ct. 420, 427 (2016) (“In *Dirks*, we explained that a tippees exposed to liability for trading on inside information only if the tippee participates in a breach of the tipper’s fiduciary duty. Whether the tipper breached that duty depends ‘in large part on the purpose of the disclosure’ to the tippee . . . The test . . . is whether the insider personally will benefit, directly or indirectly, from this disclosure.’” (quoting *Dirks*, 463 U.S. 646, 662 (1983))). Arguably, this test appears to focus the determination of liability more on the offender’s motive and the personal benefit conferred than on the harm caused to the victim and the public. *See also* Crimmins, *supra* note 325, at 347.

328. *See* Langevoort, *Fine Distinctions*, *supra* note 103, at 448 (noting that the *Dirks* Court may have been enunciating a unique state of mind test, insofar as under prevailing insider trading law after Hochfelder “the insider’s purpose and motivation appear to be crucial, whereas in the normal 10b-5 case the standard is knowledge or recklessness, neither of which makes purpose or motivation important.”); *id.* at 452 (noting that in a Second Circuit decision interpreting *Dirks’s* personal benefit standard, the court ruled that the requirement is not part of a scienter inquiry, but rather “[what] the court seems to do here is reconnect benefit from intention, rendering intention superfluous.”) (discussing S.E.C. v. Obus, 693 F.3d 276, 286 (2d Cir. 2012)).

329. *See supra* note 318 and accompanying text.

330. No mention of such concerns appears, for instance, in the courts’ formulation and discussion of the personal benefit standard in *Salman*, 137 S. Ct. at 427, *Dirks*, 463 U.S. at 662-64, or Martoma I, 869 F.3d 58, 63-64 (2d Cir. 2017).
those investors and interests are not only the real victims of unlawful insider trading, but the persons that the securities laws were designed to protect.\footnote{See Fried, supra note 294 and accompanying text.}

The following hypothetical illustrates the conceptual anomalies the personal benefit principle creates. T, a thief, meaning to cause injury to A, robs B, a relative of A, and donates half the proceeds to T’s close brother C, and the other half anonymously to charity D, both of whom invest their portion of the money and reap large profits. Analogizing this fact pattern to traditional insider trading analysis, whether T, C, and D committed actionable offenses for which they may be held liable would turn not on the financial loss and other harm B suffered from the theft, considerations that hardly enter into the inquiry, but on: T’s relationship to C and D, whether T obtained a personal benefit from the robbery, what motive T had in giving the proceeds to C and D, and whether C and D knew of the gain T derived from donating the stolen proceeds to C and D. What often makes the results of such analysis aberrational and renders the debate about it pointless, is that the personal benefit principle could be dispensed with altogether simply by shifting the theory of liability, so that, based on the identical facts, proof of that element would not be required to find a violation of Section 10(b) and Rule 10b-5.\footnote{For instance, there is authority holding that in actions brought under the misappropriation theory, the personal benefit requirement does not apply. See, e.g., supra, notes 314-15 and accompanying text. The personal benefit test would also not apply to securities fraud cases based on the same facts brought under the Sarbanes-Oxley Act, 18 U.S.C. § 1348. See supra note 63 and accompanying text. Nor would the personal benefit standard matter if the underlying action involves communication of nonpublic information in connection with a tender offer in violation of Rule 14e-3. See supra note 185 and accompanying text.}

Conversely, viewing the insider trading prohibition from the standpoint of protecting the interests of investors and capital markets from the harms caused by wrongful insider trading, none of the doctrinal guideposts governing the personal benefit rule actually matter. To the unsuspecting contemporaneous investor who purchases or sells securities while placed in an inherently unfair disadvantage in relation to an insider who possesses price-sensitive confidential information, it is of no consequence what reasons the tipper has for divulging a confidence to the trading tippee. Nor should the manner the communication is conveyed be of any concern, or for whose benefit that motive is expressed. Equally beside the point in the personal benefit inquiry are the relationship between the inside communicator and the outside trader; whether or not a breach of fiduciary duty occurred; and the tippee-trader’s awareness of the insider’s misconduct. Rather, what should count in the analysis is the insider’s unfair exploitation of an informational edge to trade in securities and realize undeserved gains, all at the expense of uninformed counterparties, and at the risk of undermining confidence in the integrity of the marketplace.
Moreover, none of the personal benefit requirements are consequential if ways to avoid them exist and law enforcers use such means to avoid strict compliance with the standard. Such undermining of established rules, however, comes at the price of injecting confusion and distortions into the law. For that reason, the better course for reform of insider trading regulation is a model that eliminates the personal benefit standard as well.

5. Fiction of Deception

A fifth fiction of insider trading fraud emerges as a composite of the preceding four constructive principles—a breach of fiduciary duty in a relationship of trust and confidence, an insider’s omission to disclose knowledge of material nonpublic information to a securities buyer or seller, and a personal benefit derived by an insider’s divulging such information to a trader. When those standards arise in connection with a securities transaction, insider trading doctrine, as structured at its conception, combines them into the requirements of a prohibition and calls the mixture deception and fraud in violation of Section 10(b) and Rule 10b-5. That conclusion created an artifice constituting another insider trading legal fiction. The concept was inherently flawed on multiple doctrinal, structural, and practical grounds, thus comprising perhaps the most fundamental and consequential error that modern insider trading law embodies. On this basis, all of the basic deficiencies associated with the other insider trading constructive principles stem from the fiction of deception. The fraud theory thus bears the cumulative ill-effects that the doctrine has inflicted upon the securities laws and capital markets.

Doctrinally, a common law fraud cause of action, as understood and applied when the securities laws were enacted in the early 1930s, generally required evidence of several elements: (1) the defendant’s misrepresentation of material fact with knowledge of its falsity and intent to deceive; (2) the plaintiff’s detrimental reliance on the false statement made in connection with the transaction; and (3) the plaintiff’s injury as a result of the reliance.

333. See Langevoort, Fine Distinctions, supra note 103 at 432 (noting that the Supreme Court in Chiarella, while narrowing the scope of the prohibition, “still sustained the fiction of insider trading as actionable deception”); id. at 459 (“[D]eception in insider trading is largely fictional”); id. at 440 (stating that insider trading “is not really fraud, even though we have chosen to call it fraud in order to preserve and embellish the useful message of investor protection.”).

334. See Langevoort, supra note 190, at 879 (noting that in a line of cases endorsing the SEC’s expansive view of Rule 10b-5, “the deception . . . is little more than secret faithlessness to the trust expected by the source of the information. That does seem very close to conjoining deception and fiduciary breach”); see also id. at 876 (noting that the Supreme Court’s rulings in Chiarella and Dirks, which adopted Cady, Roberts’s application of Section 10(b) and Rule 10b-5 to insider trading, were not persuasive because they “rely on forced views of the common law antecedents of disclosure obligations under the law of fraud”); Nagy, supra note 83, at 1337-38 (describing the “fiduciary fictions” that the Supreme Court’s insider trading opinions embrace); id at 1323; Dooley, supra note 124 at 59 (“Insider trading in no way resembles deceit. No representation is made, nor is there any reliance, change of position, or causal connection between the defendant’s acts and the plaintiff’s losses”); Bainbridge, supra note 115, at 37-38; Fisch, supra note 83, at 186.
underlying transaction; (3) resulting harm; and (4) a causal relation between the loss and the wrongful conduct. The standard generally did not apply to omissions, so that a defendant had no obligation to disclose nonpublic information he or she possessed about the transaction, except where special circumstances existed that imposed a duty to speak. Concerning purchases or sales of corporate securities involving shareholders, and in particular trades between corporate insiders and other existing stockholders, the fraud rules applied to face-to-face transactions, not to those executed anonymously on impersonal exchanges. Thus, when Congress adopted the Securities Act in 1933 and the Exchange Act in 1934 and declared unlawful any fraudulent or deceptive practice committed in connection with securities transactions, its specific use of those terms could only have contemplated the substance and structure of the common law deception and fraud doctrine as then understood and enforced.

The SEC’s application of Section 10(b) and Rule 10b-5 to insider trading in Cady, Roberts fundamentally departed from recognized common law fraud principles and thus substantially altered the analysis of liability for the misconduct. In that manner, the ruling crossed new legal frontiers. But in doing so the Commission employed a faulty premise bolstered by meager analysis, thereby preparing groundwork for a doctrinally compromised

335. See RESTATEMENT (SECOND) OF TORTS § 525 (1977); Stoneridge Invest. Partners., LLC v. Scientific-Atl., Inc., 552 U.S. 148, 157 (2008). There was substantial division in common law doctrine as to whether failure to disclose material facts in face-to-face transactions gave rise to liability for fraud. See Nagy, supra note 83, at 1323 (noting that “[t]he common law generally imposed liability for affirmative misstatements. Fraud by silence was actionable in limited circumstances, and the default rule was one of caveat emptor”). However, responding to the harsh results the caveat emptor doctrine often produced, courts gradually moved away from it by creating exceptions, in particular where special circumstances warranted a different rule. See, e.g., Strong v. Repide, 213 U.S. 419 (1909) (holding that a corporate director may owe a duty to disclose to a shareholder with whom he is trading any special facts he knows that could affect the price of the securities). The RESTATEMENT (SECOND) OF TORTS provides that a duty to disclose arises when one party possesses information that the other party “is entitled to know because of a fiduciary or other similar relationship of trust and confidence between them.” § 551(2)(a). The duty may also arise “where one party’s superior knowledge of essential facts renders a transaction without disclosure inherently unfair.” Chiarella v. United States, 445 U.S. 222, 248 (1980) (Blackmun, J., dissenting) (citing RESTATEMENT (SECOND) OF TORTS § 551(2)(e), Comment l (1977)).

336. See Nagy, supra note 83, at 1323; Fisch, supra note 83, at 186.

337. See Goodwin v. Agassiz, 186 N.E. 659, 661 (Mass. 1933) (holding that under state law, corporate directors could not be held liable for failing to disclose material facts in connection with securities purchases on a public exchange); Bainbridge, supra note 115, at 37-38; Fisch, supra note 83, at 184-87.

338. See Bainbridge, supra note 115, at 37-38; Fisch, supra note 83, at 184-87.


340. The SEC acknowledged that its conception of the scope of Section 10(b) and Rule 10b-5 stretched beyond traditional common law. It declared in Cady, Roberts that the antifraud provisions of the securities statutes and regulations aim at reaching deceptive practices “whether or not they are precisely and technically sufficient to sustain a common law action for fraud and deceit.” Id. at *3; see also id., at *5 (stating that regardless of distinctions made at common law between the fiduciary duties corporate insiders owed in connection with purchasing and selling securities, “it is not appropriate to introduce these into the broader anti-fraud concepts embodied in the securities acts”); see also Langevoort, supra note 190, at 879.
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regulatory scheme. In the form presented in *Cady, Roberts*, the incidence of insider trading involved a corporate director disclosing material nonpublic information to a business partner who then traded in securities of the insider’s company on the basis of that confidential knowledge. To justify a result that such conduct qualified as deception in violation of Section 10(b) and Rule 10b-5, the Commission contrived a theory and developed a corresponding enforcement structure of fraud substantively composed of the various legal fictions described above. That project, as subsequently endorsed by the courts, sought to achieve an apparently tortured result: to force regulation of anonymous securities transactions into a legal mold that had developed in the context of traditional face-to-face transactions. As characterized by one commentator, that enterprise amounted to “gerrymandering of fraud.”

In this respect, *Cady, Roberts* constitutes perhaps the single most important contributor to the doctrinal challenges that plague insider trading law. For this reason, though historically the decision may have acquired “the status of a relic,” close examination of the SEC’s rationale highlights how the analysis is fundamentally deficient. This, in turn, sheds light on the development of the confusion insider trading regulation presents, and could be instructive in the formulation of a comprehensive judicial, regulatory, or legislative reform of insider trading law.

