

THE INSIDER TRADING PROHIBITION ACT: A SMALL STEP TOWARDS A CODIFIED INSIDER TRADING LAW

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ABSTRACT

Many have called for reform to insider trading law, as the current judge-made doctrine is ambiguous, complicated, and ultimately permissive of many instances of trading on nonpublic information. Indeed, Congress has attempted several times to pass a uniform insider trading statute. Most recently, in December 2019, the House of Representatives passed the Insider Trading Prohibition Act (“ITPA”). The legislation codifies many current principles of insider trading jurisprudence while also expanding potential insider trading liability. Moreover, it attempts to fix gaps in the law that various cases, such as *United States v. Newman*, have declined to address.

Among other flaws, by requiring a tippee to know that the initial tipper received a personal benefit, *Newman* has made it extremely difficult for the Government to prosecute remote tippees in long tipping chains. This essentially permits insider trading in such situations, which often involve sophisticated investors at large hedge funds. The ITPA would properly eliminate this requirement that the tippee know of the tipper’s personal benefit, instead shifting the focus of the analysis to whether the tippee knew that the information itself was obtained wrongfully.

Legislation is advantageous because it provides notice and due process in a way that judge-made law cannot. Moreover, recent convoluted cases have left significant gaps that would best be filled by clearly drafted legislation. Although the ITPA is a step in the

* J.D. Candidate, Fordham University School of Law, 2021; B.B.A. Villanova University, 2018. I would like to thank the editors and staff of the *Fordham Journal of Corporate & Financial Law* for their help in the editing process. I would especially like to thank Professor Caroline Gentile for guiding me through this Note and making invaluable contributions. I could not have completed this without her advice, mentorship, and support. Thank you also to my friends and family for all their encouragement throughout law school.

right direction towards a codified insider trading law, it is not a perfect solution. This Note briefly explains the development of insider trading law and the ITPA itself, identifies some of the Act's current flaws, and proposes various improvements. The ITPA would benefit from enhanced clarity, separate standards for criminal and civil liability, and a more expansive definition of "personal benefit." A broadened definition provides an opportunity to distinguish between information used for legitimate and illegitimate corporate purposes. In sum, the altered definition seeks a balance between preventing improper motives and preserving incentives for diligent market research.

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INTRODUCTION

Chris Collins, a former member of the U.S. House of Representatives, became ensnared in a highly publicized insider trading scandal in 2018.¹ As a major stakeholder in the Australian biotech company Innate Immunotherapeutics, Collins received private information that the company's only product had failed a "do-or-die" drug trial.² He immediately called his son, Cameron Collins, from the White House lawn, who subsequently sold his stock.³

When the news of the failed drug trial became public, the company's stock price dropped 90%.⁴ Cameron saved more than \$570,000 by trading before the news was released.⁵ Cameron also passed the information along to his fiancée and her father, Stephen Zarkesy, who also sold his shares to avoid losses.⁶ Chris Collins, Cameron Collins, and Stephen Zarkesy were all charged with insider trading.⁷ Chris Collins faced up to ten years in prison, but was sentenced to twenty-six months after pleading guilty.⁸ Mr. Zarkesy's wife, daughter, and brother also sold their holdings before the price dropped, but did not face any charges.⁹

This case is a small example of just how many parties can be involved in an insider trading scheme. Often, complex cases of remote

1. Alan Feuer & Shane Goldmacher, *New York Congressman Chris Collins Is Charged With Insider Trading*, N.Y. TIMES (Aug. 8, 2008), <https://www.nytimes.com/2018/08/08/nyregion/chris-collins-insider-trading.html> [https://perma.cc/GG4Q-2SLR].

2. *Id.*

3. Kevin Breuninger, *Former GOP Rep. Chris Collins pleads guilty in insider trading case*, CNBC (Oct. 1, 2019, 4:40 PM), <https://www.cnbc.com/2019/10/01/former-gop-rep-chris-collins-pleads-guilty-in-insider-trading-case.html> [https://perma.cc/PU97-AYM4].

4. *Id.*

5. *Id.*

6. Feuer, *supra* note 1.

7. *Id.*

8. Erin Durkin, *Collins Sentenced to 26 Months for Insider Trading Scheme*, POLITICO (Jan. 17, 2020, 5:58 PM), <https://www.politico.com/states/new-york/albany/story/2020/01/17/collins-sentenced-to-26-months-for-insider-trading-scheme-1252648> [https://perma.cc/B6LX-362T]. President Trump later pardoned Collins. Bruce Golding, *Disgraced ex-pol Chris Collins released from prison after Trump pardon*, N.Y. POST (Dec. 23, 2020), <https://nypost.com/2020/12/23/ex-pol-chris-collins-released-from-prison-after-trump-pardon/> [https://perma.cc/CS82-BKAP].

9. Feuer, *supra* note 1.

tipping¹⁰ prove difficult, if not impossible, to prosecute given the current state of insider trading jurisprudence.¹¹ Indeed, this may be why prosecutors did not indict Mr. Zarksy's wife, daughter, and brother in the Collins case.¹² Many have urged for reform of insider trading law, as the current compilation of judge-made law is ambiguous, contradictory, and ultimately allows many instances of trading on nonpublic information to occur legally.¹³

Many scholars debate the justifications and efficacy of insider trading prohibitions.¹⁴ Some claim insider trading regulation is "unnecessary and counterproductive," focusing instead on the benefits such trading brings to the market, including "prompt price adjustment to new private information."¹⁵ Others justify regulation for reasons including the need to promote public disclosure and to protect confidential information as a form of corporate property.¹⁶ These debates have taken heightened significance after the U.S. Court of Appeals for the Second Circuit's decision in *United States v. Newman*.¹⁷ Many have called for legislation from Congress, and there have been previous attempts to enact a law.¹⁸ Most recently, the House of

10. The term "remote" tippee is used to refer to a tippee who is "at least one degree removed from the original tipper." Kathleen Coles, *The Dilemma of the Remote Tippee*, 41 GONZ. L. REV. 181, 184 n.18 (2006). Thus, it will be used throughout this Note to refer to a situation such as an insider-tipper giving information to an initial tippee, and that tippee then passing it to another.

11. See *infra* Section II.A.2.

12. See Andrew C. Spacone, *The Second Circuit's Curious Journey Through the Law of Tippee Liability for Insider Trading: Newman to Martoma*, 24 ROGER WILLIAMS UNIV. L. REV. 1, 7, 43 (2019).

13. See *infra* Section II.B.1.

14. See JAMES D. COX, ROBERT W. HILLMAN, DONALD C. LANGEVOORT, ANN M. LIPTON & WILLIAM K. SJOSTROM, *SECURITIES REGULATION: CASES AND MATERIALS* 868 (9th ed. 2020).

15. See *id.* ("Some economics-oriented legal scholars remain convinced that insider trading regulation is both unnecessary and counterproductive in that it frustrates prompt price adjustment to new private information.").

16. See *id.* ("Others justify restriction on a diverse set of grounds: the reduction of informational asymmetry as a means of lowering market transaction costs, the elimination of disincentives to prompt public disclosure of information by management, and—perhaps most commonly—the desire to protect confidential information as a form of corporate property.").

17. 773 F.3d 438 (2d Cir. 2014).

18. See PREET BHARARA ET AL., *REPORT OF THE BHARARA TASK FORCE ON INSIDER TRADING* 9 (2020).

Representatives passed the Insider Trading Prohibition Act (“ITPA” or the “Act”), which attempts to codify many aspects of current insider trading jurisprudence and to fix many of the gaps that exist after *Newman*.¹⁹

Part I of this Note briefly explains the development of insider trading law. Part II introduces the changes the ITPA would make and analyzes certain flaws in current insider trading jurisprudence. Part III discusses whether the ITPA poses any improvement and recommends adjustments to the bill. Ultimately, the Act would benefit from more explanatory language, differing standards of civil and criminal liability, and a broadened definition of personal benefit.

I. THE DEVELOPMENT OF CURRENT INSIDER TRADING JURISPRUDENCE

A. THE HISTORY OF RULE 10B-5 AND ITS INTERPRETATION

Congress has never legislated “with any degree of precision” a prohibition on insider trading.²⁰ In fact, federal securities laws did not exist until the 1930s,²¹ when the Securities Act of 1933 (the “Securities Act”) and the Securities Exchange Act of 1934 (the “Exchange Act”) were enacted.²² Section 10(b) of the Exchange Act is the basis for modern insider trading jurisprudence, although it is not explicit in this function.²³

Pursuant to Section 10(b), it is illegal to “use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention” of

19. See Insider Trading Prohibition Act, H.R. 2534, 116th Cong. (2019); see also Lyle Roberts, *The Insider Trading Law Is Bad. Will Congress Make It Worse?*, WALL ST. J. (Jan. 9, 2020, 6:58 PM ET), <https://www.wsj.com/articles/the-insider-trading-law-is-bad-will-congress-make-it-worse-11578614315> [<https://perma.cc/54HH-3JVS>].

