UNIVERSITY *of* PENNSYLVANIA
JOURNAL *of* LAW & PUBLIC AFFAIRS

Vol. 2 June 2017 No. 1

BEYOND THE PERSONAL BENEFIT TEST: THE ECONOMICS OF TIPPING BY INSIDERS

*Jonathan R. Macey**

Recent insider trading cases reveal a stark conceptual divide between the federal courts and the U.S. Securities and Exchange Commission (SEC) regarding liability for securities fraud in cases in which an insider (a "tipper") gives material non-public information to a market professional or close friend or other potential trader (a "tippee"). Following the landmark Supreme Court case called Dirks v. SEC, the federal courts do not impose liability on tippers or tippees unless there the tipper receives a consequential personal benefit or is a close friend or relative of the tippee. The SEC abjures this "personal benefit" requirement, and would define the concept of personal benefit so broadly as to remove it as an impediment to insider trading prosecutions.

This Article explains the economic function of the personal benefit test as establishing the criterion upon which legitimate trading on the basis of material non-public information can be distinguished from venal or corrupt trading. The Article shows that the personal benefit test, while a valuable innovation to insider trading jurisprudence, is severely limited because it does not capture all of the various motivations that cause insiders to convey material non-public information to traders. This Article fills that gap by providing a complete taxonomy of tipping and trading, and explaining the legal consequences of all of the various forms of insider trading.

* Sam Harris Professor of Corporate Law, Securities Law and Corporate Finance at Yale Law School. Thank you to Kayla DeLeon, who graduated from Yale Law School in 2017 and provided exemplary research assistance. I am grateful for comments received at the Yale Law School Faculty Workshop and from Bruce Ackerman, Henry Hansmann, Roberta Romano, and David Super.

INTRODUCTION

There is a lot of confusion about the permissibility of insider trading[1] because regulators lack a complete understanding of the legitimate, non-corrupt reasons that insiders regularly reveal material non-public information to Wall Street market professionals such as traders at hedge funds and investment banks. This incomplete understanding of why people tip is accompanied by a concomitant lack of understanding about the role that tipping plays in stock markets and reveals a core disagreement between the U.S. Securities and Exchange Commission (SEC) and the federal courts about whether the law should prohibit all or only certain forms of trading by those with an acute informational advantage over their counter-parties.

---

[1] In this Article, I use the term "insider trading" to mean the trading on the basis of an informational advantage (an informational asymmetry between purchasers and sellers) that occurs when one party trades on the basis of material non-public information that is neither reflected in the market price of the security being traded, nor available to the insider's counter-party prior to the trade. Of course insiders such as corporate officers or lawyers and investment bankers who have regular access to material non-public information sometimes trade only after such information is disclosed. Such trading is not controversial and this Article does not consider such trading.

Specifically, the confused state of the law results from the fact that we lack a complete account of the economic effects of tipping. The existing test for determining liability in tipping cases, the personal benefit test invented by Justice Powell in *Dirks v. SEC*,[2] is a brilliant innovation.[3] The point of the test is to distinguish when trading on the basis of tips from insiders is beneficial and should be permitted, versus when such trading is harmful to markets and should be banned.

But like many prototypes, it is somewhat crude. The *Dirks* test is crude because it divides tippers into two stark categories: those who receive a personal benefit in exchange for their tip and those who do not.[4] Those who receive a benefit when they tip have broken the law, while those who receive no benefit have not. The goal of this Article is to offer a more nuanced approach to tipping that better tracks the various reasons why tipping actually occurs in trading markets and more accurately sorts permissible from impermissible insider trading.

This Article begins by briefly recounting the fundamental disagreement between the SEC and the courts about the role that insider trading law plays in capital markets. The SEC takes the view that the purpose of the law is to alleviate asymmetries in information between trading parties in order to promote "fairness," which the SEC equates with parity of information among traders.[5] The Supreme Court has explicitly and repeatedly rejected the SEC's fairness approach to insider trading law. The Court's interpretation of Section 10(b) of the Securities Exchange Act of 1934[6]—the anti-fraud provision of the Exchange Act—is not designed to promote fairness among strangers who trade

---

[2] 463 U.S. 646 (1983).