As the Commission conceptualized the deception at issue in *Cady, Roberts*, the wrongful conduct involved not a misrepresentation but an omission – the insider trader’s failure to disclose to his counterparties the nonpublic price-sensitive information he possessed about the transaction that likely would have influenced a reasonable investor’s decision to buy or sell the stocks at issue. The common law traditionally imposed on corporate insiders who obtain nonpublic information by virtue of their access to confidential knowledge – generally high-level officers and directors – a fiduciary duty to disclose material facts about the company or its transactions prior to trading in the corporation’s stocks with existing shareholders. An insider’s failure to make such disclosure to the counterparty would constitute a breach of that affirmative obligation. In the SEC’s extension of the doctrine such breach of duty by omission to disclose, to the same extent as by affirmative misrepresentation, qualified as a manipulative or deceptive device and fraud in violation of Section 10(b) and Rule

341. *See supra* note 325 and accompanying text.
343. *See Part III.A.
345. *See supra* notes 326-28 and accompanying text.
347. *Langevoort, supra* note 207, at 1319.
350. *See id.*
10b-5. In fact, the wrongful conduct the SEC and courts prohibited and enforced as insider trading deception and fraud was not fraud but other species of harmful behavior that various common law causes of action recognized and redressed, for instance: negligence, misrepresentation, breach of fiduciary duty, or corporate wrongdoing.

By expanding fraud principles beyond their common law contours to encompass omissions of material nonpublic information in connection with securities transactions executed in impersonal exchanges, the restructured doctrine presented several conceptual hurdles. In principle, it is difficult to escape the conclusion that sufficient ground to support a fraud claim simply does not exist absent a clear demonstration of the traditional elements governing the cause of action – a misrepresentation or omission, deceptive intent, reliance, causation, and loss. A finding of liability in such circumstances is especially hard to reconcile in view of Supreme Court securities jurisprudence, articulated most forcefully in private securities litigation, explicitly instructing that fraud means fraud, and therefore that to impose liability in a securities action grounded on deception demands sufficient evidence satisfying each of the required standards. As one commentator explained this discrepancy: “[N]o one has even been able to articulate a robust theory of harmful marketplace deception arising from insider trading. The insider’s order is anonymous, communicating nothing except the fact of a trade, inducing no one else to take the other side except as an independent choice to offer liquidity. So where is the detrimental reliance? On whom, or what?”

351. See Langevoort, supra note 190, at 879 (noting that in the misconduct identified by some courts in finding insider trading liability under Section 10(b) and Rule 10b-5 “the deception . . . is little more than secret faithlessness to the trust expected by the source of the information. That does seem very close to conjoining deception and fiduciary breach”); see also id. at 876 (noting that the Supreme Court’s rulings in Chiarella and Dirks, which adopted Cady, Roberts’s application of Section 10(b) and Rule 10b-5 to insider trading, were not persuasive because they “rely on forced views of the common law antecedents of disclosure obligations under the law of fraud”).

352. See supra note 325 and accompanying text.

353. See Stoneridge Invest. Partners, LLC v. Scientific-Atl., Inc., 552 U.S. 148, 157 (2008). See also Chiarella v. United States, 445 U.S. 222, 234 (1980) (“Section 10(b) is aptly described as a catchall provision. But what it catches must be fraud.”); Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 476-78 (1977) (breach of fiduciary duty and corporate mismanagement absent evidence of deception are not sufficient to establish Section 10(b) liability); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976) (“The words ‘manipulative or deceptive’ . . . strongly suggest that § 10(b) intended to proscribe knowing or intentional misconduct;’ thus a showing of negligence alone is insufficient to state a violation of Section 10(b) and Rule 10b-5. See also supra note 181 and accompanying text. In this respect, the Court’s unexamined acceptance, the blind eye to the conceptual flaws manifested in Chiarella, Dirks, and other government or SEC enforcement actions, of the insider trading as deception and fraud doctrine applied to transactions in impersonal markets, stands at odds with its emphatic insistence on strict adherence with the common law fraud standards it has declared as prerequisites of liability in Stoneridge, Santa Fe Indus., Hochfelder and other the private securities litigation cases.

354. Langevoort, Fine Distinctions, supra note 103 at 431; id. at 440 (stating that insider trading “is not really fraud, even though we have chosen to call it fraud in order to preserve and embellish the useful message of investor protection.”).
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Enlarging the scope of Section 10(b) and Rule 10b-5 fraud principles to apply to insider trading transactions in impersonal markets also posed practical challenges in satisfying the evidentiary burdens of the expanded fraud concept. For instance: the infeasibility of disclosing material nonpublic information to unknown counterparties; establishing the insider’s intent to defraud when the victims are unknown; demonstrating the anonymous party’s detrimental reliance on the insider’s failure to disclose material facts; and determining the legal cause and scope of the harm the contemporaneous counterparty suffered from trading with the insider.\(^\text{355}\) If some of those investors may have been inclined to buy or sell the securities in question at the prevailing market price despite the insider’s withholding price-sensitive information, a circumstance which most investors would have no way of knowing or verifying, these evidentiary concerns are exacerbated.\(^\text{356}\)

Close review of the foregoing issues and grasping the distorting effect the insider trading fictions produce in propagating confusion in the jurisprudence are essential to gain a full understanding of the basic flaws embedded in the doctrine.\(^\text{357}\) As an initial step, any systemic overhaul of insider trading regulation, whether by judicial, statutory, or regulatory means, should encompass measures to excise each of the constructive principles from this body of law, clearing the ground for reform that begins at the core with a simpler prohibition.

Several points emerge from this analysis that suggest a more appropriate framework by which to reconstruct insider trading law to promote greater fairness and efficiency in its enforcement. The prohibition should be released from the burden of its fraud predicate and thereby removed from Section 10(b)’s harness. Instead, it should be classified as an offense bearing its own statutory grounding, unique qualities, and standards for assessing liability. To these ends, a restructured insider trading prohibition should reflect the distinct feature expressing the harmful effects that insider trading implicates: a person’s exploitation of a position of “superior knowledge of essential facts that renders a transaction without disclosure inherently unfair.”\(^\text{358}\)

B. The Court Wades In: The Bog Expanded, Confusion Compounded

There is another leading culprit in the story of how and why insider trading law developed into the quagmire it has become: the United States Supreme Court. By most accounts the Court, like a muddied upstream source, may be the


\(^{356}\) See id.

\(^{357}\) See, e.g., Nagy, supra note 83, at 1337-38 (describing the “fiduciary fictions” that the Supreme Court’s insider trading opinions embrace); Langevoort, Fine Distinctions, supra note 103, at 459 (stating that “deception in insider trading is largely fictional”).

\(^{358}\) Chiarella, 445 U.S. at 248 (Blackmun, J., dissenting) (citing RESTATEMENT (SECOND) OF TORTS § 551(2)(e), Comment l (1977)).
worst offender. In a series of cases spanning four decades from *Chiarella* to *Salman*, the Court approved the insider trading prohibition largely as devised by the SEC, though also variously endorsing, compressing, and expanding the doctrine. In this manner, the Court introduced into insider trading jurisprudence a substantial measure of faults, anomalies, and incoherence of its own making. Rather than address the problem head on, it has tended to ignore the issues, often by reiterating formulaic or conclusory expressions of the Section 10(b) and Rule 10b-5 fraud doctrine as it exists.

The Supreme Court’s failure to come to grips with a serious conceptual issue, made worse by adding its own layers of flawed doctrine, gives rise to additional concerns. In the vacuum created by the Court’s absence of guidance, law enforcers endeavor to contrive ways to work around or disregard perceived faulty principles, further complicating the already pervasive doctrinal vagueness and bewilderment. A vicious cycle then arises in which confusion builds upon itself and expands into ever larger circles. Each of the Supreme Court’s insider trading cases exemplifies how and to what extent analytic shortcomings in the Court’s conceptualization of insider trading regulation underscore the Court’s significant role in exacerbating the problems. Commentary has amply reported those failings and need not be reviewed in full here. Selected highlights are recited below insofar as they bear on the extent to which Supreme Court jurisprudence validated a legal theory of insider trading grounded on fictional principles, enabling a flawed prohibition and attendant confusion to take root.

In *Chiarella*, the Court affirmed the SEC’s conceptualization of insider trading as a species of fraud and deception in violation of Section 10(b) and Rule 10b-5. To get there doctrinally, the Court substantially reconstructed prevailing common law principles in two respects. First, the Court endorsed

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359. See generally Langevoort, supra note 190 at 870–78; Bainbridge, supra note 115, at 37-39; Painter et al., supra note 103, at 160-91.
360. See id.
361. See, e.g., Salman v. United States, 137 S. Ct. 420, 427 (2016) (“We adhere to Dirks, which easily resolves the narrow issue presented here.”); United States v. O’Hagan, 521 U.S. 642, 651-52 (1997) (“Under the ‘traditional’ or ‘classical theory’ of insider trading liability, § 10(b) and Rule 10b-5 are violated when a corporate insider trades in the securities of his corporation on the basis of material, nonpublic information. Trading on such information qualifies as a deceptive device’ under § 10(b), we have affirmed, because ‘a relationship of trust and confidence [exists]’. ”) (quoting Chiarella, 445 U.S. at 228); Dirks v. S.E.C., 463 U.S. 646, 654 (1983) (“In Chiarella, we accepted the two elements set out in Cady Roberts for establishing a Rule 10b-5 violation.”); Chiarella, 445 U.S. at 230 (“Thus, the administrative and judicial interpretations have established that silence in connection with the purchase or sale of securities may operate as a fraud actionable under § 10(b) despite the absence of statutory language or legislative history specifically addressing the legality of nondisclosure.”). See also Bainbridge, supra note 103, at 1632 (noting that the Court’s decision in *O’Hagan*, presented with alternative approaches “kept the [insider trading] prohibition in its securities fraud straight-jacket.”)
362. See supra notes 190-98 and accompanying text.
363. See id.
364. See supra note 350 and accompanying text.
366. See Fisch, supra note 83, at 188-89; Langevoort, supra note 190, at 871-72.
the strained fictional notion of fraud and deception the SEC had promulgated in *Cady, Roberts*.367 This concept, by the Commission’s own admission, was not constrained by “whether or not they are precisely and technically sufficient to sustain a common law action for fraud and deceit,” but rather was actuated by the SEC’s vision of the securities laws having “generated a wholly new and far-reaching body of Federal corporation law.”369

Despite accepting the core principle of the *Cady, Roberts* doctrine, the Supreme Court sought to retrench its application by strapping it to a reinforced doctrine of fiduciary duty.370 That principle recognized a relationship of trust and confidence existing between corporate insiders and shareholders and securities buyers and sellers.371 It imposed on corporate insiders an obligation to the shareholders on the other side of a purchase or sale of securities to disclose material nonpublic information the insider possesses about the issuer or the transaction and to abstain from trading on the basis of such knowledge.372 In accepting the SEC’s theory, the Court introduced all of the murkiness associated with fiduciary duty analysis into insider trading law.373

The *Chiarella* Court also engaged in its own selective restatement of the common law of deception.374 In support of its more vigorous fiduciary duty doctrine, the Court stated that liability for fraud by failure to disclose material nonpublic information before consummation of a securities trade arises “only when [the trader] is under a duty to do so.”375 The common law obligation relating to omissions, however, had broader application that directly touched upon the insider trading context.376 As Justice Blackmun pointed out in his *Chiarella* dissent, the doctrine also encompassed circumstances “where one party’s superior knowledge of essential facts renders a transaction without disclosure inherently unfair.”377