20. COX, *supra* note 14, at 867. Although Section 16(b) of the Securities Exchange Act of 1934 allows an issuer affected by insider trading to recover insider short-swing profits, it is limited in scope and hardly used. *Id.*; see also Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition*, 52 WASH. & LEE L. REV. 1189, 1229 (1995).

21. See COX ET AL., *supra* note 14, at 19.

22. See *id.* at 5–7.

23. See *United States v. Newman*, 773 F.3d 438, 445 (2d Cir. 2014) (“Although Section 10(b) was designed as a catch-all clause to prevent fraudulent practices . . . neither the statute nor the regulations issued pursuant to it, including Rule 10b-5, expressly prohibit insider trading.”) (internal citation omitted).

any rules or regulations of the U.S. Securities and Exchange Commission (SEC).²⁴ Further, SEC Rule 10b-5 prohibits any person from employing “any device, scheme, or artifice to defraud . . . in connection with the purchase or sale of any security.”²⁵ Based on this provision, insider trading jurisprudence subsequently developed in what Judge Jed S. Rakoff has described as a “topsy-turvy” fashion.²⁶

In the 1960s, the SEC began relying on these antifraud provisions to prohibit corporate insiders from trading based on material nonpublic information.²⁷ Initially, courts accepted an “equal access” theory of insider trading.²⁸ Essentially, those who benefitted from inside information disturbed the expectation of markets that all investors “have relatively equal access to material information.”²⁹ Thus, *anyone* who obtained material nonpublic information had a duty to either “disclose it to the investing public . . . [or] abstain from trading.”³⁰ It was critical that the trading entailed some form of manipulation or deception.³¹

Eventually, the Supreme Court rejected this equal access theory and instead embraced the “classical theory”³² as a way to limit the scope of insider trading liability.³³ In *Chiarella v. United States*, the Court explained that Section 10(b) does not create a duty to disclose when “anyone” possesses nonpublic information, but rather that a duty exists only when there is a “relationship of trust and confidence between parties to a transaction.”³⁴ Thus, as a “markup man” for a financial printer hired to print documents regarding a takeover bid, Chiarella did

24. 15 U.S.C. § 78j.

25. 17 C.F.R. § 240.10b-5.

26. *United States v. Whitman*, 904 F. Supp. 2d 363, 372 (S.D.N.Y. 2012) (Rakoff, J.) (remarking on “the topsy-turvy way the law of insider trading has developed in the courts”), *aff’d*, 555 F. App’x 98 (2d Cir. 2014).

27. See *Cady, Roberts & Co.*, Exchange Act Release No. 6668, 1961 WL 60638, at *3–4 (Nov. 8, 1961).

28. See *SEC v. Tex. Gulf Sulphur Co.*, 401 F.2d 833, 848 (2d Cir. 1968).

29. *Id.*

30. *Id.*

31. See *Santa Fe Indus. v. Green*, 430 U.S. 462, 473–74 (1977).

32. The classical theory focuses on the duty of the corporate insider to either fully disclose or else abstain from trading on nonpublic information. See Michael P. Kenny & Teresa D. Thebaut, *Misguided Statutory Construction to Cover the Corporate Universe: The Misappropriation Theory of Section 10(b)*, 59 ALB. L. REV. 139, 181 (1995).

33. See generally *Chiarella v. United States*, 445 U.S. 222 (1981).

34. *Id.* at 230, 235.

not have any relationship of trust and confidence to the target companies whose stocks he traded, and was therefore not liable.³⁵

Years later, the Supreme Court adopted “misappropriation theory” as a complement to the classical theory.³⁶ Rather than focusing on the insider’s relationship to the issuer of the securities, misappropriation theory premises liability on a “breach of duty owed to the *source* of the information.”³⁷ In *United States v. O’Hagan*, a partner at a law firm representing the acquiring company in a tender offer purchased securities in the target company.³⁸ The Supreme Court found O’Hagan liable because he breached a duty owed to his law firm.³⁹ While under *Chiarella*, O’Hagan would only have been prohibited from trading securities of the acquiring company (the entity to which he owed a relationship of trust and confidence), under the misappropriation theory, O’Hagan was prohibited from trading securities of both the acquiring and target companies unless he disclosed his trades to the source of the information—his law firm.⁴⁰

B. TIPPER-TIPPEE LIABILITY

Both the classical and misappropriation theories prohibit an insider from trading on her own account, or from tipping another who then trades on this information.⁴¹ A tippee derives a duty to disclose or abstain from the insider-tipper.⁴² However, a tippee is not prohibited from trading anytime they receive nonpublic information from the tipper.⁴³ Instead, the tipper must have benefitted, directly or indirectly, from disclosing the information to the tippee.⁴⁴ Without a personal gain to the insider-tipper, “there has been no breach of duty to stockholders” and correspondingly, “there is no derivative breach” by the tippee.⁴⁵

35. See *id.* at 224, 233–34.

36. See *United States v. O’Hagan*, 521 U.S. 642, 652–53 (1997).

37. *Id.* at 652 (emphasis added).

38. *Id.* at 647.

39. *Id.* at 653, 660.

40. *Id.* at 651–52.

41. See *SEC v. Obus*, 693 F.3d 276, 285–86 (2d Cir. 2012). This Note will refer to this concept as “tipper-tippee liability.”

42. See *Dirks v. SEC*, 463 U.S. 646, 659 (1983).

43. See *id.* at 654–55.

44. *Id.* at 662.

45. *Id.*

This “personal benefit” requirement is satisfied if the tipper receives a “pecuniary gain or reputational benefit that will translate into future earnings.”⁴⁶ Circumstances that may lead to an inference of this benefit include, “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.”⁴⁷ Additionally, a benefit may be inferred “when an insider makes a gift of confidential information to a trading relative or friend” and “[t]he tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient,” also known as gift theory.⁴⁸ In sum, the tippee inherits a fiduciary duty to shareholders not to trade only when the insider has breached his duty by disclosing the information (for a personal benefit), and the tippee knows (or should know) that there has been a breach.⁴⁹

Both the personal benefit requirement and the tippee knowledge requirement were further explained in *United States v. Newman*.⁵⁰ The tippee must know not only that the “insider disclosed confidential information,” but also “that he did so in exchange for a personal benefit.”⁵¹ Further, the court narrowed the ability to establish a personal benefit under gift theory.⁵² After *Newman*, this sort of personal benefit required 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.”⁵³ The Supreme Court later abrogated this portion of *Newman* in *Salman v. United States*.⁵⁴ However, the Supreme Court noted that the *Salman* opinion did not affect the other holdings in *Newman*, particularly the requirement that tippees know “the information they traded on came from insiders or that the insiders received a personal benefit in exchange for the tips.”⁵⁵

46. *Id.* at 654, 663.

47. *Id.* at 664.

48. *Id.*

49. *See id.* at 660.

50. 773 F.3d 438 (2d Cir. 2014).

51. *Id.* at 442.

52. *See Dirks*, 463 U.S. at 664.

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

54. 137 S. Ct. 420, 428 (2016).

55. *Id.* at 425 n.1.

The most recent landmark case in insider trading jurisprudence is *United States v. Martoma*.⁵⁶ In affirming the conviction of Martoma, the Second Circuit found that a *quid pro quo* existed between Martoma and the insider, Dr. Gilman, based on consulting agreements.⁵⁷ Additionally, *Martoma* modified gift theory by suggesting that a personal benefit could include a stand-alone intention to benefit another, even without any preexisting relationship.⁵⁸ This is a new development in insider trading jurisprudence, as prior cases all agreed there must be some sort of relationship to establish a personal benefit under gift theory.⁵⁹

C. THE INSIDER TRADING PROHIBITION ACT

On December 9, 2019, the House of Representatives passed the Insider Trading Prohibition Act.⁶⁰ The Act codifies certain aspects of existing law, but also expands potential insider trading liability.⁶¹ Most notably, the bill shifts the focus from fraud and deception to whether information was obtained “wrongfully.”⁶²

The ITPA prohibits the purchase or sale of securities while a person is aware of material nonpublic information, if the person “knows, or recklessly disregards, that such information has been obtained

56. 894 F.3d 64 (2d Cir. 2017). There were two *Martoma* opinions published by the Second Circuit. See generally *id.*; 869 F.3d 58 (2d Cir. 2017); see also Donald C. Langevoort, *Watching Insider Trading Law Wobble: Obus, Newman, Salman, Two Martomas, and a Blaszcak*, GEORGETOWN LAW FACULTY PUBLICATIONS AND OTHER WORKS 5 (2019), <https://scholarship.law.georgetown.edu/facpub/2209> [<https://perma.cc/YN8G-RLBM>]. The second, superseding opinion is the one discussed here.

57. See *Martoma*, 894 F.3d at 68–69, 71.

58. See *id.* at 74–75 (“The comma separating the ‘intention to benefit’ and ‘relationship . . . suggesting a *quid pro quo*’ phrases can be read to sever any connection between them.”).