[3] *See generally* Jonathan R. Macey, *The Genius of the Personal Benefit Test*, 69 STAN. L. REV. ONLINE 64 (2016) (arguing that the personal benefit test, and insider trading law more generally, is clear and sensible, and that any arguments to the contrary stem from inconsistencies among the executive branch and the judiciary—not between the federal courts themselves).

[4] *See* Dirks v. SEC, 462 U.S. 646, 663 ("To determine whether a disclosure itself deceives, manipulates, or defrauds shareholders, the initial inquiry is whether there has been a breach of duty by the insider. This requires courts to focus on . . . whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings." (citation and quotations omitted)).

[5] *See e.g.* Jonathan R. Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9, 35 & n.133 (1984) (finding that the SEC in *Dirks* harkened back to a "bygone fairness era")

[6] Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified at 15 U.S.C. §§ 78a–78pp (2006)). The SEC adopted Rule 10b-5, pursuant to the authority delegated to it in §10(b). 17 C.F.R. § 240.10b-5 (1980); *see also* United States v. O'Hagan, 521 U.S. 642, 651 (1997) ("Pursuant to its § 10(b) rulemaking authority, the Commission has adopted Rule 10b–5").

in anonymous markets. Rather, it is designed to police trading by insiders, as well as the interactions of insiders and Wall Street traders, and to regulate the improper use of proprietary corporate information.[7]

Because the SEC views any sort of trading on the basis of an informational advantage as unfair, it would ban all such trading. For the SEC, the motivation of a tipper is irrelevant because all tipping is bad given that it enables trading on the basis of an informational advantage over one's counter-party.[8] In sharp contrast, the Court's view is that only tipping that reflects a breach of a tipper's pre-existing duties of trust and confidence is problematic.[9]

The difference between the SEC's approach and that of the Supreme Court could not be more profound. Because the SEC views trading on the basis of any sort of informational advantage as wrongful, the Commission regards all trading on the basis of tipping by an insider as wrongful and deleterious to the functioning of capital markets.[10] In stark contrast, while the Court condemns trading on the basis of tips in certain contexts, it views such insider trading as highly salutary to the proper functioning of capital markets in other contexts.[11]

Because the Court's personal benefit test[12] is designed to sort useful (efficient) insider trading from harmful (inefficient) insider trading, the test has no value to the SEC, because the SEC denies the underlying distinction on which the personal benefit test is based. From the SEC's perspective, no sorting is required—and hence no sorting test is needed—because all trading by

---

[7] Jonathan R. Macey & Maureen O'Hara, *Regulation and Scholarship: Constant Companions or Occasional Bedfellows?*, 26 YALE J. ON REG. 89, 106 (2009).

[8] *See* Dirks v. SEC, 463 U.S. 646, 651 ("The SEC concluded: Where tipees - *regardless of their motivation* or occupation - come into possession of material corporate information that they know is confidential and know or should know came from a corporate insider, they must either publicly disclose that information or refrain from training" (emphasis added) (citation and internal quotations omitted)).

[9] *See* Dirks v. SEC, 463 U.S. 646, 654-55 (citing Chiarella v. United States, 455 U.S. 222, 232 ("[T]here can be no duty to disclose where the person who has traded on inside information 'was not [the corporation's] agent, . . . was not a fiduciary, [or] was not a person in whom the sellers [of the securities] had placed their trust and confidence.'").

[10] *See Dirks v. SEC*, 463 U.S. 646, 655 ("The SEC's position . . . is that a tippee 'inherits' the . . . obligation to shareholders *whenever* he receives inside information from an insider" .)