Perhaps most significantly, *Chiarella* rechanneled the course and overarching objective of insider trading regulation away from the path in which

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367. See id.
369. *Id. But see* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 473 (1977) (expressing concern about application of Section 10(b) and Rule 10b-5 that may effectively “federalize a substantial portion of the law of corporations that deal in securities, particularly where established state policies of corporate regulation would be overridden”); *see also* Langevoort, *Fine Distinctions*, supra note 103 at 430-31.
370. See Langevoort, *supra* note 103, at 872 (“Chiarella, then, was plainly a retrenchment decision, running against a broad based trend in both federal and state law.”)
372. See id.
373. See Painter et al., *supra* note 103, at 157; Langevoort, *supra* note 190, at 872-73.
376. See Langevoort, *supra* note 190, at 872 (“Disingenuously citing state law to support a rule that had long since ceased to apply, the Court held that a duty of disclosure to the marketplace would not arise absent a preexisting fiduciary relationship between buyer and seller.”); *Nagy*, *supra* note 83, at 1337-38.
it had evolved under Cady, Roberts and the Second Circuit’s decision in Texas Gulf Sulphur.\(^{378}\) The Chiarella Court effectively repurposed the aim of insider trading regulation and its disclosure obligation so as to promote rigid adherence to a fiduciary duty theoretically existing between insiders and buyers and sellers of securities with whom they trade.\(^{379}\) To this end, the Court expressly rejected the principle of promoting fairness and confidence in honest markets that could be fostered by preventing insiders from exploiting, for personal gain, access to confidential information developed for corporate purposes, thereby taking unfair advantage of investors who do not possess such access.\(^{380}\)

Building on the flawed deception theory it had endorsed in Chiarella, the Court in Dirks added several more layers of complexity to insider trading regulation.\(^{381}\) In that case, the Court, again without examining the baseline deficiency of the deception predicate, reiterated the principle that equated insider trading with fraud in violation of Section 10(b) and Rule 10b-5.\(^{382}\) But the Court expanded the scope of the prohibition by embracing its application to tipper-tippee relationships.\(^{383}\) In another attempt to circumscribe the parameters of the regulation, the Court imposed three requirements overlaid as elements of insider trading liability.\(^{384}\) It enlarged the concept of a fiduciary duty existing in a relationship between the parties to a securities transaction by holding that the disclosure obligation could originate indirectly from an insider/tipper and extend its scope to cover an outsider/tippee, thus imposing Section 10(b) and Rule 10b-5 liability derivatively.\(^{385}\) For the purpose of imputing the tipper’s unlawful conduct to the trading tippee, the Court enunciated the personal benefit standard as a limiting principle, thus enabling the propagation of the immense body of “confused and confusing”\(^{386}\) personal benefit principle jurisprudence described above. This principle conferred corporate insider status on a large and indefinite category of outsiders-turned-fiduciaries who trade securities on the basis of confidential information.\(^{387}\) Part III.A.4. elaborates on the analytical weaknesses

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\(^{378}\) See Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968); see also infra notes 459-67 and accompanying text.

\(^{379}\) See Langevoort, supra note 190, at 872-73.

\(^{380}\) See Chiarella, 445 U.S. at 233 (rejecting recognition of “a general duty between all participants in market transactions to forgo actions based on material nonpublic information” because “such a broad duty . . . departs radically from the established doctrine that duty arises from a specific relationship between two parties.”).

\(^{381}\) See Dirks v. S.E.C., 463 U.S. 646, 654-55 (1983). See also Nagy, supra note 83, at 1338-39 (noting that it is “more than a stretch” to say that the common law principle precluding co-conspirators from benefiting from a breach of an insider’s duty to the corporation “spawns a fiduciary duty of disclosure on the part of a tippee that would render his silence a fraud.”); Langevoort, supra note 190, at 872; Painter et al., supra note 103, at 166.

\(^{382}\) See Dirks, 463 U.S. at 654-55.

\(^{383}\) See id. See also supra note 373 and accompanying text.

\(^{384}\) See id. \(^{385}\) See id.; see also supra note 190, at 873; Nagy, supra note 83, at 1338-39.

\(^{386}\) Fisch, supra note 83, at 179.

\(^{387}\) See supra note 278 and accompanying text.
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and impracticalities of those faulty concepts. As stated there, each defective doctrine gave rise to countless controversies for litigants and law enforcers, and created substantial uncertainties in the capital markets.

_**O’Hagan**_ presents perhaps the most compelling illustration of the Supreme Court’s substantial contribution to the fundamental deficiencies of prevailing insider trading law.388 There, the Court affirmed the application of the misappropriation theory of insider trading liability.389 In doing so, however, it created several new conceptual inconsistencies that gave rise to baffling outcomes.390 First, the Court once more expanded the already abundantly illogical fiduciary duty principle.391 In _Chiarella_, the Court declared that the trader owed the insider’s fiduciary duty to disclose arising from a relationship of trust and confidence to the other party to the securities transaction relating to shares of the insider’s corporation.392 In _O’Hagan_, however, the trader was not a traditional insider, but a misappropriator.393 _O’Hagan_ had no relationship to the corporation whose stocks he bought and sold, nor to the investors with whom he traded.394 Rather, he was a partner of a law firm that represented a client involved in a confidential tender offer with the corporation whose shares _O’Hagan_ traded in.395 To overcome the conceptual impediment that application of the classical insider trading model presented under these circumstances, the Court declared that the insider’s fiduciary duty to disclose is owed “not to the trading party, but to the source of the information.”396 On the Court’s theory, the sources were _O’Hagan_’s law firm and its tender offer client.397 In effect, under this construction the misappropriating trader was constructively deemed both an insider and a fiduciary. Moreover, based on this reasoning the Court asserted that there would be no Section 10(b) violation if the misappropriating fiduciary discloses his intention to trade to the source of the nonpublic information.398

Second, the Court’s designation of the source of the confidential information as the beneficiary of the fiduciary obligation owed by the recipient created conflict with the rights and interests of other participants with significant stakes

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388. See Painter et al., _supra_ note 103, at 155 (noting that the Court in _O’Hagan_ “rendered a confusing opinion that left many questions unresolved.”); _id._ at 157 (noting the “pervasive inconsistencies” among lower court interpretation of the misappropriation theory and that the _O’Hagan_ decision “does little to clarify this ambiguous body of case law.”).
390. See Painter et al., _supra_ note 103, at 155, 157, 179-80, 188-200.
391. See _id._ at 179-180 (noting that _O’Hagan_ “permits a fiduciary to trade on material, nonpublic information with the consent of the principal. A fiduciary is permitted to trade even without the principal’s consent so long as disclosure is made to the principal first.”).
393. See _O’Hagan_, 521 U.S. at 653-54.
394. See _id._ at 647-48, 653-54.
395. See _id._
396. _Id._ at 658.
397. See _id._ at 647-48, 653-54.
398. See _id._ at 652-54.
in the underlying transaction: the issuer of the shares the insider traded, investors who purchased or sold those securities unaware of the informational advantage the insider possessed, and the capital markets potentially affected by the transaction.\textsuperscript{399} Reflecting this conflict, the Court’s opinion declared that ensuring honest capital markets and promoting investor confidence was an “animating purpose” of the securities laws.\textsuperscript{400} But the Court undermined that pronouncement of overarching legislative intent by the Court’s theory that the insider’s fiduciary duty to disclose nonpublic information in connection with securities trading is owed to the source.\textsuperscript{401} In this view, the person defrauded, who presumably is the victim entitled to claim the protection of the securities laws from the harms inflicted by insider trading, is neither the investor who trades at a substantial informational disadvantage and may have incurred consequential losses, nor the capital markets generally.\textsuperscript{402} The Court further undercut its reference to the securities laws investor and capital markets protection goals by its conclusory introduction of another conflicting legal principle – corporate property rights theory – into the insider trading liability analysis.\textsuperscript{403} Specifically, the Court remarked that “[a] company’s confidential information . . . qualifies as property to which the company has exclusive use.”\textsuperscript{404}

The Court’s property rights doctrine declares as the victim the “principal” who entrusted the trader with access to the confidence, and who is thus deprived of the “exclusive use of that information.”\textsuperscript{405} This notion runs counter to two essential principles the securities laws embody. First, any profits that the offender derives from insider trading and are disgorged during SEC enforcement proceedings are recovered for the benefit of private investors who suffer losses from unlawful insider trading transactions, not for the source of the nonpublic information.\textsuperscript{406} Second, Section 20A of the Exchange Act\textsuperscript{407} creates a private cause of action, enabling contemporaneous traders, and not the source, to sue for damages they incur from securities transactions with insiders.\textsuperscript{408}

\textsuperscript{399} See Painter et al., supra note 103, at 179 (noting that under the O’Hagan Court’s approach, “the trading itself does not trigger Section 10(b) liability. Neither does failure to disclose the information to the public or to other market participants. Rather, it is the failure to disclose the trading to the source of the information that is the critical deceptive act.”).

\textsuperscript{400} O’Hagan, 521 U.S. at 653.

\textsuperscript{401} See Painter et al., supra note 103, at 175 (noting that under the misappropriation theory the Court endorsed in O’Hagan, “[t]he critical determination in each case is whether a fiduciary relationship exists creating a duty to disclose to the principal the fiduciary’s use of information. At the very least, this inquiry is tangential to the fundamental policy concerns of Congress in enacting the 1934 Act: investor protection and integrity of the market.”).

\textsuperscript{402} See id.

\textsuperscript{403} See O’Hagan, 521 U.S. at 652.

\textsuperscript{404} Id. at 654.

\textsuperscript{405} Id. at 652

\textsuperscript{406} See LANGEVOORT, supra note 190 at 878.

\textsuperscript{407} See 15 U.S.C. § 78t-1(b)(1), (2).

\textsuperscript{408} See LANGEVOORT, supra note 190 at 878.
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Moreover, importing the information property rights theory into the insider trading liability context potentially creates substantial doctrinal confusion and bizarre outcomes in practice. If the informational property belongs to the corporation or source, those persons can legally control the use of the nonpublic information. Accordingly, several peculiar consequences could follow. The source may lawfully authorize insider trading by the recipient on the basis of nonpublic information, or else theoretically it could waive a violation of company policy against insider trading. Moreover, the trader could defy an instruction by the source not to proceed with the transaction and theoretically comply with the doctrine simply by making a pro forma disclosure of an intent to buy or sell securities on the basis of the nonpublic information. In any of these developments, conferring an informational property right on the corporation or source would tend to subordinate the interests and priority of investors and capital markets in the analysis of insider trading liability, and potentially frustrate the enforcement function of regulators and prosecutors, thus weakening the statutory framework of the securities laws. This is because, conceptually, information property rights theory is incompatible with the objective of investor protection as a central goal of Section 10(b) and Rule 10b-5 insider trading regulation.

C. Failing Grade

The extensive flaws that Supreme Court insider trading law embodies is commonplace in the commentary. So is the view that each time the Court has intervened to address unresolved issues, its opinions have created more doctrinal inconsistency and confusion, perhaps making matters worse. In fact, the Court’s insider trading jurisprudence has prompted an exhaustive literature amply documenting, in blunt and unflattering terms, the shortcomings of the Court’s opinions. As one commentator noted:

There seems to be general agreement that the Supreme Court has not done a very good job in the securities area, especially in recent years. Scholars operating in a wide spectrum of ideological and jurisprudential paradigms have criticized the Court’s recent securities opinions. Supreme Court securities law decisions typically lack a

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409. See Bainbridge, supra note 103, at 1645-46 (“If we are concerned with protecting the source of the information’s property rights, we generally ought to permit the source to authorize others to trade on that information. In contrast, legalizing authorized trading makes little sense if the policy goal is the traditional securities fraud concern of protecting investors and maintaining their confidence in the integrity of the markets”); id. at 1649 (“If a misappropriator brazenly discloses his trading plans to the source, and then trades (either with the source’s approval or over its objection), Rule 10b-5 is not violated.”