59. See *Dirks v. SEC*, 463 U.S. 646, 664 (1983) (explaining there can be a breach of fiduciary duty if an insider “makes a gift of confidential information to a trading relative or friend”); *Salman*, 137 S. Ct. at 427 (affirming the gift-giving standard set in *Dirks* that a “gift of confidential information to ‘a trading relative’” constitutes a personal benefit); *United States v. Newman*, 773 F.3d 438, 452 (2d Cir. 2014), (“To the extent *Dirks* suggests that a personal benefit may be inferred from a personal relationship between the tipper and tippee, where the tippee’s trades ‘resemble trading by the insider himself followed by a gift of the profits to the recipient’ . . . we hold that such an inference is impermissible in the absence of proof of a meaningfully close personal relationship”), *abrogated by Salman*, 137 S. Ct. 420.

60. Insider Trading Prohibition Act, H.R. 2534, 116th Cong. (2019).

61. *Id.*

62. See *id.*; BHARARA ET AL., *supra* note 18, at 12.

wrongfully, or that such purchase or sale would constitute a wrongful use of such information.”⁶³ “Wrongful” has many possible definitions within the Act, including if the information was “obtained by” or “would constitute”:

(A) theft, bribery, misrepresentation, or espionage . . . (B) a violation of any Federal law protecting computer data or the intellectual property or privacy of computer users; (C) conversion, misappropriation, or other unauthorized and deceptive taking of such information; or (D) a breach of any fiduciary duty, a breach of a confidentiality agreement, a breach of contract, a breach of any code of conduct or ethics policy, or a breach of any other personal or other relationship of trust and confidence for a direct or indirect personal benefit (including pecuniary gain, reputational benefit, or a gift of confidential information to a trading relative or friend).⁶⁴

The Act also makes clear that it is not necessary that the person trading knows how the information was obtained, or that the person trading knows whether a someone in the chain of communication received a personal benefit, so long as the trader “was aware, consciously avoided being aware, or recklessly disregarded that such information was wrongfully obtained, improperly used, or wrongfully communicated.”⁶⁵

Thus, the Act codifies certain aspects of existing case law.⁶⁶ For example, the definition of “wrongful” includes a breach of fiduciary duty or any other breach of trust and confidence for a personal benefit.⁶⁷ Further, prohibiting trading while “aware” of information parallels the “knowing possession” standard used in the Second Circuit and Rule 10b5-1(b).⁶⁸

However, the bill also would make numerous changes to existing law.⁶⁹ For example, a clear prohibition on computer hacking is new to

63. H.R. 2534, 116th Cong. (2019).

64. *Id.*

65. *Id.*

66. See Jonathan E. Richman & Joshua M. Newville, *House Passes Proposed Legislation Defining Insider Trading*, NAT’L L. REV. (Dec. 12, 2019), <https://www.natlawreview.com/article/house-passes-proposed-legislation-defining-insider-trading> [<https://perma.cc/8BT2-RTFM>].

67. H.R. 2534, 116th Cong. (2019).

68. See Richman & Newville, *supra* note 66.

69. See H.R. 2534, 116th Cong. (2019); Richman, *supra* note 66; Stephen L. Ascher, Charles D. Riely & Melissa T. Fedornak, *H.R. 2534 Insider Trading*

insider trading law.⁷⁰ Additionally, the ITPA eliminates the *Newman* requirement that a tippee know of the tipper's personal benefit.⁷¹ Further, it must be "reasonably foreseeable" to the tipper that the tippee will trade on the information given, which aims to protect disclosure to those who would not use the information for securities trading, such as journalists.⁷² Moreover, the Act insulates a fund manager in a situation of employee misconduct if the manager was not involved.⁷³

II. COMPARING TIPPER-TIPPEE LIABILITY AND THE ITPA

A. GAPS REMAINING AFTER *MARTOMA*, *SALMAN*, AND *NEWMAN*

After *Newman*, prosecuting tipper-tippee insider trading became significantly more difficult.⁷⁴ This was especially so in cases of "remote" tipping (as opposed to direct tipper-tippee liability).⁷⁵ The Government must prove that the insider-tipper disclosed confidential information for a personal benefit, and that the tippee knew of this breach, including the tipper's personal benefit.⁷⁶ The facts of *Newman* itself illustrate the gaps this standard creates.⁷⁷

Prohibition Act Passes House, LEXOLOGY (Dec. 13, 2019), <https://www.lexology.com/library/detail.aspx?g=65be634b-9aaa-433e-b520-21267826e9ff> [https://perma.cc/HVE5-XYUY].

70. See Ascher et al., *supra* note 69 (explaining that although the government has brought cases where insiders obtained information through hacking, these cases do not necessarily "fit neatly" within current insider trading jurisprudence and the Second Circuit has even suggested not all forms of computer hacking violated the anti-fraud statute).

71. See H.R. 2534, 116th Cong. (2019); *United States v. Newman*, 773 F.3d 438, 442 (2d Cir. 2014).

72. H.R. 2534, 116th Cong. (2019); see also Ascher et al., *supra* note 69.

73. H.R. 2534, 116th Cong. (2019) ("Except as provided in section 20(a), no person shall be liable . . . solely by reason of the fact that such person controls or employs a person who has violated this section, if such controlling person or employer did not participate in, or directly or indirectly induce the acts constituting the violation of this section."); see also Richman & Newville, *supra* note 66 ("This provision could provide protection to a fund manager whose employee has gone rogue, as long as the employer itself did not participate in or induce the alleged misconduct.").

74. See Maria Babajanian, Note, *Rewarded for Being Remote: How United States v. Newman Improperly Narrows Liability for Tippees*, 46 STETSON L. REV. 199, 201 (2016).

75. See *id.* at 201, 202 n.20.

76. See *Newman*, 773 F.3d at 442, *abrogated by* *Salman v. United States*, 137 S. Ct. 420 (2016). Although *Dirks* explains that the tippee is liable if he knew or should

In *Newman*, several financial analysts at hedge funds and investment firms shared information tipped from company insiders of Dell and NVIDIA.⁷⁸ The analysts exchanged these companies' earnings numbers before they were publicly released.⁷⁹ However, the Second Circuit reversed the judgment of the lower court and vacated the convictions against Newman, a portfolio manager at Diamondback Capital Management, and Chiasson, a portfolio manager at Level Global Investors.⁸⁰ Because Newman and Chiasson were three and four levels removed from the insider, the Government failed to prove that they knew of the benefit the insider-tipper received from exchanging this information.⁸¹

However, this ruling is problematic considering that Newman and Chiasson were sophisticated investors and portfolio managers at billion-dollar hedge funds.⁸² They knew Dell's and NVIDIA's public earnings announcements were forthcoming in May 2008.⁸³ Although one could plausibly argue that Newman and Chiasson did not know the information was traded on a nonpublic basis,⁸⁴ this seems highly unlikely.⁸⁵ Plainly, a sophisticated investor knows that the receipt of a

have known of a breach by the tipper, the case is silent on whether the tipper must know specifically of the tipper's personal benefit. *Dirks v. SEC*, 463 U.S. 646, 660 (1983). However, *Newman* concludes "the answer follows naturally from *Dirks*." 773 F.3d at 447.

77. See *id.* at 442–44.

78. See *id.*

79. *Id.* at 443.

80. *Id.* at 442–43, 455.

81. See *id.* at 443, 448, 455.

82. See Amanda Cantrell, *Diamondback Founders Return With Billion-Dollar Hedge Fund*, INSTITUTIONAL INVESTOR (Sept. 17, 2019), <https://www.institutionalinvestor.com/article/b1h6d9xw5dwdxj/Diamondback-Founders-Return-With-Billion-Dollar-Hedge-Fund> [https://perma.cc/2ZNY-J45P]; Daniel Fisher, *Former Level Global Counsel Says Insider-Trading Decision Didn't Clarify Much*, FORBES (Dec. 10, 2016, 7:51 AM), <https://www.forbes.com/sites/danielfisher/2016/12/10/former-level-global-counsel-says-insider-trading-decision-didnt-clarify-much/#5beb2553154b> [https://perma.cc/UP6P-ZDVS].

83. *Newman*, 773 F.3d at 443.

84. See Tebsy Paul, *Friends with Benefits: Analyzing the Implications of United States v. Newman for the Future of Insider Trading*, 5 AM. U. BUS. L. REV. 109, 126 (2015).