[11] *See* Chiarella v. United States, 445 U.S. 222, 242-43 (providing a list of examples and concluding that, "[i]n each of these instances, trading is accomplished on the basis of material, nonpublic information, but the information has not been unlawfully converted for personal gain."); *Dirks*, 463 U.S. at 646, ("Imposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market.").

[12] *See supra* note 4.

insiders on the basis of tips is harmful because all such trading is based on an informational advantage that the SEC views as fundamentally unfair. Thus it is not surprising that the SEC dislikes the personal benefit test and has tried for decades to undermine it in every way that it can.[13]

After an Introduction and describing the role played by the personal benefit test in Part II,[14] the third Part of the Article articulates a taxonomy of tipping that indicates the different contexts in which tipping by insiders occurs, and describes the social welfare gains and losses associated with insider trading on the basis of tips of material non-public information in each of these contexts.[15] Part IV synthesizes the analysis in Part III by contrasting how tipping and trading is viewed from a legal perspective by the SEC, and the federal courts.[16] Part IV also shows how the law of insider trading would change if the efficiency-oriented analysis proposed in this Article were to be implemented. A conclusion follows.[17]

The goal of this Article is to show that the personal benefit test requires tweaking and to suggest appropriate revisions. As it stands, the personal benefit test is simultaneously under and over inclusive, legalizing some trading that

---

[13] Macey, *supra* note 3, at 65-66 (noting the various ways in which the SEC has attempted to regulate the trading of information). For example, in a direct response to *Chiarella v. United States*, 445 U.S. 222 (1980), the SEC promulgated Rule 14(e)(3), which eliminates the Supreme Court's requirement of a personal benefit in insider trading cases involving tender offers on the basis of special SEC authority to regulate tender offers. 17 C.F.R. 240.14e-3 (1981). Likewise, the SEC promulgated Regulation FD, which purports to eliminate the very selective disclosure that the Supreme Court approved in *Dirks*. 17 C.F.R. §§ 243.100-243.103 (2011). Regulation FD prohibits U.S. public companies from making selective, non-public disclosures to analysts. *Id.* A concern with the rule is that it might lead to fewer disclosures and lower quality of analyst forecasts, and thus diminish the quality and efficiency of the capital markets. *See* Armando Gomes, Gary Gorton and Leonardo Madureira, *SEC Regulation Fair Disclosure, Information and the Cost of Capital*, 13 J. CORP. FIN. 300, 300 (2007) (demonstrating that Regulation FD caused a significant shift in analyst attention away from small firms). The SEC also adopted litigation stances in *Chiarella* and *Dirks* that rejected the Supreme Court's long-held view that tipping should be decriminalized in certain contexts. *Chiarella*, 445 U.S. at 235 (declining to apply "such a new and different theory of liability" that the appellate court had invoked to affirm the conviction and rejecting the SEC's alternative theory in support of liability "that petitioner breached a duty to the acquiring corporation when he acted upon information that he obtained by virtue of his position as an employee of a printer employed by the corporation"); *Dirks*, 463 U.S. at 656 (asserting that the SEC's litigation position in the case "differs little from the view that [the Supreme Court] rejected as inconsistent with congressional intent in *Chiarella*").

[14] *See* Part II, *infra at* 42-54.

[15] *See* Part III, *infra* at 54-78.

[16] *See* Part IV, *infra* at 79-81.

[17] *See* Part V, *infra* at 81-83.

should be banned and penalizing other trading that should be rewarded. The test is under-inclusive in that some people who provide tips to insiders should be prohibited from doing so even if they do not receive a personal benefit for their tips. The test is over-inclusive because certain trading can be socially beneficial in spite of the fact that the insider providing the tip has received a personal benefit from a trader in exchange for the tip.

A more complete taxonomy of the nature of tipping is important for normative reasons. On the one hand, if there were no venal reasons for tipping, then it would make sense to permit all tipping. But it is trivially easy to show that there are plenty of venal reasons for tipping. On the other hand, it would also be an oversimplification to label all tipping as stemming from venality, and ban tipping in its entirety. Creating a more complete taxonomy, however, does not completely solve the analytical problem. Having created that taxonomy, one must then examine the various contexts in which tipping occurs and determine the contexts in which it should be banned, the contexts in which it should be grudgingly tolerated, and the contexts in which it should be encouraged.