410. See id.
411. See id.
412. See id.
413. See id. at 1645.
414. See infra notes 409-441 and accompanying text.
415. See, e.g., Bainbridge, supra note 103, at 1632; Nagy, supra note 83, at 1339-40.
416. See Bainbridge, supra note 103; Nagy, supra note 83, at 1339-40.
broad, consistent understanding of the relevant public policy considerations. Worse yet, they frequently lack such basis as doctrinal coherence and fidelity to prior opinions.417

The discussion here focuses on another point related to this phenomenon. On every occasion from Chiarella to Salman in which the Court had the opportunity to correct the enduring errors embedded in its insider trading jurisprudence, the Court ignored or sidestepped the issue.418 The Court did not clarify the definition and scope of the prohibition, potentially relieving the doctrine’s substantive and structural weaknesses and eliminating the fictional constructions that burden prevailing law.419 Instead, it remained steadfast to its jurisprudence, at each turn choosing instead not only to adhere to the existing jurisprudential course despite its manifest primal flaws, but to reaffirm the core principle on which its insider trading doctrine stands: the much discredited theory of liability based on breach of fiduciary duty and fraud that gives the existing prohibition its wobbly doctrinal footings.420

Moreover, raising a perhaps even graver concern, is another troubling development commentators have noted that sound loud alarms which should be heard on high.421 It is the phenomenon that some lower courts, perhaps evincing frustration with the absence of coherence and consistency in the Supreme Court’s insider trading jurisprudence, and though paying respectful lip service to applicable opinions, have pursued directions guiding the evolutionary branching of the law that veer substantially from the Court’s precedents and guidance.422

Whether unconcerned about the conceptual defects embedded in insider trading law, oblivious to the critics, or untroubled by the lower courts’ redirecting the growth of the law onto a course at times deviating from the jurisprudential path charted by controlling Supreme Court precedent, the message the Court’s doctrinal entrenchment suggests is unambiguous. However the Court perceives the state of its current insider trading doctrine, whether right or wrong, deficient or sound, or through head-in-the-sand firmness and fidelity, the Court seems wedded to its doctrine.423 For this reason, the analysis returns to a point raised

417. Bainbridge, supra note 103, at 1636; id at 1589. (stating that the Court’s ruling in O’Hagan made a “hash” out of securities law); id. at 1591 ("The O’Hagan Court[ ] ducked, misunderstood, or mishandled virtually every issue presented by that case"); id at 1632 (“In most respects the Court left Rule 10b-5 in a worse state than it found it”); id. at 1633("[O’Hagan] posed more questions than it answered"); Langevoort, supra note 190, at 868 (“[S]cholars and learned practitioners . . . give[e] the Court’s securities law opinions low grades for logic, clarity, and usefulness in future cases); see also Langevoort, Fine Distinctions, supra note 103 at 441-446; Nagy, supra note 83, at 1324-36; Painter et al., supra note 103, at 160-87; Fisch, supra note 83, at 184-215.
418. See supra notes 265-68, 409-11 and accompanying text.
419. See id.
420. See, e.g. supra note 352 and accompanying text.
421. See infra notes 418-25 and accompanying text.
422. See id.
423. A complicating obstacle is that not only the Supreme Court but apparently Congress and the SEC as well seem satisfied with existing insider trading rules despite their fundamental failings. See Fisch, supra note 83, at 180 n.5 (noting that "when Congress promulgated the Insider Trading Sanctions Act of
earlier. If the major overhaul of insider trading law is to occur, it is unlikely to originate from the Supreme Court. This reality lends more immediacy to pursuing reform by legislation or formal regulatory action.

D. A House Divided

The Supreme Court’s internally conflicted approach to securities regulation manifested in *Chiarella*, *Dirks*, and *O’Hagan* has produced noteworthy consequences in two other respects. First, the push and pull of insider trading legal principles driven in contrary directions, at different times even while reviewing the same concept, have yielded irreconcilable liability determinations, breeding further inconsistency in the securities laws. Second, a Supreme Court insider trading philosophy at odds with itself has emerged from the polarized responses this phenomenon has engendered within law enforcement circles. In any hierarchy, disparities, mixed signals, and a lack of a clear directional compass at the top tends to register variably, at times colliding, across the tiers down the ranks. At the ground level of the legal system where formally established rules are given effect, flawed jurisprudence similarly takes expression in discordant directions as it is interpreted and applied by law enforcers. Some lower courts, regulators, and prosecutors generally incline to toe the mark; they strive in good faith to observe controlling interpretations, adhering as nearly as possible to the literal meaning and application of the instructions that come from above.

But devout observance may have a downside. On occasions in which the high court’s logic and reasoning leave palpable gaps in controlling jurisprudence, or create compelling doubt about its wisdom, rigid orthodoxy tends to propagate bad law. By contrast, other law enforcers recognize the fundamental challenges that Supreme Court guidance poses when precedents create confusion

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1984 it considered including a definition of insider trading but decided not to so, believing that the existing substantive law was adequately clear.”); *id.* at 181 n.7 (“The SEC has continually opposed the enactment of a statutory definition” of insider trading, fearing enactment of a rule would create gaps in the law).

424. *See*, e.g., *infra* note 428 and accompanying text.

425. *See infra* notes 420-428 and accompanying text.

426. *Langevoort, supra* note 190, at 865 (“Adjudication of securities law disputes is a task reserved almost exclusively for the lower courts and, to a lesser extent, SEC administrative proceedings”); *Bainbridge, supra* note 103, at 1640 (noting that because of the infrequency of the Supreme Court’s securities opinions, “the ballgame typically is not the specific pronouncement the Supreme Court makes [in] a given case, but how that pronouncement is interpreted, extended, and/or restricted by the lower courts. Lower court judges frequently engage in creative reinterpretation of Supreme Court opinions in this area. . .”).


428. *See id.*

429. *See Nagy, supra* note 83, at 1340 (noting that the Supreme Court’s faulty insider trading law methodology “may well have emboldened lower courts to approach new cases with similar results-oriented reasoning”); *TXO Prod. Corp. v. Alliance Res. Corp.*, 509 U.S. 443, 500 (1993) (“[All judges] know how to mouth the correct legal rules with ironic solemnity while avoiding those rules’ logical consequences.”) (O’Connor, J., dissenting).
or leave substantial room for uncertainty. In response, they take greater liberties with the law handed down. Even if paying respectful lip service to the higher authority, where the given standard appears ambiguous or would generate unduly severe results, this judicial philosophy seeks grounds for drawing distinctions, pronouncing elaborations, or offering clarifications. This tendency, according to one commentator, may “cause a gradual reversion back to the status quo or trend.” In effect, that trajectory could arc in opposite directions. In some respects, it may shift the law backwards. In other ways it may intitate a course heading forward in new directions.

In particular, by means of such reaction and resistance, both passive and active, some of the responses the SEC and the lower courts have adopted to address troublesome insider trading doctrine have produced ad hoc adjustments of the rules that, irrespective of the Supreme Court’s jurisprudence, have operated to pare down their fictional edges and thus mitigate their application. If adding some doctrinal conflict and confusion into the mix, however, this undercurrent has produced other fundamental, sometimes salutary effects. Gradually eroding the force of insider trading doctrine’s constructive elements, it has tended, consistent with the notion of “legal equilibria,” to revert the trend of insider trading law toward the regulatory structure prevailing in an earlier regulatory regime.

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430. See Langevoort, supra note 190, at 865-68.
431. See, e.g., id. at 873 (noting the tendency of the lower courts to construe Chiarella and Dirks as narrowly as possible, demonstrating “a consistent willingness to fiduciarize any person who came into possession of information he or she knew — or should have known — came from someone who was misusing it”).
432. See Nagy, supra note 83, at 1321 (remarking that Supreme Court insider trading jurisprudence is “unique in the liberties taken by courts and the SEC to simply ignore such dictates whenever their application would produce outcomes inconsistent with overarching policy objectives”); id. at 1340.
433. Langevoort, supra note 190, at 867 (referring to the concept termed “legal equilibria”). Explaining this phenomenon, Professor Langevoort remarked that: “If the state of the law was generally well-settled or steadily moving in a particular direction prior to the Court’s decision, any departure from that status quo or trend will be met with resistance in the lower courts. Unless the Supreme Court’s decision either (a) was particularly persuasive or (b) reflects a significant break in political consensus that the lower courts find especially resonant, then dynamic interpreters will cause a gradual reversion back to the status quo or trend.” Illustrations of this development may be found in some of the prominent cases in which lower courts and the SEC strained to give effect to various aspect of the Supreme Court’s insider trading jurisprudence that raised practical concerns, especially where it represented substantial departures from long-established principles. See id. at 872-76 (noting that “lower courts have restored an analytical structure that emphasizes the way the information is obtained and used rather than any disclosure obligation based on pre-existing relationships”); id. at 867 n.7 (citing cases presenting instances where judges “have refused to accept a passive enforcement role” and have sought to materially modify Supreme Court doctrine); id at 887 (noting instances of “lower court revisionism that, while officially giving due respect to the Court’s decision, quietly nudges the law back toward the status quo.”).
434. See Langevoort, Fine Distinctions, supra note 103, at 461 (noting the leading role played by the judges of the Second Circuit Court of Appeals in “preserving and extending [SEC Chairman] Cary’s original ideas as against the competing impulses of federalism and restraint”).
435. Id.
436. See id.; Bainbridge, supra note 103, at 1603 (noting that the SEC used the misappropriation theory “as a means of curving the prohibition back towards the direction in which Texas Gulf Sulphur had initially set it.”); Nagy, supra note 83, at 1364-65 (“[I]nsider trading jurisprudence . . . has shifted almost
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fraud and fiduciary duty doctrines, that conceptualization reduces to a simpler model of insider trading prohibition in a substantial respect. It has closer connection with the securities laws’ overriding public policy objectives of protecting investors and capital markets.

To a substantial degree, the streamlined doctrine described in the preceding paragraph approaches the fairness-based concept of equality of access to information articulated by the SEC and some lower courts following Cady, Roberts. But, ironically, a formidable obstacle still slows the course of this evolution: the Supreme Court’s firm adherence to its contrary jurisprudence based on the principles of deception and fraud by breach of fiduciary duty, despite the scorching commentary, conflicting directions of lower court rulings, and growing signs that in practice the law may be trending in a countervailing course. Nonetheless, because Supreme Court review of particular issues occurs relatively infrequently, it is the route charted by the lower courts that often gives the growth of the law its day-to-day direction and evolutionary pathway on the ground, and that could serve as a guidepost for legislative or regulatory reform.

IV. PURPOSES AND CROSS-PURPOSES

A. Amazing Maze

At some point in the course of insider trading law’s development, the means became disconnected from its ends. With enforcement of vague rules, the purpose of regulation blurred. Both the doctrinal content and policy aims of the prohibition became subjects of disputes and confusion. Hence, a complex

437. See supra notes 371-373, 427, 430 and accompanying text.
438. See supra notes 425-430 and accompanying text.
439. Langevoort, supra note 190, at 866-67 (noting the “revisionism” some judges undertake under these circumstances, to the extent they “prefer to engage in more creative interpretation of a Supreme Court opinion, subtly revising its meaning to conform to their own sense of preferred policy and result. They know that the Court is unlikely to revisit the question soon and, when it and if it does, it will probably have a different membership”).
440. See, e.g., Langevoort, supra note 190, at 870-73. This discussion traces the evolution of insider trading regulation from common law antecedents to Cady, Roberts’ abstain or disclose rule and investor protection and equality of access to information premise adopted by the Second Circuit in Texas Gulf Sulfur. The development then proceeded through the retrenchment course the Supreme Court adopted in Chiarella and Dicks that altered the direction and purpose of the prohibition towards fiduciary duty principles and gave rise to the great confusion associated with the doctrine of insider trading as deception and fraud under Section 10(b) and Rule 10b-5.
441. See, e.g., supra note 94 and accompanying text.
body of law emerged in which strict application of doctrinal standards produced aberrational outcomes, or demanded constructions that raised questions about the primary objectives insider trading regulation was designed to serve, or about the persons and interests the prohibition should protect – in other words, its public policy underpinnings.