85. See Bruce Dorris, *If the Supreme Court Won't Help Stop Insider Trading, Who Will?*, FRAUD MAGAZINE (Oct. 2015), <https://www.fraud-magazine.com/article.aspx?id=4294990341> [https://perma.cc/4SLV-NXYZ].

company's earnings numbers before they are publicly announced constitutes material nonpublic information.⁸⁶ Further, a number of courts have said that "it can be reckless to ignore the likelihood that multiple accurate tips were somehow the product of innocence."⁸⁷ In sum, Newman and Chiasson could not have been unaware that they were trading on inside information, which was the Government's exact argument in *Newman*.⁸⁸ Essentially, "as sophisticated traders, they must have known that information was disclosed by insiders in breach of a fiduciary duty, and not for any legitimate corporate purpose."⁸⁹ Yet, the Second Circuit vacated their convictions and ordered their indictments be dismissed.⁹⁰

Aside from this major flaw, other gaps remain after *Newman*.⁹¹ For example, the court used the phrase "should have known" at some points in the opinion, but at others simply focused on actual knowledge.⁹² The court even discussed that there was insufficient evidence to establish that Newman and Chiasson "knew, or *deliberately avoided knowing*" the information came from insiders.⁹³ These suggestions of lower standards of scienter conflict with the conclusion of the court that "a tippee's knowledge of the insider's breach necessarily requires knowledge that the insider disclosed confidential information in exchange for personal benefit."⁹⁴ Thus, the actual holding of *Newman* ignores the "should know" language in *Dirks*.⁹⁵

Further, *Newman* suggests that in other circumstances a tippee's knowledge of the tip's source could be inferred, such as when a tip is

86. See *id.*

87. Langevoort, *supra* note 56, at 41–42 ("[T]he leaks were high quality and repeated, suggesting deliberateness from within the companies.").

88. See *Newman*, 773 F.3d at 443–44.

89. *Id.*

90. *Id.* at 455.

91. See Langevoort, *supra* note 56, at 38–39.

92. *Newman*, 773 F.3d at 455 (stating that the facts at hand did not support the Government's inference that "defendants *knew, or should have known*, that the information originated with a corporate insider" (emphasis added)).

93. *Id.* (emphasis added).

94. *Id.* at 449. For example, there is no suggestion in the court's actual holding that anything less than actual knowledge (such as "reckless disregard") would suffice to establish liability. See *id.*

95. Langevoort, *supra* note 56, at 38–39 (noting that although at points in the opinion, the *Newman* court quotes the language in *Dirks*, it is never actually addressed).

“sufficiently detailed and proprietary.”⁹⁶ There could also be tips that are so “overwhelmingly suspicious” that a tippee must “[know] or consciously [avoid] knowing” this information stemmed from an insider receiving a personal benefit.⁹⁷ However, the court found that the tips did not rise to that level of suspicion in *Newman*.⁹⁸ This conclusion is problematic, because if *Newman* is not an example of “suspicious” information that could be inferred to be from an inside source, it is difficult to imagine what is.⁹⁹

These gaps remain even after *Salman* and *Martoma*. In *Salman*, the Supreme Court abrogated part of *Newman*’s holding related to gift theory and what exactly is considered a personal benefit.¹⁰⁰ However, the tippee’s knowledge was not an issue in *Salman*, as the tipping involved family members.¹⁰¹ *Salman* was involved in a tipping scheme with his brother-in-law, Maher Kara, and Maher’s brother, Michael Kara.¹⁰² *Salman* learned from Michael that the source of the information exchange was Maher.¹⁰³

The tippee’s knowledge was also not an issue in *Martoma*, as that case dealt with direct tipper-tippee liability.¹⁰⁴ However, the Second Circuit reaffirmed *Newman*’s holding that a tippee must be aware that

96. *Newman*, 773 F.3d at 455 (“[I]n this case, where the financial information is of a nature regularly and accurately predicted by analyst modeling, and the tippees are several levels removed from the source, the inference that defendants knew, or should have known, that the information originated with a corporate insider is unwarranted.”). However, even if that were so, it would not, without more, “permit an inference as to that source’s improper *motive* for disclosure.” *Id.*

97. *Id.*

98. *Id.*

99. See *Langevoort*, *supra* note 56, at 41 (“[T]he leaks were high quality and repeated, suggesting deliberateness from within the companies.”).

100. *Salman v. United States*, 137 S. Ct. 420, 423–24, 428 (2016) (“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 . . . we agree with the Ninth Circuit that this requirement is inconsistent with *Dirks*.” (citation omitted)).

101. *Id.* at 427–28.

102. *Id.* at 423–24.

103. *Id.* at 425.

104. *United States v. Martoma*, 894 F.3d 64, 76 (2d Cir. 2017) (“We observe that, unlike the defendants in *Newman*, *Martoma* received confidential information directly from the tipper, and he does not claim that he was unaware of any personal benefit Dr. Gilman received.”).

the tipper breached a fiduciary duty and that the tipper received a personal benefit in doing so.¹⁰⁵

1. Rationales

Newman emphasizes capital market efficiency and incentivizing investors to seek an informational advantage.¹⁰⁶ The court explicitly states that “nothing in the law requires a symmetry of information in the nation’s securities markets.”¹⁰⁷ The holding is rooted in precedent, such as *Chiarella*, which rejected any notion that equal access to information for all was required under federal securities laws.¹⁰⁸ To be sure, since *Chiarella*, the Supreme Court has never adopted an approach to insider trading that embraced complete information parity.¹⁰⁹ *Newman* reasons that requiring a tippee to know of the tipper’s benefit strikes the proper balance between protecting a “corporation’s interest in confidentiality” and “promoting efficiency in the nation’s securities markets.”¹¹⁰

Dirks invoked many of the same rationales.¹¹¹ The facts of *Dirks* illustrate exactly why courts have deliberately chosen to limit the possible breadth of insider trading liability.¹¹² There, *Dirks* was an officer of a broker-dealer firm that provided investment analysis of insurance company securities to institutional investors.¹¹³ He received a tip from Ronald Secrist, a former officer of Equity Funding of America, alleging there were fraudulent practices within the company that led to overstatement of the company’s assets.¹¹⁴ In response, *Dirks* visited

105. *Id.* (“The Court persuasively explained that both were required.”).

106. *See* *United States v. Newman*, 773 F.3d 438, 449 (2d Cir. 2014):

The policy rationale [for prohibiting insider trading] stops well short of prohibiting all trading on material nonpublic information. Efficient capital markets depend on the protection of property rights in information. However, they also require that persons who acquire and act on information about companies be able to profit from the information they generate

Id. (quoting *United States v. Chestman*, 947 F.2d 551, 578 (2d Cir. 1991) (Winter, J., concurring)).

107. *Id.*

108. *Id.*

109. *See* *Salman v. United States*, 137 S. Ct. 420, 423 (2016). *But cf.* 17 C.F.R. § 240.14e-3 (embracing equal access theory in the context of insider trading regarding tender offers).

110. *Newman*, 773 F.3d at 449.

111. *See generally* *Dirks v. SEC*, 463 U.S. 646 (1983).

112. *Id.* at 648–49.

113. *Id.* at 648.

114. *Id.* at 649.

Equity Funding's headquarters, interviewed several of its officers and employees, and confirmed charges of fraud from certain employees (although not from senior management).¹¹⁵ Dirks and his firm did not own any Equity Funding stock, but Dirks openly discussed his findings with many clients and investors—some of whom subsequently sold their holdings in Equity Funding.¹¹⁶ Dirks even urged the *Wall Street Journal* to write a story on the fraud allegations, but the newspaper refused.¹¹⁷ During the two weeks Dirks conducted this investigation, Equity Funding's stock price fell dramatically, which eventually forced the New York Stock Exchange to halt trading.¹¹⁸

The SEC brought an investigation against Dirks.¹¹⁹ The Court of Appeals for the District of Columbia Circuit ruled against him.¹²⁰ However, the U.S. Supreme Court reversed, holding that a breach only occurs when the insider-tipper receives a personal benefit.¹²¹ Here, Secrist received no personal benefit—he did not obtain any monetary compensation for his tips, nor was his purpose to make a “gift” to Dirks.¹²² To the contrary, Secrist was motivated by a desire to expose the fraud occurring at Equity Funding.¹²³ Thus, without a breach by Secrist, there was no derivative breach by Dirks.¹²⁴

A key part of the *Dirks* holding was the importance of investment analysts in securities markets. Dirks himself played a crucial role in exposing Equity Funding's fraud, which had avoided the scrutiny of regulators and other public sources of information.¹²⁵ This efficient market justification is emphasized throughout the Court's opinion.¹²⁶ For example, the Court reasons that a broader rule could have an “inhibiting influence on the role of market analysts” who often “ferret out and

115. *Id.*

116. *Id.*

117. *Id.* at 649–50 (explaining that the newspaper refused to publish due to libel concerns).

118. *Id.* at 650.

119. *Id.*

120. *Id.* at 651–52.

121. *Id.* at 663.

122. *Id.* at 666–67.

123. *Id.* at 667.

124. *Id.*

125. *Id.* at 649, 651–52 (noting that the SEC even recognized Dirks' important role “in bringing [Equity Funding's] massive fraud to light,” and thus only censured him as a result of the investigation).