If there were no salutary reasons for insiders to provide tips of material, non-public information, then it would make sense to ban all such tipping. Because it turns out that, as a descriptive matter, tipping by insiders that then leads to trading can sometimes be benign as well as nefarious, some sort of rule is needed to distinguish between these two possibilities so that benign tipping is allowed or even encouraged while nefarious tipping is prohibited and sanctioned. The vast confusion in insider trading law reflects the inability of the current legal landscape to grapple with the various subjective contexts in which insider trading can occur. Through its tipping taxonomy, this Article strives to establish scaffolding upon which a more context-specific legal treatment for insider trading can be built.

I. *Dirks v. SEC*: The Invention of the Personal Benefit Test

The landmark case of *Dirks v. SEC*[18] shows the stark difference between the Supreme Court's approach to insider trading and the SEC's approach to such trading. The fact pattern depicts one of several contexts in which the SEC would have banned insider trading, while the Court indicated that such trading should not merely be tolerated but actively encouraged.

In 1973, the SEC sued and censured Raymond Dirks, a securities analyst who specialized in evaluating publicly traded insurance companies, for tipping *The Wall Street Journal* and some of his firm's trading clients about a massive fraud that he had uncovered at the insurance company Equity

[18] 463 U.S. 646 (1983).

Funding.[19] The prosecution of Mr. Dirks reflected the delivery on a promise that then-SEC Chair John Shad had made while decrying the fact that insider trading was perceived as widespread and expressing his concern that such trading had undermined investor confidence in the capital markets.[20] In his remarks, Chairman Shad promised that the SEC would "come down with hobnail boots to give some shocking examples to inhibit the activity."[21] Similarly, then-Director of Enforcement at the SEC John Fedders described insider trading as "stealing by people in white shirts and suspenders."[22]

Unmoved by the fact that Dirks had played a major role in uncovering the fraud at Equity Funding, the SEC maintained that Dirks had committed securities fraud because his tips enabled trading on the basis of material non-public information before such information was disclosed to the public.[23] The Supreme Court rejected the SEC's decision to take enforcement action against Dirks and admonished the Commission for ignoring its prior ruling in *Chiarella v. United States*.[24] The Court reiterated that it is only illegal to trade on inside information when such trading is done in breach of a pre-existing fiduciary-like obligation of trust and confidence to the source of the information.[25] In *Dirks*, the Supreme Court again explicitly rejected the SEC's view that anyone who received non-public information from a corporate insider automatically "inherited" the insider's legal obligation to either make the information public or abstain from trading.[26] Rather, the Court clarified that liability for trading on the basis of tips from insiders depends on whether the insider-tipper breached a fiduciary duty when she provided the tip.[27]

---

[19] Linda Greenhouse, *Dirks Gets His Day in Court*, N.Y. TIMES (Mar. 22, 1983), http://www.nytimes.com/1983/03/22/business/dirks-gets-his-day-in-court.html.

[20] *Fair to All People: The SEC and the Regulation of Insider Trading*, SEC HIST. SOC'Y, http://www.sechistorical.org/museum/galleries/it/counterAttack_c.php (last visited Sept. 3, 2016).

[21] Kenneth B. Noble, *S.E.C. Chief Plans Insider Trade Curb*, N.Y. TIMES, Oct. 26, 1981, at D1.

[22] *Illegal Insider Trading Seems to Be on Rise; Ethics Issues Muddled*, WALL ST. J., Mar. 2, 1984, at 1.

[23] *Fair to All People*, *supra* note 7.

[24] 445 U.S. 222 (1980).

[25] 463 U.S. 646, 656-57 (1983) (characterizing the SEC's stance as "differ[ing] little from the view that we rejected as inconsistent with congressional intent in *Chiarella*," and that "conflicts with the principle set forth in *Chiarella* that only some persons, under some circumstances, will be barred from trading while in possession of material nonpublic information").