In large part, controversy about the public ends supporting insider trading regulation arises in widespread objections to the fraud premise grounding the doctrine. In turn, that debate prompted extensive inquiry seeking alternative concepts to explain and justify a prohibition of insider trading. A host of theories advocating various aims – some incongruent, some disparate and inapt, some plainly misguided – sprung from those endeavors. According to one commentator, for example, the objectives courts, regulators, and scholars have ascribed to insider trading restrictions, engendering complexity and broad disagreement, include: “preventing of unfair information asymmetries in trading transactions, promotion of confidence in the market, promotion of disclosure, prevention of fraud, protection of proprietary information, enforcement of fiduciary duties, or some combination of the foregoing purposes.”

This debate transcends conflicting judicial perspectives and academic discourse. It matters because the issues it implicates are fundamental. The rationale supporting any legal action could play a decisive role in determining what conduct defines the offense and who constitutes the particular beneficiaries and victims the law intends to protect. That decision could then resolve vital questions such as which transactions are permissible or penalized, who has standing to commence a legal action to claim a remedy, who is entitled to recover losses from violations of the rules, and who is convicted or acquitted in

442. Compare Chiarella v. United States, 445 U.S. 222 (1980) with S.E.C. v. Materia, 745 F.2d 197 (1984). In both cases an employee of a financial printer, both corporate outsiders, obtained pre-publication information about securities transactions and traded on the basis of that confidential information. In Chiarella, based on application of classical theory fiduciary principles, the defendant’s conviction of Rule 10b-5 violations was overturned because, as an outsider, he had breached no duty to the parties with whom he traded, nor to the corporation whose shares he bought and sold on the basis of nonpublic information. In Materia, the defendant was found liable for Rule 10b-5 violations based on an application of misappropriation theory, under which the fiduciary principle applies to a duty owed to the source of the information. See also Bainbridge, supra note 103, at 1603 (“Had the misappropriation theory been available against Chiarella . . . [the] conviction could have been upheld even though he owed no duties to those with whom he had traded. Instead, the breach of duty he owed to [his employer] would have sufficed”).

443. Some scholars have described this development in terms of “legal equilibria.” Langevoort, supra note 190, at 867. See also id. at 877 (noting that after Chiarella and Dirks some lower courts engaged in reconstruction of insider trading doctrine because those cases “broke an equilibrium that the federal and state judiciary had come to accept concerning the affirmative duty to disclose in business transactions. The Court had tried to move the law backwards, toward caveat emptor,” and thus that by the Court’s subsequent adoption of the misappropriation theory “the equilibrium was essentially restored”).

444. See supra Part III.A.5.

445. See Painter et al., supra note 103, at 219-20.

446. See id.

447. Id.

448. See infra notes 444-48 and accompanying text.
connection with particular events. On the commercial side, these circumstances could adversely affect capital markets. Uncertainty about such basic questions creates doubt among traders and analysts as to where the line defining permissible and prohibited financial practices may be drawn at any particular time or place. Because contemporaneous trading in impersonal securities markets depends significantly on large volume, high speed, and maximum availability of information, absence of a reliable and predictable bright-line test that provides guidance for the day-by-day conduct of business may produce inhibiting effects on the industry. Finally, and perhaps most fundamental in the chain of consequential events, conflicts and uncertainty concerning the policy ends and interests protected by insider trading law can raise significant issues implicating federalism, separation of powers, and due process.

B. Fair Dealing: Investor and Market Protection

If the structure of the existing insider prohibition were discarded, the starting point for a new regime should begin with a clear understanding of the public policy goals to be served by regulating insider trading. Among the numerous goals advanced by legislators, regulators, courts, and scholars, the most compelling is fairness to protect investors and promote confidence in capital markets.

449. See, e.g., Moss v. Morgan Stanley Inc., 719 F.2d 5, 13 (2d Cir. 1983) (holding that clients of investment banks did not have standing to bring a private cause of action for insider trading because the defendants, broker-dealer employees of the firm who traded in securities on the basis of confidential information about a tender offer, breached obligations of trust and confidence they owed to their employers, but that those duties did not extend to shareholders and other investors).

450. See, e.g., Dirks v. S.E.C., 463 U.S. 646, 658-59 (1983) (noting that imposition of an unduly broad insider trading disclose or abstain rule “could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market.”).

451. See id.

452. See id.

453. See, e.g., Santa Fe Industries v. Green, 430 U.S. 462, 478-479 (1977) (expressing concern about application of Section 10(b) and Rule 10b-5 that may effectively “federalize a substantial portion of the law of corporations that deal in securities, particularly where established state policies of corporate regulation would be overridden”).

454. See, e.g., Whitman v. United States, 135 S.Ct. 352, 354 (2014) (Denial of Petition for Writ of Certiorari) (Statement of Scalia and Thomas, J.J.) (expressing concern about judge-made criminal law as it pertained to insider trading regulation, stating that “only the legislature may define crimes,” and that “Congress cannot, through ambiguity, effectively leave that function to the courts—less to the administrative bureaucracy”).

455. See, e.g., Fisch, supra note 83, at 181 (noting that a consequence of maintaining prohibited insider trading conduct as broad as possible is that “traders are receiving prison sentences for conduct that, at the time of prosecution, presents judicial issues of first impression,” a result that “implies obvious due process concerns”); Painter et al., supra note 103, at 197. The Supreme Court has rejected constitutional challenges to insider trading criminal liability asserted on vagueness grounds. See, e.g., Salman v. United States, 137 S. Ct. 420, 428 (2016); United States v. O’Hagan, 521 U.S. 642, 666 (1997). The Court, however, did not engage in a searching constitutional analysis of the various ways in which scholars maintain that the fluid elements of case-by-case judge-made insider trading criminal law doctrine raises serious uncertainties that implicate due process concerns. See, e.g., Fisch, supra note 83, at 181; Painter et al., supra note 103, at 197.
markets.\textsuperscript{456} The fairness theory is also consistent with fostering the individual safeguards and preventing the economic harms to investors and the financial industry that the securities statutes contemplated, both originally and in subsequent amendments.\textsuperscript{457} To the extent the securities laws address the purposes of the statutes, they clearly evince an overarching objective of safeguarding investors and capital markets from deception and manipulation, and thus promoting confidence in the integrity and stability of the securities industry.\textsuperscript{458} Applied to regulation of insider trading under the \textit{Cady, Roberts} doctrine,\textsuperscript{459} the securities statutes seek fairness for investors by protecting them from exploitation when insiders take advantage of access to material nonpublic information obtained by reason of their relationship to the corporation and trade on that basis.\textsuperscript{460} Prohibiting such conduct facilitates the flow of information, thus enhancing the volume of material facts available to investors and market analysts at any particular time,

\textsuperscript{456} One of the leading alternative conceptualizations proposed to explain and justify insider trading regulation is grounded on property rights to information. See, e.g., Bainbridge, \textit{supra} note 103, at 1591 ("The insider trading prohibition ought to be viewed as a means of protecting property rights in information, rather than as a means of preventing securities fraud"). The property rights perspective has found expression in some judicial opinions. See \textit{O’Hagan}, 521 U.S. at 654 (remarking that "[a] company’s confidential information . . . qualifies as a property to which the company has a right of exclusive use"); \textit{United States v. Libera}, 989 F.2d 596, 600 (2d Cir. 1993) (declaring that the purpose of the misappropriation theory is "to protect property rights in information"). An entirely different perspective, based on the law and economics theory, would abolish insider trading regulation altogether. See, e.g., Epstein, \textit{supra} note 140 at 1486.

\textsuperscript{457} \textit{See supra} notes 452-456 and accompanying text.

\textsuperscript{458} For academic literature discussing theories arguing fairness to investors and capital markets as grounds for insider trading regulation, see, e.g., Ian B. Lee, \textit{Fairness and Insider Trading}, 2002 COLUM. BUS. L. REV. 119, 142 (2002) (arguing that "markets contain an internal morality which both supplies the normative justification for market transactions and suggests that a successful market will be characterized by fair trading rules"); Fisch, \textit{supra} note 83, at 227 (suggesting that a statutory reform of insider trading regulation should be predicated on an insider’s duty to the securities marketplace because "the overall structure and objectives of the federal securities laws . . . are aimed primarily at the protection of investors and the capital markets"); see also Victor Brudney, \textit{Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws}, 93 HARV. L. REV. 322, 346, 355 (1979); Langevoort, \textit{supra} note 190, at 883; \textit{Nagy, supra} note 83, at 1355. Support for the investor protection premise finds expression as well in judicial and SEC opinions and congressional statements referring to the text of the statutes. See, e.g., \textit{O’Hagan}, 521 U.S. at 658 (noting as "an animating purpose of the Exchange Act: to insure (sic) honest securities markets and thereby promote investor confidence"); \textit{Central Bank v. First Interstate Bank}, 511 U.S. 164, 173-74 (1994) (asserting that among "the broad congressional purposes behind the [securities laws are] to protect investors from false and misleading practices that might injure them"); \textit{see also Basic Inc. v. Levinson}, 485 U.S. 228, 230 (1988); \textit{In re Cady, Roberts & Co.}, 40 S.E.C. 907, 1961 WL 60638, at *4 (S.E.C. Nov. 8, 1961); \textit{see also H.R. Conf. Rep. No. 94-229, p. 91 (1975), U.S.C.C.A.N. 1975, p. 323 (noting that the antifraud provisions of the securities laws were designed largely "to assure that dealing in securities is fair and without undue preferences or advantages among investors")}. But see \textit{supra} notes 373-379 and \textit{infra} note 459 and accompanying text for discussion of the extent to which the Supreme Court undercut this principle in \textit{Chiarella, Dirks}, and \textit{O’Hagan} by expressing contradictory principles and embracing a conflicting property rights theory.

\textsuperscript{459} Prior to \textit{Cady, Roberts}, the only prohibition on insider trading in effect was the restriction on short-term swing profits contained in Section 16 of the Exchange Act. See 15 U.S.C. § 78p.

\textsuperscript{460} \textit{See Cady, Roberts}, 1961 WL 60638, at *4 (noting that one of the principal elements of the securities laws’ antifraud provisions expresses "the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.").
and advancing equality of access to essential marketplace knowledge. The securities statutes’ historical and economic contexts, as well as the language of the legislation itself, support this proposition.