126. *Id.* at 649–52, 658–59.

analyze information” by meeting and questioning corporate insiders.¹²⁷ The nature of the information analysts receive in these circumstances “cannot be made simultaneously available to all of the corporation’s stockholders or the public generally.”¹²⁸

In sum, the rationale behind both *Newman* and *Dirks* is that it would be detrimental to the market if legitimate searches for information were “chilled by the threat of liability.”¹²⁹ Indeed, the “constant informal communication process between the issuer and competing individual analysts has . . . been recognized as an important contribution to marketplace efficiency[,]”¹³⁰ which remains the case even after the SEC adopted Regulation Fair Disclosure (“Reg FD”).¹³¹ Although one could argue that given the “semi-strong” form of the efficient market hypothesis, insider trading prohibitions should not affect market efficiency,¹³² it is not always easy to separate “public” and “nonpublic” information into distinguishable, “black-and-white,” categories.¹³³ In

127. *Id.* at 658.

128. *Id.* at 659.

129. See Langevoort, *supra* note 56, at 30.

130. COX ET AL., *supra* note 14, at 892 (citing Daniel R. Fischel, *Insider Trading and Investment Analysts: An Economic Analysis of Dirks v. Securities and Exchange Commission*, 13 HOFSTRA L. REV. 127 (1984)). Some have even argued insider trading regulation is “both unnecessary and counterproductive in that it frustrates prompt price adjustment to new private information.” *Id.* at 868.

131. *Id.* at 893; see also John L. Campbell, Brady J. Twedt, & Benjamin C. Whipple, *Did Regulation FD Prevent Selective Disclosure?*, THE CLS BLUE SKY BLOG (Jul. 18, 2016), <https://clsbluesky.law.columbia.edu/2016/07/18/did-regulation-fd-prevent-selective-disclosure/> [<https://perma.cc/Z4CD-TWPS>] (“[A]nalysts and institutional investors were concerned that an unintended consequence of [Reg FD] would be firms reducing their overall disclosure levels, ultimately resulting in less efficient markets.”). In 2000, the SEC passed Reg FD to prevent issuers from selectively disclosing material information. See COX ET AL., *supra* note 14, at 893. It mandates insiders who have disclosed private information to share that same information publicly (or abstain from disclosing the private information in the first instance). See 17 C.F.R. §§ 243.100–243.103. However, the efficacy of Reg FD is questionable. See, e.g., Campbell, *supra*.

132. See COX ET AL., *supra* note 14, at 88. In its “semi-strong” form, the efficient capital market hypothesis states that security prices reflect all publicly available information. *Id.*

133. Matt Levine, *Justices Will Know Insider Trading When They See It*, BLOOMBERG OPINION (Jan. 19, 2016, 5:48 PM), <https://www.bloomberg.com/opinion/articles/2016-01-19/justices-will-know-insider-trading-when-they-see-it> [<https://perma.cc/AMK5-89B7>].

fact, it is more often the case that the information analysts are seeking is a shade of gray.¹³⁴

For example, “public” information is typically that which is reasonably accessible to all investors.¹³⁵ It might seem obvious to say that newspaper articles are “public,” and that the unpublished results of a new drug’s clinical trial are “nonpublic.”¹³⁶ However, there is a vast amount of information that falls in between these opposite ends of the spectrum.¹³⁷ Is observing employees entering and leaving a factory from a public parking lot material nonpublic information? What about flying a drone over an industrial plant? What about a securities analyst hearing from an investor-relations person, “Yeah, things are trending a little lower than we thought . . .”?¹³⁸ Essentially, the concern is that strictly enforcing insider trading will make it harder for investment analysts to do their jobs and have a chilling effect on this sort of “gray”¹³⁹ information that drives the efficiency of markets.¹⁴⁰ Without limitations such as those imposed in *Chiarella* and *Dirks*, analysts would be left hoping that the SEC’s prosecutorial discretion will weigh in their favor.¹⁴¹

2. Critiques

The bottom line after *Newman* is that some people who have traded on material nonpublic information will simply be permitted to do so—as *Newman* itself illustrates, it is now incredibly difficult for the

134. See SHEELAH KOLHATKAR, BLACK EDGE 105-06 (2017) (describing public information as a “white edge,” obviously nonpublic and illegal information as “black edge,” and the trickier information in between as “grey edge”).

135. COX ET AL., *supra* note 14, at 872-73.

136. United States v. Martoma, 894 F.3d 64, 69 (2d Cir. 2017).

137. See KOLHATKAR, *supra* note 134, at xviii-xix.

138. *Id.* at 106.

139. *Id.* at 105-06.

140. See Langevoort, *supra* note 56, at 30-32; see also Levine, *supra* note 134 (explaining that an open exchange of information between shareholders and managers should be encouraged as this makes security prices more accurate and markets more efficient).

141. *Dirks v. SEC*, 463 U.S. 646, 664 n.24 (1983) (“Without legal limitations, market participants are forced to rely on the reasonableness of the SEC’s litigation strategy, but that can be hazardous, as the facts of this case make plain.”).

Government to prosecute remote tippees.¹⁴² It is hard to prove that the tippee knew of the tipper's personal benefit when there is a long chain of tippees removed from the initial disclosure of inside information.¹⁴³ One could even go as far as to say that *Newman* allows insider trading in these long tipper-tippee chains.¹⁴⁴

Preet Bharara, former United States Attorney for the Southern District of New York, described *Newman* as “essentially legalizing the don’t-ask-don’t-tell information gathering model” and granting “permission to trade on material nonpublic information, as long as you don’t know too much about where it came from.”¹⁴⁵ This especially manifests in large, decentralized hedge funds such as those involved in *Newman* and *Martoma*.¹⁴⁶ Indeed, it seems very unlikely that the manager of a hedge fund with a decentralized, separately managed, and competitive structure could ever be found guilty of insider trading.¹⁴⁷ *Martoma* itself illustrates this difficulty.¹⁴⁸

Matthew Martoma managed a portfolio at S.A.C. Capital Advisors (“SAC Capital”), focused on pharmaceutical and healthcare companies.¹⁴⁹ With the help of expert networking firms, Martoma consulted with doctors working on an Alzheimer’s drug clinical trial for two pharmaceutical companies, Elan and Wyeth.¹⁵⁰ Dr. Sidney Gilman, chair of the safety monitoring committee for the clinical trial, told Martoma the unsuccessful results of the trial before they were published; SAC Capital subsequently reduced its position in Elan and Wyeth, and entered into short-sales and option trades.¹⁵¹ Martoma was indeed convicted of insider trading, but his relations with Dr. Gilman could be described as direct tipper-tippee liability.¹⁵² On the other hand, federal

142. Sara Almousa, Comment, *Friends with Benefits? Clarifying the Role Relationships Play in Satisfying the Personal Benefit Requirement Under Tipper-Tippee Liability*, 23 GEO. MASON L. REV. 1251, 1276 (2016); Jessica Hostert, Note, *Great Expectations, Good Intentions, and the Appearance of the Personal Benefit in Insider Trading: Why the Stage Needs Reset After Martoma*, 43 S. ILL. UNIV. L.J. 703, 717 (2019).

143. Langevoort, *supra* note 56, at 37.

144. *See id.*

145. KOLHATKAR, *supra* note 134, at 291–92.

146. Levine, *supra* note 133.

147. *Id.*

148. *See generally* United States v. Martoma, 894 F.3d 64 (2d Cir. 2017).

149. *Id.* at 68–69.

150. *Id.* at 69.

151. *Id.* at 69–70.

152. *Id.* at 76.

prosecutors had pursued Steven Cohen, manager of SAC Capital, for almost a decade.¹⁵³ In addition to difficulties “flipping” witnesses to gain evidence against Cohen, after the U.S. Supreme Court denied certiorari in *Newman*, the chances of prosecutors convicting Cohen severely diminished.¹⁵⁴

Although the “market efficiency story”¹⁵⁵ might be true, when a large player like SAC Capital sells its holdings in Elan and Wyeth and shorts 4.5 million shares of Elan, earning roughly \$80.3 million in gains and \$194.5 million in averted losses, investors lose confidence in the market.¹⁵⁶ This is especially so when Martoma subsequently receives a \$9 million bonus from SAC Capital.¹⁵⁷ This loss in confidence discourages investment not only from retail investors, but also other investment analysts.¹⁵⁸ Ultimately, despite the arguments in support of market efficiency, the fundamental unfairness of this sort of conduct has led the SEC to continue to emphasize the need for regulation.¹⁵⁹

Further, a flaw in this “market efficiency” argument can also be seen in *Dirks* itself. As the dissent points out, if Dirks and Secrist wanted the market to be aware of the fraud occurring at Equity Funding, they could have reported this information to the SEC.¹⁶⁰ Eventually, Dirks did meet with the SEC’s Deputy Director of Enforcement, but only after his clients had “unloaded close to \$15 million of Equity Funding stock” before the price plummeted.”¹⁶¹ Dirks’ clients essentially “shift[ed] the losses that were inevitable due to the Equity Funding fraud from themselves to uninformed market participants.”¹⁶² Thus, even in a “beneficial” situation such as *Dirks*, where the insider exposed a massive fraud occurring in the company, shareholders still suffered from

153. See KOLHATKAR, *supra* note 134, at 281.

154. *Id.* at 282, 291 (“[The Supreme Court’s denial of certiorari] was yet another measure of vindication for Cohen . . .”). The structure of SAC Capital “was organized to insulate Cohen from the behavior of lower-level traders and analysts.” *Id.* at 143.