Promoting fairness to investors and protecting them by regulating insider trading as means of enhancing the flow of material information to financial markets are also manifest in longstanding regulatory and judicial precedent. According to one commentator: “Much, if not most, of the judicial discussion of insider trading has been in terms of fairness and equal treatment of all investors.” That objective was explicit as initially embraced and applied by the SEC in Cady, Roberts. The Supreme Court too has noted the investor


462. The fairness-based intention of protecting investors and markets as an overarching objective of the securities laws is manifest in several interrelated provisions that comprise the framework of the Exchange Act. Tellingly, Section 10(b), confers authority upon the SEC to promulgate rules defining practices encompassed by the phrase “any manipulative or deceptive device or contrivance” that would constitute violations of the statute. Exchange Act § 10(b), 15 U.S.C. § 78(b). Specifically, that provision confines the scope of such relation to that “necessary or appropriate in the public interest or for the protection of investors.” Id. And Section 2 specifically enumerates among its essential goals the protection of interstate commerce and the national banking and credit systems so as “to insure the maintenance of fair and honest markets.” Exchange Act § 2, 15 U.S.C. § 78b. In Section 16(b), which contains the only explicit mention of insider trading in the original statutory framework of the securities laws, Congress recognized that a purpose of placing some limitation on insider trading was “preventing the unfair use” of inside information that was acquired by virtue of the insider’s relationship to the company. Id. § 16(b), 15 U.S.C. § 78p. In this provision, Congress recognized two critical aspects of insider trading unfairness concerns: the exploitation of the trader’s informational advantage to capitalize on material information not available to other participants in the marketplace, and the possession of that business edge by reason of access provided by an inside connection that other investors lack. See Fisch, supra note 83, at 227-28 (“It is the fact that an insider has obtained his informational advantage because of his position, and the fact that this position is attributable to the presence of other less-privileged transactors in the market, that makes the insider’s use of nonpublic information unfair”) (emphasis in original). For more recent congressional affirmations reflecting the fairness principles that the securities laws embody, see H.R. Conf. Rep. No. 94-229, 94th Cong., 1st Sess. 91-92 (1975); Pub. L. 100-704, 100th Cong. (1988), 15 U.S.C. § 78u.

463. See infra notes 458-463 and accompanying text.


465. Cady, Roberts, 1961 WL 60638, at *5. Referred to as “parity of information,” the concept as the Chiarella Court described it, would recognize “a general duty between all participants in market transactions to forego actions based on material nonpublic information.” Chiarella v. United States, 445 U.S. 222 (1980); see also S.E.C. v. Texas Gulf Sulphur Co., 401 F.2d, 833, 848 (2d Cir. 1968). The parity of information concept was argued before the Supreme Court in both Chiarella and Dirks. On both occasions the Court explicitly disapproved the theory. See Chiarella, 445 U.S. at 233. Some scholars have suggested, however, that the Court may have misunderstood or mischaracterized the theory. According to this view, the aim of the parity of information doctrine is not equal information, but equal access to information. See, e.g., Brudney, supra note 458, at 354; see also Fisch, supra note 83, at 190-91 n.44-45. The Cady, Roberts conception of the public policy and goals underlying the securities laws and insider trading rules was endorsed early on by the courts. See Texas Gulf Sulphur, 401 F.2d at 851-52 (declaring that “[t]he core of Rule 10b-5 is the implementation of the Congressional purpose that all investors should have equal access to the rewards of participation in securities transactions.”); but see Chiarella, 445 U.S. at 433. Explaining the distinction between the two concepts, one scholar stated that “equal access ‘... viewed most broadly ... does not extend so far as to require actual equality of sharing of information. Viewed more narrowly it would presumably deny an informational advantage to those who seek to use otherwise nonpublic information which they are precluded by legal restrictions from disclosing to public investors.” Brudney, supra note 458, at 354-55.
protection aim of the securities laws. Consistent with this view of statutory policy, the Court in O’Hagan recognized as an “animating purpose of the Exchange Act: to insure honest securities markets and thereby promote investor confidence.” As a practical matter, the Court acknowledged, “investors likely would hesitate to venture their capital in a market where trading based on misappropriated nonpublic information is unchecked by law.

By the same token, other policy objectives advanced in support of insider trading regulation – whether protecting corporate secrets and property rights to information, enforcement of fiduciary duties, promoting honest corporate management, or preventing fraud – present no compelling arguments consistent with the substantive text of the securities laws or their stated public policy goals of protecting investors and promoting confidence in capital markets. Investors’ faith in the integrity of the marketplace, and therefore their decisions to engage in securities transactions, are more likely to be materially influenced by actual losses caused to securities buyers and sellers by insider trading on the basis of an unfair informational advantage than by whether or not the insider breached a fiduciary duty or misused a corporation’s informational property.

Thus, ample reasons exist to tear down the prevailing insider trading regime and building anew on a foundation of a simpler, streamlined doctrine grounded on fairness principles designed to protect investors and capital markets. To bolster such a project, compelling public purposes embraced by statutes, case law, and regulatory objectives offer further support. Part V examines how these principles and resources may be combined to generate a reconstructed system of insider trading regulation that emerges from the preceding historical overview and the conceptual failings of the existing insider trading prohibition.

V. FULL CIRCLE

A. The Essentials

The aftermath of Newman presented another occasion for renewed interest in Congress to consider insider trading legislation. Three different bills were introduced in the 114th Congress in 2015 and one in the 116th Congress in 2019 proposing amendments to the Exchange Act that would define and prohibit

467. Id. But, further illustrating the internal inconsistency in the Supreme Court’s insider trading philosophy, the O’Hagan Court also declared that the victim of insider trading violations that its doctrine recognizes is the source of the nonpublic information, presumably the corporation or the offending insider, and not necessarily the investors and capital markets involved in trading at an informational disadvantage and consequently suffer losses as a result. See id. at 652, 657.
468. Id. See also supra notes 389–407 and accompanying text.
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insider trading. In view of such recent calls for legislative action, and the prospect that eventually some insider trading statute may result from such efforts, Part V regards the occasion as an opportunity to advance the proposal whose essentials issue logically from the preceding discussion. At the outset, effective reform should take into account the conceptual defects in prevailing insider trading law that, from its origins, make the current regulatory structure hopelessly deficient as a foundation for improvement. Accordingly, the existing framework should be scrapped altogether. With that structure razed and its foundation cleared, a comprehensive and effective statutory response to the various insider trading regulation problems should contain three major components that emanate compellingly from the preceding analysis.

First, the legislation should specify, and support with empirical findings, the public harms insider trading produces that would justify a statutory declaration of the conduct defined as unlawful. This provision would refute critics and skeptics, such as proponents of the law and economics perspective, who contend that insider trading should be deregulated because it causes no quantifiable injuries to investors or capital markets and in fact may be beneficial to corporations and their managers. Second, to resolve the prevailing sharp disagreement over the public policy goals the insider trading prohibition should serve, the legislation should articulate a clear overriding purpose. On this point, the statute should explicitly proclaim that its paramount objectives are those identified and analyzed above: safeguarding investors and capital markets to reinforce investor confidence and thus strengthen the integrity and stability of the nation’s securities industry. Third, insider trading law reform should plainly specify the substantive legal theory – here fairness-based principles – upon which the prohibition and its structural framework are grounded.

Consistent with the preceding outline, the starting point for devising effective insider trading regulation would be to remove the prohibition from its grounding and classification as deception and fraud within the scope of Section 10(b) and Rule 10b-5. Instead, the conduct should be declared unlawful under a distinct provision situated within Section 16 of the Exchange Act. Section 16 already specifically references insider trading and makes clear Congress’s original

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recognition that at least one form of the practice – trading in the corporation’s securities by certain company officials for short-swing profits – should be proscribed.\textsuperscript{471} Lifting insider trading regulation from the forced basis it occupies within Section 10(b) and recognizing it as a “sui generis”\textsuperscript{472} offense under Section 16, would immediately do away with the most fundamental controversy surrounding modern insider trading doctrine: the longstanding legal debate regarding the meaning of the concepts of fraud and deception and their application through Section 10(b) and Rule 10b-5 to insider trading. With the fraud predicate removed from an insider trading prohibition the entire structure of interconnected fictional constructions discussed above would necessarily collapse. Those principles warrant elimination because they not only import distortion and confusion into the law, but simply make no sense in the context of contemporaneous securities trading in impersonal capital markets.

Doing so would create the opportunity to replace the existing doctrine with a leaner and more effective regulatory regime that follows from the foregoing analysis. To this end, the statute would declare unlawful: (1) any trading or tipping involving a purchase or sale of securities; (2) in which any person possesses material nonpublic information about the issuer or its transactions that was prepared for corporate purposes; (3) that was obtained by such person by means other than independent market research and analysis conducted by the trader or another person; (4) that the trader knows or should know is not publicly available; and thus that (5) would confer upon that trader an inherently unfair advantage over other parties to the transaction or to other investors in the

\textsuperscript{471} Section 16 of the Exchange Act, 15 U.S.C. § 78p, perhaps even more so than Section 10(b), bears directly on insider trading rules and serves as a more appropriate cornerstone of the insider trading concept which this Article suggests. First, in subsection 16(a), the statute contains a definition of insider which encompasses three categories of persons: a director, officer, or beneficial owner of more than 10 percent of any class of equity securities of any registered issuer. See id. at § 78p(a). Second, subsection 16(b) imposes a constraint on securities transactions in which this class of insiders can engage involving the shares of their corporation. See id. at § 78p(b). Any profit they realize from the purchase and sale of shares of that issuer within less than six months prior to their acquisition inures to the corporation, which could recover it by legal action against the insider directly, or derivatively through a shareholder action. Third, the restriction establishes a bright line standard for its violation: strict liability. See Magma Power Co. v. Dow Chemical Co., 136 F.3d 316, 320-21 (2d Cir. 1998). The restriction applies “irrespective of any intention” on the part of the insider in entering into the transaction. 15 U.S.C. § 78p(b). Moreover, Subsection 16(b) clearly expresses the public policy actuating the restriction. Its declared purpose is “preventing the unfair use of information which may have been obtained by [the insider] by reason of his relationship to the issuer.” Id. This provision embodies a point that goes to the core of the insider trading debate, and that serves as an underpinning of the statutory reform proposed here: an explicit recognition of promoting fairness and curtailing inequitable informational advantage as essential principles of insider trading regulation. Legislation introduced in Congress in 1987 as Senate Bill 1380, titled the “Insider Trading Proscriptions Act of 1987,” would have added a provision to Section 16A of the Exchange Act declaring insider trading unlawful. For the history of this legislation and other unsuccessful congressional efforts to define the insider trading prohibition by statute see, e.g. LANGEVOORT, INSIDER TRADING, supra note 103 §§ 13.1 – 13.11; Nagy, supra note 83, at 1367; Fisch, supra note 83, at 235-36.

\textsuperscript{472} Langevoort, Fine Distinctions, supra note 103, at 440.
marketplace, who lack feasible access to the particular confidential information.\textsuperscript{473}

The preceding definition and principles for assessing liability seeks to resolve several major difficulties that often arise under existing insider trading law. First, this approach would avoid the vexing inquiries burdening the current regime concerning the meaning and applicability of various principles. As elaborated above in Part III’s discussion of insider trading law’s fictions, common controversies include: the propriety of the means by which the insider acquired the nonpublic information; the relationship of the insider to the corporate issuer and to the trading party; the personal motivation behind the insider’s communication of confidential information; the recipient’s knowledge of the misconduct and any gain the offender derived from it; and the insider’s impractical and illusory obligation to disclose material nonpublic information to the counterparty or to the source before trading in securities.\textsuperscript{474} Under the proposed definition, each of these elements would not matter. The only relationship that should have any bearing on insider trading liability would be the connection between a trader who enjoys an unwarranted informational advantage by reason of knowingly possessing nonpublic information, and the parties on the other side of the transaction, including other market investors who lack feasible access to the confidential communication at issue.

Second, the proposal would account for the realities and needs of modern securities transactions by recognizing that efficient operation of impersonal capital markets depends on the vital roles played by various investment professionals – specialists, analysts, broker-dealers, and securities exchange officials.\textsuperscript{475} Such persons may possess material nonpublic information by virtue of their own financial research and independent assessments prepared as part of the proper functioning of the securities markets.\textsuperscript{476} To the extent such information derives from the investment skills, knowledge, and professional methods employed by market specialists in the ordinary course of business, their

\textsuperscript{473} This proposal embodies the essence of the broad investor protection concept advanced by Chief Justice Burger’s dissent in \textit{Chiarella}, where he stated that “a person who has misappropriated nonpublic information has an absolute duty to disclose that information or to refrain from trading.” 445 U.S. 222 (1980). In \textit{O’Hagan}, the Supreme Court made reference to this theory but did not address it purportedly because the government did not propose its adoption. \textit{See United States v. O’Hagan}, 521 U.S. 642, 655 n.6 (1997).