155. See *supra* Section II.A.1.

156. See *Martoma*, 894 F.3d at 70; see also KOLHATKAR, *supra* note 134, at 117; Babajanian, *supra* note 74, at 199.

157. See *Martoma*, 894 F.3d at 70 (2d Cir. 2017).

158. See KOLHATKAR, *supra* note 134, at 153 (explaining that the SEC received a referral letter about SAC Capital’s suspicious trades from a trader at RBC Capital Markets).

159. Spacone, *supra* note 12, at 11.

160. *Dirks v. SEC*, 463 U.S. 646, 668–69 (1983) (Blackmun, J., dissenting).

161. *Id.* at 670.

162. *Id.*

Secrist, their fiduciary, exposing inside information.¹⁶³ Justice Blackmun criticizes the majority as justifying the misconduct “because the general benefit derived from the violation of Secrist’s duty to shareholders outweighed the harm caused to those shareholders.”¹⁶⁴ In sum, although Dirks did expose a massive fraud, at the end of the day his clients profited while the rest of the market suffered losses.¹⁶⁵

B. THE ITPA SEEKS TO CLOSE THOSE GAPS

The ITPA attempts to expand tipper-tippee liability in a few ways.¹⁶⁶ First, the Act prohibits a person from tipping if it is “reasonably foreseeable” that the tippee will trade based on the tip.¹⁶⁷ Additionally, it seeks to restrain tipping chains by prohibiting an initial tippee from passing it on to a second tippee who then trades.¹⁶⁸

Most notably, the ITPA eliminates the tippee knowledge requirement of *Newman*.¹⁶⁹ It prohibits trading while aware of material nonpublic information if the trader “knows, or recklessly disregards, that such information has been obtained wrongfully, or that such purchase or sale would constitute a wrongful use of such information.”¹⁷⁰ The Act explicitly states:

It shall not be necessary that the person trading while aware of such information . . . knows the specific means by which the information was obtained or communicated, or whether any personal benefit was paid or promised by or to any person in the chain of communication, so long as the person trading while aware of such information or making the communication . . . was aware, consciously avoided being aware, or recklessly disregarded that such information was wrongfully obtained, improperly used, or wrongfully communicated.¹⁷¹

Thus, the focus shifts from whether the tippee knew of the personal benefit the tipper received to whether the tippee knew the information

163. *Id.* at 672–73.

164. *Id.* at 676–77.

165. *Id.*

166. H.R. 2534, 116th Cong. (2019).

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.* (emphasis added).

itself was obtained wrongfully.¹⁷² This “make[s] it easier for prosecutors to establish that a trader knew what he was doing was wrong.”¹⁷³

Thus, if *Newman* were to take place after the enactment of the ITPA, it would no longer be necessary that Newman and Chiasson knew of the personal benefit received by the original tipper, which was nearly impossible as Newman and Chiasson were three and four levels removed from the original tipper.¹⁷⁴ The focus would instead be whether Newman and Chiasson were aware, consciously avoided being aware, or recklessly disregarded that the information they traded on was “wrongful.”¹⁷⁵

Similarly, consider a scenario where a junior investment banker, Maria, wishes to transition into the hedge fund business.¹⁷⁶ She approaches a hedge fund manager at a party and slips a note with a tip about one of her upcoming deals in the manager’s pocket, with a “you’re welcome,” her name, and e-mail address.¹⁷⁷ If the hedge fund manager trades on this information, it would likely be considered in “reckless disregard” for the wrongfulness of the information.¹⁷⁸ In contrast, under current insider trading law, it would be easier to craft a defense that the hedge fund manager did not know whether there was a breach or whether Maria received any personal benefit.

However, under both these scenarios, the insider-tipper must still receive a personal benefit. The difference between the ITPA and current insider trading law is that under the ITPA, the tippee need not know of this personal benefit.¹⁷⁹

1. Rationales

Many have urged Congress to codify insider trading in legislation for some time.¹⁸⁰ Indeed, insider trading case law has been described as a “garden maze of doctrine that has too many circles and dead ends,”

172. *Id.*

173. Roberts, *supra* note 19.

174. H.R. 2534, 116th Cong. (2019); *United States v. Newman*, 773 F.3d 438, 443 (2d Cir. 2014).

175. H.R. 2534, 116th Cong. (2019).

176. COX ET AL., *supra* note 14, at 892.

177. *Id.*

178. H.R. 2534, 116th Cong. (2019).

179. *Id.*

180. BHARARA ET AL., *supra* note 18, at 14.

possessing “unnecessary complications,” and overall, “wobbling.”¹⁸¹ Creating judge-made law based on Section 10(b) and Rule 10b-5 is flawed in itself, as Rule 10b-5 is meant to regulate fraud, which is attenuated from the act of insider trading.¹⁸² Further, given that insider trading can impose criminal penalties, legislation can provide notice and due process in a way that judge-made law cannot, especially after the confusion created by many recent cases.¹⁸³

Shifting the focus of the inquiry to whether the information was obtained “wrongfully” adds clarity, while also expanding the scope of insider trading liability.¹⁸⁴ The ITPA focuses on the nature of the information itself and how it was obtained, rather than the tippee’s knowledge of the tipper’s personal benefit.¹⁸⁵ Thus, the ITPA curtails trading on information obtained in long chains of tippees that is permitted under existing insider trading law.¹⁸⁶ Under such a framework, portfolio managers of decentralized hedge funds cannot simply put many layers of analysts in between the investor and ultimate trader to avoid liability.¹⁸⁷ To the contrary, the ITPA prohibits turning a blind eye or purposely ignoring the source of the information.¹⁸⁸

2. Critiques

On the other hand, many disagree that legislation is the proper way to regulate insider trading. Common law does have some advantages, such as allowing judges to tailor holdings to the specific facts of the case.¹⁸⁹ Further, many believe that a clear statute in the insider trading context just provides “a roadmap for fraud” for sophisticated market

181. Langevoort, *supra* note 56, at 5, 50.

182. COX ET AL., *supra* note 14, at 868 (explaining that part of the conceptual difficulty of insider trading law stems from the conflict that exists between its “broad fairness-based aim” and “the narrower statutory mechanism that must be used to combat it”).

183. Langevoort, *supra* note 56, at 2, 7.

184. See *supra* Section II.A.2.; BHARARA ET AL., *supra* note 18, at 14.

185. Ascher et al., *supra* note 69.

186. H.R. 2534, 116th Cong. (2019).

187. See *supra* Section II.A.2.

188. See H.R. 2534, 116th Cong. (2019).

189. Jill E. Fisch, *Constructive Ambiguity and Judicial Development of Insider Trading*, 71 SMU L. REV. 749, 758 (2018).

actors to evade liability.¹⁹⁰ Legislation deprives the Government of the flexibility to prosecute new, creative insider trading misconduct.¹⁹¹

Additionally, the Act did not eliminate the personal benefit requirement altogether.¹⁹² Many argue that this requirement should be removed as it causes confusion, uncertainty, and incongruent results.¹⁹³ Worst of all, it permits insider trading even when there was an apparent breach of a duty.¹⁹⁴ In sum, it narrows the scope of insider trading liability without proper justification.¹⁹⁵ For example, as the REPORT OF THE BHARARA TASK FORCE ON INSIDER TRADING explains, “the requirement can create the misimpression in the market . . . that a pure gift of material nonpublic information, without any expectation of reciprocity, to someone who trades on that information might be allowed.”¹⁹⁶

The limiting nature of including this personal benefit approach can be illustrated using an example. Imagine Jamie Dimon, CEO of J.P. Morgan, taking the train home from work, and as he is rushing to get off at his stop, leaves a binder with confidential information in his seat. Another train passenger, picks up this binder, looks inside, and subsequently trades on this information. Under existing case law and the ITPA, there would be no liability—Dimon received no benefit by forgetting his binder on the train. This is so even if it was apparent to the passenger that this information is confidential. On the other hand, if the ITPA removed the personal benefit requirement altogether, the train passenger would be liable.¹⁹⁷

Further, because of the Act’s narrow definition of personal benefit, the ITPA would still not hold Newman or Chiasson, or even our

190. *Id.* at 760–61 (“If it is difficult to determine the precise behavior that will subject a trader to insider trading liability, it will be more difficult for a trader who would skirt the law to identify the precise limits on his or her behavior.”); *see also* Reed Harasimowicz, Note, *Nothing New, Man!—The Second Circuit’s Clarification of Insider Trading Liability in United States v. Newman Comes at a Critical Juncture in the Evolution of Insider Trading*, 57 B.C. L. REV. 765, 791 (2016).

191. Harasimowicz, *supra* note 190, at 791–92.

192. H.R. 2534, 116th Cong. (2019).

193. *See* BHARARA ET AL., *supra* note 18, at 15–16.

194. *Id.* at 16.

195. *Id.*

196. *Id.*

197. H.R. 2534, 116th Cong. (2019). This action would likely constitute a breach of a code of conduct or ethics policy. Additionally, the hypothetical passenger at least recklessly disregarded the possibility that the information was obtained wrongfully.

ambitious investment banker, Maria, who slipped a tip to the hedge fund manager, liable.¹⁹⁸ In *Newman*, the benefit to the insider was one to investor relations personnel, who wished to establish relationships with firms and analysts that were in a position to buy their company's stock.¹⁹⁹ The investor relations insider may give tips of good news in hopes that when there is bad news, the analysts are less likely to sell, or at least not as much as they would if they did not receive inside information.²⁰⁰ This information exchange creates a benefit to the investor relations personnel through traditional forms of compensation such as a raise, promotion, or stock options.²⁰¹ Although selective disclosure of this kind is prohibited by Reg FD, it is not a recognized personal benefit under current insider trading law.²⁰² Thus, in spite of the ITPA's attempts to reverse *Newman*, *Newman* and *Chiasson*'s conduct would still likely be permitted under the ITPA.²⁰³ Similarly, the benefit Maria likely seeks is a job with the hedge fund manager.²⁰⁴ This personal benefit is also not necessarily included under existing insider trading jurisprudence, nor is it recognized in the ITPA.²⁰⁵

Further, the ITPA contains various unclear aspects of its own.²⁰⁶ Some have remarked that the bill would lead to more confusion and give prosecutors too much discretion.²⁰⁷ The bill provides no guidance on what "constitutes the necessary confidentiality agreement, contract, or relationship of trust and confidence."²⁰⁸ Further, although many are pleased with the shift in focus to "wrongfulness," this term has

198. See *supra* Section II.B.

199. *United States v. Newman*, 773 F.3d 438, 453–55 (2d Cir. 2014).

200. See *id.* at 454–55 (describing investor relations personnel "routinely 'leak[ing]' earnings data in advance of quarterly earnings" in order to "establish relationships with financial firms who might be in a position to buy Dell's stock").

201. See Martin Bengtzen, *Private Investor Meetings in Public Firms: The Case for Increasing Transparency*, 22 *FORDHAM J. CORP. & FIN. L.* 33, 52–53 (2017) (explaining firms hold private investor meetings for many "intangible" reasons such as "bond[ing]" with investors, convincing them to buy stock, and generating liquidity).

202. COX ET AL., *supra* note 14, at 893.

203. H.R. 2534, 116th Cong. (2019).

204. COX ET AL., *supra* note 14, at 892.

205. See *supra* Section I.B.

206. See H.R. 2534, 116th Cong. (2019).

207. See Roberts, *supra* note 19 ("The bill would perplex investors, give prosecutors too much discretion, and bedevil the courts.").

208. *Id.*

ambiguities of its own.²⁰⁹ Thus, the ITPA may not provide significantly more clarity than current insider trading jurisprudence.²¹⁰

Others have criticized the Act because it does not distinguish between criminal and civil liability.²¹¹ The Act describes the relevant mental state as being aware, consciously avoiding such awareness, or recklessly disregarding the possibility of wrongfully obtained information for all offenders.²¹² The Bharara Task Force suggests making the intent requirements explicit in two ways.²¹³ First, the state of mind should be clearly defined as “willfulness” for criminal violations and “recklessness” for civil violations.²¹⁴ Second, in terms of the tippee’s knowledge of the underlying breach, for criminal liability, the tippee should know that the tipper obtained or communicated information wrongfully, and for civil liability, the tippee should have at least recklessly disregarded that fact.²¹⁵

III. STATUTORY SOLUTIONS

A. THE ITPA OFFERS MANY ADVANTAGES OVER EXISTING INSIDER TRADING JURISPRUDENCE

The ITPA offers many improvements to insider trading law that should be implemented, including the sheer fact that it is legislation and the elimination of the requirement that the tippee know of the tipper’s personal benefit.

1. *Legislation is Necessary*

First, legislation is indeed necessary to clarify the confusing, “topsy-turvy” jurisprudence that has developed in insider trading law.²¹⁶ Thus, Congress should not abandon this attempt to codify insider trading

209. Fisch, *supra* note 189, at 762.

210. *See id.*

211. BHARARA ET AL., *supra* note 18, at 17.

212. *See* H.R. 2534, 116th Cong. (2019); BHARARA ET AL., *supra* note 18, at 17.

213. *See* BHARARA ET AL., *supra* note 18, at 17.

214. *Id.*

215. *See id.*

216. *See supra* Section II.B.1.; *United States v. Whitman*, 904 F. Supp. 2d 363, 372 (S.D.N.Y. 2012), *aff’d*, 555 F. App’x 98 (2d Cir. 2014).

jurisprudence as it has in the past.²¹⁷ Despite some advantages to common-law, the bottom line is that those who commit insider trading can be subject to criminal liability.²¹⁸ This presents a need to provide notice on what activities will result in jail-time, and which will not.²¹⁹ Especially after the confusing line of cases stemming from *Newman* to *Salman* to *Martoma*, judge-made law has left significant gaps that would be best filled by clear, well written legislation.²²⁰

2. Elimination of Newman's Tippee Knowledge Requirement

Second, the ITPA properly no longer requires that the tippee know of the personal benefit received by the tipper.²²¹ In addition to being a source of confusion, this requirement made it extremely difficult to prosecute insider trading and encouraged a system of non-accountability, ignorance, and purposeful shielding of liability.²²²

The difference the Act would make can be seen in a case such as *Martoma*, and the difficulty law enforcement officials had in prosecuting Cohen, the manager of SAC Capital.²²³ Under the ITPA, Cohen would likely face liability as the information was wrongfully obtained (Dr. Gilman breached a confidentiality agreement by disclosing the results of the drug trial early to Martoma for a personal benefit) and Cohen at least recklessly disregarded that fact (or more likely, actually knew this was the case).²²⁴ Requiring knowledge of the personal benefit received, on the other hand, makes this extremely difficult.²²⁵ Holding Cohen accountable is a beneficial result, because he was instilling a culture at SAC Capital where insider trading was rampant.²²⁶

217. See *supra* Section II.B.1.

218. See *supra* Section II.B.1.

219. See *supra* Section II.B.1.

220. See *supra* Section II.A.

221. H.R. 2534, 116th Cong. (2019).

222. See *supra* Section II.A.2.

223. See *supra* Section II.A.2.

224. See H.R. 2534, 116th Cong. (2019); see generally *United States v. Martoma*, 894 F.3d 64 (2d Cir. 2017).

225. See *supra* Section II.A.2.

226. KOLHATKAR, *supra* note 134, at 248, 250–51. Although the Act does contain a provision meant to insulate fund managers, Cohen would still likely face liability. Given the culture instilled at SAC Capital, one could argue he “indirectly induced the acts constituting the violation of this section.” H.R. 2534, 116th Cong. (2019).

B. WAYS TO IMPROVE THE ITPA

Despite the Act's advantages, the ITPA has flaws of its own. Enhancing clarity, differentiating between civil and criminal liability, and broadening the definition of "personal benefit" are all improvements that should be made before the bill becomes law.

1. *Clarity*

The ITPA has many sources of ambiguity and may indeed be more confusing than current insider trading jurisprudence. The Senate should add clarity in amending the bill.

Specifically, the "catchall provision" defining wrongfulness seems to attempt to codify certain aspects of existing insider trading jurisprudence, but leads to more questions than answers.²²⁷ The clause defines one aspect of wrongfulness as "a breach of any other personal or other relationship of trust and confidence for a direct or indirect personal benefit (including pecuniary gain, reputational benefit, or a gift of confidential information to a trading relative or friend)."²²⁸ Missing from this phrase is the *Dirks* language that a personal benefit can be inferred from "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."²²⁹

The ITPA's omission of this language could suggest the drafters wished to overrule this way of proving a personal benefit, but it is unclear from the current wording. Further, *Martoma* suggests that a stand-alone intention to benefit is enough to satisfy this aspect²³⁰—whether this is codified or overruled is also unclear. Moreover, in terms of gift theory, the statute only includes the language "trading relative or friend," and not the requirement imposed in *Newman* and later affirmed in *Salman*, that there must be a "close personal relationship" when tipping a relative or friend.²³¹ Again, the omission could suggest the House is overruling this aspect of *Newman*, but it is unclear.

227. H.R. 2534, 116th Cong. (2019).

228. *Id.*

229. *Dirks v. SEC*, 463 U.S. 646, 664 (1983).