\textsuperscript{474} \textit{See supra} Part III.

\textsuperscript{475} \textit{See, e.g.}, Dirks v. S.E.C., 463 U.S. 646, 658-59 (1983).

\textsuperscript{476} This aspect of the proposed reform raises a question as to how and where to draw the line in determining what qualifies as legitimate independent research and analysis supporting efficient securities market operations. Like most such inquiries, formulating an answer would require a process that is fact-intensive and contextual, and that may draw upon reasonable inferences that the circumstances may support. \textit{See, e.g.}, U.S. v. Newman, 775 F.3d 438, 454 (2d Cir. 2014) (abrogated on other grounds, \textit{Salman} v. United States, 137 S. Ct. 420, 428 (2016)).
efforts to gather, use, or propagate valuable intelligence should not be
inhibited.477

Third, sound insider trading reform should reflect an additional reality that a
standard demanding categorical equality of information for all market
participants at all times is neither practical nor attainable.478 As the Supreme
Court remarked in O’Hagan, “informational disparity is inevitable in the
securities markets.”479 Some investors, especially those with extensive holdings
and large resources, can afford to pay for the cost of sophisticated market
research and high frequency trading and therefore are able to trade ahead of
others.480 Through such means, they can obtain market analysis and
recommendations not available to persons unable or unwilling to purchase those
services.481 Thus, the approach suggested here would underscore that its purpose
is not to codify an overly broad regime seeking absolute parity of information
for all investors at all times. Rather, the objective would seek to return insider
trading regulation to an approximation of the concept of equality of opportunity
to access price-sensitive information envisioned by the SEC in Cady, Roberts
and endorsed by the Second Circuit in Texas Gulf Sulphur.482

B. Congressional Measures

Using the forgoing concepts as the framework for a model insider trading
statute, this discussion turns to a review of the several bills introduced in
Congress to address insider trading. In the 114th Congress, which convened in
2015, two bills – H.R. 1173 and H.R. 1625 – were proposed in the House of
Representatives, and one – S. 702 – in the Senate.483 Another bill – H.R. 2534 –
was introduced in the House in the 116th Congress in 2019.484 Even as only
legislative proposals, the provisions of these bills are instructive. They express
current perspectives and concerns about insider trading law and point to ideas
that have garnered some support, thus signaling the potential directions a

477. The Supreme Court expressed this concern in Dirks. Describing the inhibiting effect an overly
broad disclosure rule would have on the role of market specialists, the Court noted that their function in
gathering and analyzing information, sometimes by direct discussions with corporate insiders, “is
necessary to the preservation of a healthy market. It is the nature of this type of information . . . that [it]
cannot be made simultaneously available to all of the corporation’s stockholders or the public generally.”
Dirks, 463 U.S. at 658-59.
479. Id.
480. See INVESTOPEDIA, What is High-Frequency Trading (updated June 25, 2019),
481. See id.
482. See Texas Gulf Sulphur, 401 F.2d 833, 848 (2d Cir. 1968) (stating that Rule 10b-5 “is based in
policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal
exchanges have relatively equal access to material information”); supra note 430 and accompanying text.
483. See supra note 464 and accompanying text.
484. See id.
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legislative response could take. Analysis these proposed bills thus would inform the insider trading reform debate, particularly by asking two key questions: (1) To what extent would the content and structure of insider trading regulation under the proposed regime accomplish improvements specifically designed to correct the particular deficiencies that characterize prevailing law? (2) Or, instead, do the principles and directions the bills embrace, in relation to existing law, represent merely more of the same? In other words, are they a warming over and recycling of concepts laden with similar or new flaws that are likely to fall short of the substantial departures from existing law necessary to reach the real crux of the problem?

Measured against the essentials of the comprehensive insider trading law reform suggested in this Article, the bills introduced in the House, disappointingly, fall far short of the mark. They are bound to fail achieving any meaningful improvement to the problem because none of these bills appears to reflect consideration of the fundamental historical and doctrinal flaws that existing law incorporates. In brief, they would not constitute an effective alternative to the existing insider trading prohibition and for that reason do not offer much beyond more of the same. Viewed in this light, the proposals would not demonstrate a willingness by Congress to discard the prevailing regime’s fraud-based predicate and fiduciary duty doctrines, along with the attendant fictional principles, and embrace the opportunity to develop a simpler regulatory model. Of the four proposed bills, the third detailed below, S. 702, contains some promising features that would at least be a helpful step forward towards the overhaul proposed by this Article.

1. H.R. 1173

H.R. 1173 contains three principal provisions. First, it would amend Section 10 of the Exchange Act by adding a new subsection (d). The legislation would expressly make it unlawful for any person to purchase or sell any security based on information that the person knows or should know is material inside information.

Second, the bill defines the term “insider information” to mean information that is nonpublic and was obtained under three circumstances: (1) illegally; (2) directly or indirectly from an issuer with an expectation that the

485. H.R. 1625, for example, mirrors S. 1680, a bill that received serious attention and gained substantial support during Congress’ attempts in 1987 to enact insider trading law reform. See Langevoort, Insider Trading, supra note 103, at §§ 13.2-13.4. For discussion of other proposals whose provisions serve as antecedents to those that the recent bills advance, see Painter et al., supra note 103, at 221-27.

486. See 485. See Langevoort, Insider Trading, supra note 103, at §§ 13.2-13.4; Painter et al., supra note 103, at 221-27.

487. See infra note 494 and accompanying text.

488. H.R. 1173 §§ 1, 2(a).

489. Id. at § 2(a)(1).
information will be maintained confidential or used only “for a legitimate business purpose;” or (3) in violation of a fiduciary duty. Third, the bill’s rules of construction specify that interpretation of the insider trading prohibition may not affect liability under Section 10(b) or require a personal benefit to any party.

H.R. 1173 does little to address the fundamental issues that comprise the root sources of the prevailing insider trading law’s doctrinal problems. First, by inserting the amendment within the parameters of Exchange Act Section 10 as a new subsection (d), as opposed to a standalone section, the legislation creates an ambiguity in statutory interpretation. Section 10 is currently titled “Regulation of the Use of Manipulation and Deceptive Devices.” A question thus arises as to whether or not designating the new insider trading prohibition under the umbrella of Section 10 as a new subsection (d) removes it entirely from the deception and fraud underpinnings that expressly govern Section 10(b). If lodging the legislation within Section 10 is designed to ground the prohibition on fraud-based principles in the style of existing law, H.R. 1173 would amount to absolutely nothing as a means of advancing insider trading law reform. At best, the bill would represent a standstill not worth the effort. Moreover, H.R. 1173’s definition of “inside information” would reinforce two problems that complicate existing law. First, it specifies that the term refers to nonpublic information the recipient obtained illegally from an issuer (1) with the expectation that it would remain confidential or be used for legitimate business purposes, or (2) in violation of a fiduciary duty. These provisions introduce two new concepts likely to open major uncertainty about the new statute’s vagueness and uncertain scope in another field of controversy: What constitutes illegality and legitimate business purposes? Worse yet, the definition would codify the fiduciary duty principle, which necessarily would import into the new regime the entire superstructure of conceptual difficulties that encumber the term as it applies under existing Section 10(b) and Rule 10b-5 doctrine.

More fundamentally, the bill implicates the second major flaw of prevailing insider trading law underscored above: the absence of an explicit connection between doctrinal elements of the prohibition and the core purposes served by insider trading regulation. To the extent H.R. 1173 grounds its insider trading definition on findings of illegality, legitimate business purposes, and fiduciary

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490. Id. at § 2(a)(2).
491. Id. at § 2(a)(2)(A) and (B).
493. This ambiguity may be reinforced by H.R. 1173’s rule of construction declaring that the new provision does not affect liability under Section 10(b). See H.R. 1173 § 2(a)(2)(B). To the extent the new legislation may be interpreted to retain the doctrinal basis and structure of the existing Section 10(b) in place, it would do nothing to eliminate any of the underlying insider trading problems described above. Curiously, the provision in the rule of construction precluding an interpretation that would require a personal benefit to any party may have been meant to abrogate Newman. It is unclear to what extent that rule would affect insider trading liability analysis under the Dirks personal benefit jurisprudence.
duty, the legislation’s theoretical premise would be misplaced. It would focus the liability inquiry, as is the case under existing law, on the trader’s means of obtaining nonpublic information and the insider’s motivation and breach of duty underlying the improper disclosure of a confidence. By elevating these principles as the standards for determining liability, the legislation would fail to recognize the premises of fairness and protection of investors and capital markets as the central purposes of the prohibition and proper tests of liability.

2. **H.R. 1625**

H.R. 1625, unlike H.R. 1173, would amend Section 16 of the Exchange Act, rather than Section 10. The bill would add a new Section 16A containing two prohibitions. Subsections (a) and (b) declare it unlawful for any person, directly or indirectly, to purchase or sell any security while in possession of material nonpublic information, or to communicate such information. The purchase or sale must be: (1) “relating to such security;” (2) if the person “knows, or recklessly disregards” that (3) the information “has been obtained wrongfully,” or that (4) “such purchase or sale . . . would constitute a wrongful use of such information.” And subsection (c) specifies that trading or communicating on the basis of inside information is wrongful only if the conduct would constitute “theft, bribery, misrepresentation, or espionage,” or “a violation of any Federal law protecting computer data,” or “conversion, misappropriation, or other unauthorized and deceptive taking of such information or a breach of any fiduciary duty or any other personal or other relationship of trust and confidence.”

This bill addresses perhaps the most significant conceptual objection to insider trading law: its grounding on the deception and fraud predicate for liability that governs the application of Section 10(b). Rather than amending Section 10, as H.R. 1173 and S. 702 would do, H.R. 1625 would locate the insider trading prohibition in a new Section 16A. In doing so, the bill would incorporate the most consequential component of the reform this Article proposes. That strategy presumably would relieve insider trading regulation of the entire complex of confusing and conflicting fictions elaborated in Part III above that overlay and so burden prevailing law. Notably, the amendment would

494. See Fisch, supra note 83, at 225-26 (arguing that under these circumstances a corporation would be able “to authorize its officers or employees to trade on the basis of inside information,” effectively compelling the government to defer to the corporation’s determinations concerning entitlement to its information); *see also* id. at 227 (noting that the “overall structure and objectives of the securities laws . . . are aimed primarily at the protection of investors and capital markets, not at the protection of . . . fiduciary duties”).

495. *See* H.R. 1625 §§ 1, 2(a).

496. *Id.* at § 16A.

497. *Id.* at § 16A(a).

498. *Id.* at §§ 16A(a) – (c).

499. *Id.*
specifically do away with the doctrine that the inside trader has knowledge of the particular means by which nonpublic information was obtained or conveyed, and with the tipper/tippee liability personal benefit requirement, if the trader knows that the information was wrongfully acquired.