230. See *United States v. Martoma*, 894 F.3d 64, 76 (2d Cir. 2017).

231. *Salman v. United States*, 137 S. Ct. 420, 425 (2016); *United States v. Newman*, 773 F.3d 438, 452 (2d Cir. 2014).

Perhaps a solution to these many ambiguities is to amend the “including” language to be “including, but not limited to.” However, this may still be ambiguous as to whether it is codifying the above-mentioned aspects of *Dirks*, *Newman*, and *Martoma* (for example, a court may wonder why Congress chose to list certain aspects in the phrase, but not others). Thus, the Act should explicitly state what aspects from these holdings it is adopting or rejecting. For example, including language that “[i]t shall not be necessary that the person trading . . . [knows] whether any personal benefit was paid or promised by or to any person in the chain of communication” explicitly overrules aspects of *Newman*.²³² Similar clarity should be added to other parts of the statute.

Additionally, in defining “wrongfulness,” it seems “for a direct or indirect personal benefit” modifies all the breaches mentioned in the rest of the clause because commas are used rather than semicolons, which would denote separation.²³³ However, given at least the Second Circuit’s emphasis on commas,²³⁴ it would not be surprising for a court to interpret these clauses as separate—for example, that “personal benefit” only modifies a “breach of trust and confidence,” whereas “a breach of contract” is wrongful in itself, without any personal benefit to the tipper.²³⁵ This is something the Senate should consider and clarify.

2. Civil and Criminal Liability

The ITPA does not differentiate between civil and criminal liability, and, as the Bharara Task Force argues, it should.²³⁶ In terms of notice and due process, it should be clear what activities will send you to jail, and those that will not.²³⁷ Market participants should not be left to hope for reasonableness in prosecutors’ litigation strategies, but instead

232. H.R. 2534, 116th Cong. (2019).

233. *Id.*; Raymond B. Marcin, *Punctuation and the Interpretation of Statutes*, 9 CONN. L. REV. 227, 237 (1977) (explaining that the use of semicolons operated to separate clauses within a statute).

234. *Martoma*, 894 F.3d at 74 (“The commas separating the ‘intention to benefit’ and ‘relationship . . . suggesting a *quid pro quo*’ phrases can be read to sever any connection between them.”).

235. H.R. 2534, 116th Cong. (2019).

236. *Id.*; BHARARA ET AL., *supra* note 18, at 17.

237. See *supra* Section II.B.1.

should be able to know when their actions are criminal, and when their actions will only be subject to civil liability.²³⁸

In differentiating between criminal and civil liability, the Act should incorporate the suggestion of the Bharara Task Force that the state of mind should be clearly defined as “willfulness” for criminal violations and “recklessness” for civil violations.²³⁹ Additionally, in terms of the tippee’s knowledge of the underlying breach, “for criminal liability, the tippee should know that the tipper obtained or communicated information wrongfully, and for civil liability, the tippee should have at least recklessly disregarded that fact.”²⁴⁰ This will at least limit the potential scope of criminal liability, while also providing notice and due process.²⁴¹

3. Broaden the Scope of the Personal Benefit Definition

Shifting the focus of the inquiry to “wrongfulness” presents an opportunity to distinguish between information used for a “corporate or otherwise permissible purpose,” and illegitimate or self-serving purposes.²⁴² However, retaining the personal benefit requirement restricts this potential. Although some argue for elimination of the personal benefit requirement altogether,²⁴³ I argue instead that it should be kept, and the definition of “personal benefit” be broadened.

238. *Dirks v. SEC*, 463 U.S. 646, 664 n.24 (1983). Often, what determines whether a criminal or civil suit is brought in the insider trading context is not the conduct itself, but rather the sufficiency of evidence. Peter Henning, *Blurred Lines in Pursuing Insider Trading Cases*, N.Y. TIMES (Aug. 15, 2016) <https://www.nytimes.com/2016/08/16/business/dealbook/blurred-lines-in-pursuing-insider-trading-cases.html> [<https://perma.cc/8FTV-K34T>]; Walter Pavlo, *Insider Trading: Civil or Criminal Crime?*, FORBES (Oct. 24, 2013, 8:15 AM) <https://www.forbes.com/sites/walterpavlo/2013/10/24/insider-trading-civil-or-criminal/#2b9aba1d6564> [<https://perma.cc/EC45-68D2>]. For a discussion of the difference between, i.e. federal narcotics laws, and federal insider trading laws, see Miriam H. Baer, *Insider Trading’s Legality Problem*, 127 YALE L.J. F. 129 (2017).

239. BHARARA ET AL., *supra* note 18, at 17. Although the current standard for criminal enforcement by the Department of Justice (DOJ) is “willfulness” and the standard for civil enforcement at the SEC is “recklessness,” this should be clearly included in the statute defining liability itself. *Id.*

240. *Id.*

241. *Cf.* Baer, *supra* note 238, at 137, 148.

242. BHARARA ET AL., *supra* note 18, at 15.

243. *Id.*

Currently, its meaning under the ITPA is not clear and is too limiting. The impact of the ITPA would be minimal and only create more confusion than already exists in current insider trading jurisprudence.

To remedy these issues, the statute's last catchall definition of wrongful should be amended. In addition to what is listed in Sections (A)(c)(1)(A), (B), and (C), material nonpublic information should be considered "wrongful" only if the information has been obtained through means of, or its communication or use would constitute, directly or indirectly:

(D) a breach of any fiduciary duty, a breach of a confidentiality agreement, a breach of contract, a breach of any code of conduct or ethics policy, or a breach of any other personal or other relationship of trust and confidence for a direct or indirect personal benefit.

A direct personal benefit includes, but is not limited to: a tipper receiving a pecuniary gain; or a relationship between the insider and the recipient that suggests a quid pro quo.

An indirect personal benefit shall include: (1) a reputational benefit; (2) a gift of confidential information to a trading relative or friend; or (3) an increase in pay, a bonus, a job opportunity, a promotion, or any other benefit that arises from self-serving actions lacking a legitimate corporate purpose.

This change is advantageous because now *Newman*, *Chiasson*, and even *Maria* would be found liable, but *Dirks* would not. For example, investor relations employees in *Newman* could be described as seeking a benefit for a bonus or promotion.²⁴⁴ Further, *Maria* was pursuing a job opportunity by slipping a note to the hedge fund manager.²⁴⁵ On the other hand, *Dirks* would still not face liability. The insider, *Secrist*, was not seeking any sort of pay increase, bonus, job opportunity, or promotion.²⁴⁶ Therefore, these additions would attain a balance between "legitimate" and "illegitimate" corporate purposes.²⁴⁷

Some may argue that this provision contains ambiguities of its own and does not properly account for the market efficiency interests at

244. *United States v. Newman*, 773 F.3d 438, 453-55 (2d Cir. 2014).

245. *COX ET AL.*, *supra* note 14, at 892.

246. *Dirks v. SEC*, 463 U.S. 646, 663-65 (1983).

247. It is important to note that although seeking a promotion or increase in pay is not in itself an illegitimate business purpose, exchanging material nonpublic information in exchange for this promotion or increase in pay is. See *COX ET AL.*, *supra* note 14, at 892.

hand. Although one could say phrases such as “self-serving” and “legitimate corporate purpose” are new to insider trading law, these ideas stem from *Dirks* itself.²⁴⁸ Further, although the provision certainly does broaden the scope of insider trading liability, that is the point. Moreover, this takes a similar approach to what is already prohibited by Reg FD.²⁴⁹ Although this is broader than liability under Reg FD,²⁵⁰ it attempts to seek the proper balance between improper motives, and preservation of sufficient incentives for diligent market research. Further, it is still a more limiting principle than eliminating the personal benefit requirement altogether. For example, the train commuter who trades on Jamie Dimon’s binder would escape liability as Dimon would not attain a personal benefit there, even under the suggested broader definition.²⁵¹

CONCLUSION

The judge-made law of insider trading is long overdue for codification in legislation. The ITPA is a step in the right direction, but there are still improvements to be made before the statute is enacted. The ITPA properly eliminates *Newman*’s requirement that a tippee know of the personal benefit the tipper-insider gained in revealing this information. However, the Act needs to improve in clarity, separate the standards for criminal and civil liability, and provide a more expansive definition of “personal benefit.” In sum, although legislation is necessary, an ambiguous statute may make insider trading law even more “topsy-turvy”²⁵² than it was before.

248. *Id.* at 663 (“The SEC argues that, if inside-trading liability does not exist when the information is transmitted for a proper purpose but is used for trading, it would be a rare situation when the parties could not fabricate some ostensibly legitimate business justification for transmitting the information.”).

249. 17 C.F.R. §§ 243.100–243.103.

250. *Id.*

251. In fact, if this occurred, the *opposite* of a promotion or increase in pay would be the likely result.

252. *United States v. Whitman*, 904 F. Supp. 2d 363, 372 (S.D.N.Y. 2012), *aff’d*, 555 F. App’x 98 (2d Cir. 2014).