On closer look, however, though seemingly relieving the insider trading prohibition of its Section 10(b) fraud premise, H.R. 1625 would actually leave the entire Section 10(b) and Rule 10b-5 deception framework intact and still applicable through a back door. That result would follow from the bill’s definition of “wrongful” acquisition, communication, or use of confidential information if the means the trader employs to get the nonpublic material constitutes any of the specified offenses.500 Similar to their effect in H.R. 1173 described above, these concepts would import into the new Section 16A the entire maze of vague and needless doctrines that so complicate and hamper existing insider trading law predicated on Section 10(b), in particular by referencing “deceptive taking,” breach of fiduciary duty, and a “personal” or “other” relationship of trust and confidence.501

H.R. 1625, like H.R. 1173, would do nothing more than carry over the full range of basic flaws and conceptual absurdities associated with existing insider trading regulation, leaving the deception and fiduciary principles in effect. Among the complexities this proposal would leave unresolved are: the impracticalities of applying the abstain or disclose doctrine in the context of trading in impersonal markets, the notion that insiders owe a fiduciary duty to the source of the confidential information, and the question of whether disclosure to the source or the other party to the trade would absolve the insider from liability.

3. S. 702

The Senate proposal, S. 702, is the simplest yet broadest of the three bills proposed in 2015. It would, like H.R. 1173, amend Section 10 of the Exchange Act by adding a new subsection (d).502 Subparagraph (A) would apply to inside traders and subparagraph (B) to tippers.503 The bill declares it unlawful for any person to purchase or sell any security on the basis of material nonpublic information “that the person knows or has reason to know is not publicly available, or to knowingly or recklessly to communicate such information to another person.504 Subsection (2) defines “not publicly available” to exclude “information that the person has independently developed from publicly

500. Id. at § 16A(c)(1).
501. Id.
502. See S. 702 §§ 1, 2(1).
503. Id.
504. Id. at § 2(1)(A).
A rule of construction in subsection (4) provides that nothing in the amendment shall be interpreted to affect liability under Section 10(b). This bill would endorse substantial aspects of the statutory reform model proposed in this Article specifically designed to address the conceptual and practical flaws ingrained in existing insider trading rules. It adopts the knowing possession standard and would apply to securities transactions executed on the basis of information that a trader or communicator has reason to know is not publicly available. The premise for liability would presumably discard Section 10(b)’s prevailing fraud-based theory and associated fictions, thereby embodying an essential feature of the comprehensive improvements advanced here. This approach would also obviate hair-splitting conflicts over hazy details regarding the relationships, methods, and motivations involved in how traders or tippers obtain or transmit the nonpublic information. To address concerns over potential inhibition of the legitimate activities of securities industry participants in gathering and analyzing market data, the bill excludes from the definition of information “not publicly available” knowledge about the securities at issue that the trader develops independently from public sources, another vital feature that the proposal advanced here would incorporate into its statutory reform.

As a whole, the provisions of S. 702 direct the analysis of insider trading liability to the considerations which should bear most in the assessment of liability for the offense. First, the proposal focuses on the persons most relevantly affected by insider trading – the counterparties and other investors who do not possess material, price-sensitive facts known to the insider on the other side of the transaction. Second, the proposal highlights a critical circumstance that gives rise to the insider trading liability: Whether at the time the particular securities transaction is executed an insider trader enjoyed an unfair advantage by possessing information that the insider knew was not available to the other party or to the market in general, and that the trader did not develop independently. Oddly, however, S. 702 contains an incongruous provision that invites ambiguity and thus detracts from its otherwise novel and far-reaching approach. Similar to what H.R. 1173 does directly (and H.R. 1625 indirectly through its definitional back door), the Senate bill would create an anomaly because the proposed amendment would be inserted as part of Section 10, arguably thereby falling under the umbrella of the deception and manipulation provisions of Section 10(b). To this extent, the bill contains an internal conflict and raises questions as to whether Section 10(b) doctrine would supersede the simpler

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505. *Id.* at § 2(2).
506. *Id.* at § 2(4).
507. *See supra* Part V.A.
508. S. 702 § 2(B)(2).
509. *Id.*
regulatory structure the bill otherwise adopts, and if so, which specific provisions of the Section 10(b) doctrine the bill would incorporate. To the extent the bill would retain any part of the existing Section 10(b) fraud premise and fiduciary duty principles, it would entirely vitiate its intent as a measure of any meaningful reform.

4. H.R. 2534

H.R. 2534, introduced in the 116th Congress in May 2019, in all essential respects is a copy of H.R. 1625.510 Accordingly, a review of its provisions would mirror the favorable points and inherent flaws embodied by H.R. 1625 as analyzed above. Section 16A(c) of the bill does contain a provision not included in H.R. 1625 that is noteworthy and raises questions about its intent and implications.511 It states the sense of Congress that the amendments the new statute would enact “are intended to supersede section 10(b) [of the Exchange Act] with regard to the wrongful use or wrongful communication of material, nonpublic information in connection with the purchase or sale of securities.”512 The import of this provision is not clear, but it could be read to suggest that the new Section 16A would be the exclusive regime for enforcing insider trading regulation, closing the Section 10(b) back door referred to above that H.R. 1625 would leave open.

C. Model Statute: Australia

How other jurisdictions have addressed insider trading issues statutorily may help inform Congress’s development of an effective legislative approach. The insider trading law enacted in Australia, which one commentator described as “the broadest insider trading prohibition in the world,”513 is a particularly instructive model for that endeavor. The Australian statute was adopted as Section 1043A of the Corporations Act 2001(Cth) (the “Corporations Act”).514 Sections 1043A(1)-(2) provide that if a person possesses inside information and knows, or reasonably should know that it constitutes inside information, that insider “must not . . . apply for, acquire, or dispose of [specified securities]” or procure another person or enter into an agreement to perform any of these acts,515 nor communicate such information to another person who is likely trade on the

511. See H.R. 2534 § 16A(c).
512. Id.
513. LANGEVOORT, INSIDER TRADING, supra note 103, at § 14.11; Keith Kendall & Gordon Walker, Insider Trading in Australia, in RESEARCH HANDBOOK ON INSIDER TRADING 369 (Stephen M. Bainbridge ed., 2013), (noting that Australia’s insider trading prohibition “is one of, if not the widest in the world”).
515. Id. at § 1043A(1)(a)–(d).
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basis of those securities. The statute defines “inside information” broadly in Section 1042A. The term extends to information that “is not generally available,” and that if it were generally available, “a reasonable person would expect it to have a material effect on the price or value of particular [securities].”

Australia’s statute is expansive and constructs a framework of insider trading regulation that is less complex than exists under United States law. To that extent, the Australian model reflects the approach taken by S. 702 and the reform advanced in this Article. First, the Australian statute adopts a far-reaching definition of inside information. Its application to information “not generally available” encompasses a broad range of matters that the marketplace does not have access to, and which may affect the price of particular securities. Such a large ambit may extend to several categories of information classified by the source or subject, including information developed by a particular issuer with which the trader is connected, and relating to matters concerning (1) the affairs of that company or its securities, (2) an outside issuer with which the insider is not connected, (3) a particular outside issuer, or (4) the securities market more generally.

Second, the applicable standard for violation is knowing possession. That is the concept the proposal advanced here supports and that S. 702 also would adopt. The legislation declares it unlawful for a person to transact in securities if he or she “possesses inside information and knows” or should know that the information is not generally available to others. Unlike the test of wrongful acquisition or use which H.R. 1625 and H.R. 2534 would prescribe, under the Australian statute the source of the nonpublic information and the means by which the insider obtains it are irrelevant considerations in the assessment of liability. Moreover, the relationship that counts for the purposes of the statute is the trader’s connection to the nonpublic information through knowing possession of it, rather than any connection to the corporation or other source of the communication. Consequently, this approach does not create distinctions

516. Id. at § 1043A(2)(a)-(e).
517. Id. at § 1042A (Definitions).
518. Id.
519. See supra note 499 and accompanying text.
520. Corporations Law § 1042A.
521. Id.
523. See supra note 508 and accompanying text.
524. Corporations Act § 1043A(1).
525. See supra note 510 and accompanying text.
among categories of insiders by reference to their relationship to the corporation or its officials, to the insider’s employment or motivation for divulging confidential information, or to any fiduciary principle. By these provisions, the statute avoids some of the most difficult and contentious pitfalls that create insider trading law’s universally faulted confusion in the United States, including the multitude of complex issues raised by each of the fictional doctrines examined above.

The Australian statute’s framework produces insider regulation encompassing the broadest possible theoretical grounding with minimal doctrinal encumbrances. In effect, the concept that emerges from Australia’s statute reduces to the doctrine of equality of opportunity for all investors to access price-sensitive information concerning corporations and their securities. So stated, this is the principle that the United States Supreme Court unequivocally rejected in *Chiarella* and *Dirks*, but that the evolving trend of insider trading law which the SEC and some lower court rulings embrace. Fundamentally, the approach is based on a broad concept of fairness serving paramount objectives of protecting investors and promoting confidence in capital markets.

**CONCLUSION**

Insider trading law as it developed in the United States under Section 10(b) and Rule 10b-5 is doctrinally flawed and unworkable in practice. Though labeled as deception and fraud for the purposes of technical and linguistic observance of the securities statutes, the conduct is fraud in name only. It does not accord with the standards that define common law fraud and that the Supreme Court has declared must be established to impose liability for violation of the securities laws. To overcome that reality and justify enforcement of a prohibition of insider trading as fraud, courts and the SEC resorted to constructing several doctrinal fictions on which existing insider trading regulation is grounded. That

527. See id. at 156 (noting that Australia’s insider trading prohibition is “undergirded by the parity of information theory”); Kendall & Walker, supra note 513, at 368 (stating that Australia’s insider trading prohibition is based on a “market fairness theory,” which holds that every securities market investor should be accorded an “equal opportunity to access the relevant information”) (emphasis in original). The overall goal of parity of information fostered by means of a knowing possession standard underlies the similarly expansive insider trading statutes adopted by the European Union and several of its member states. For a discussion of the European experience with insider trading regulation, see Langevoort, Insider Trading, supra note 103 §§ 14:04 – 14:09 (observing that “the current structure of European law creates a noticeably broader insider trading than in the United States, not tied to fiduciary responsibility but rather something equivalent to ‘equal access.’ In many ways, it is the law that the United States started with in Cady Roberts and Texas Gulf Sulphur, without the curtailment of Chiarella and Dirks”); see also Edward Greene & Olivia Schmid, Duty-Free Insider Trading, 2013 Colum. Bus. L. Rev. 369, 373 (2013) (discussing the European insider trading regulation).

528. See supra notes 427-34 and accompanying text. See Bainbridge, supra note 103, at 1603.
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phenomenon has given rise to the complexity, conceptual distortions, and enduring confusion surrounding insider trading law in the United States.

Overall, these circumstances pose perhaps the most basic and baffling puzzle lodged inside the modern insider trading enigma. Assuming the large scope of the deficiencies current insider trading regulation embodies, and the gravity of the concerns those failings generate, what principle or policy would justify maintaining the prevailing theoretical foundation and structure of the insider trading prohibition in place? More critical still is another inquiry that now arises: the absence of suitable corrective measures from the authorities charged with addressing such fundamental legal problems. Why have Congress and the SEC not stepped in with responsive legislation or regulation? And why has the Supreme Court not even acknowledged the existence of such elemental errors and inefficiencies and frequent distortions of doctrine? To the contrary, on the various occasions it has been called upon to intervene with curative guidance, the Court has strongly reaffirmed the core principles of insider trading regulation that it originally embraced in Chiarella and Dirks.

If a favorable timing and momentum for the necessary reform developed in Congress, the SEC, or the Supreme Court to improve insider trading law, the starting point for any such measure should be stripping away the cumbersome fictional elements responsible for creating the inconsistencies and confusion that characterize current doctrine. The core of a simpler and more coherent regulatory scheme exists in the model that follows from the preceding discussion. Effective insider trading regulation requires grounding in Section 16 and a legal theory based on fairness principles designed to protect investors and promote integrity and confidence in the marketplace by prohibiting securities transactions executed on the basis of knowing possession of unwarranted informational advantages.