[26] *Fair to All People, supra* note 7.

[27] *Dirks v. SEC*, 463 U.S. 646, 664.

A. *The SEC vs. the Courts: Fairness or Efficiency? A Philosophical Impasse*

The disagreement between the SEC and the courts on insider trading doctrine is based on a firm and irreconcilable difference about the root justification for regulating insider trading. The SEC, firmly embedded in its bureaucratic role of protecting the securities markets, rejects the premise that material non-public information is a form of intellectual property. Accordingly, the SEC also rejects the idea that socially desirable trading based on such information is possible. As such, the SEC does not countenance any trading on the basis of informational asymmetries, even that which is done to glean the rewards of costly and socially desirable research into fundamental company values or to reveal an ongoing corporate fraud. Rejecting the view that trading can at least potentially advance a number of valuable social goals, the SEC is of the view that anyone in possession of material non-public information should be forbidden to use it at all, ever.[28] Only after the relevant information on which the trading is based has been public can it be used, according to the SEC.[29]

The SEC's view is that insider trading must be prohibited because it is unfair to the trader's counter-party. As a consequence of this view, the SEC believes that those "who possess material non-public information, must disclose it before trading or abstain from trading until the information is publicly disseminated."[30] The fairness approach presupposes that trading on the basis of material non-public information "operates as a fraud [sic] all other buyers and sellers in the market."[31]

In contrast, the Court, abjuring conclusory, unspecified notions of "fairness" and embracing empirically verifiable concepts such as property rights and efficiency, rejects the SEC's equal treatment philosophy and its concomitant "disclose or abstain" doctrine. The Court's 1980 decision in *Chiarella v. U.S.*[32] was the watershed opinion that rejected the SEC's fairness approach and embraced a property rights approach that focused on the allocation of rights to trading that are created by employment contracts and other agreements creating relationships of trust and confidence between the

---

[28] *In re* Cady, Roberts & Co., 40 S.E.C. 907 (1961); *see also* Thomas C. Newkirk, Associate Dir., Div. of Enforcement, SEC, Speech at 16th International Symposium on Economic Crime (Sept. 19, 1998) (citing *Cady, Roberts*), https://www.sec.gov/news/speech/speecharchive/1998/spch221.htm.
[29] *Id*.
[30] *Fair to All People, supra* note 7.
[31] Newkirk, *supra* note 14 (citing SEC v. Texas Gulf Sulphur, 401 F.2d 833 (2d Cir. 1968), in which the court had adopted the SEC's reasoning in *Cady, Roberts*).
[32] 445 U.S. 222 (1980).

companies that create information and the people to whom such information must be entrusted.[33] Three years later, Dennis Carlton and Daniel Fischel were the first formally to conceptualize insider trading law as seeking to establish the efficient allocation of property rights in information."[34]

The practical differences between the SEC's fairness approach and the Court's property rights approach are significant. For example, a trader in possession of inside information can satisfy the SEC's demand for fairness simply by publicly disclosing the information in her possession (or directly to her counter-party if the transaction will not occur on a registered stock exchange or Alternative Trading System, such as a dark pool).[35] Suppose, for example, that a lawyer in a large law firm came into possession of the material non-public information that one of her firm's clients was about to make a bid to purchase all of the shares of a large publicly traded company at a substantial premium over that company's current market price. Suppose further that the lawyer, seeing a great profit-making opportunity, bought shares in the target company before the client made its bid, and made a tidy profit selling the newly acquired shares to her client. The SEC would view the lawyer's trading as illegal because of the unfairness to the selling shareholders who lacked the critical information upon which the lawyer's purchases were predicated. The lawyer would not have violated the insider trading prohibitions, under the SEC's fairness test if she had erased her unfair advantage over her counter-parties by disclosing the information about the bid publicly before buying shares in the target company.

The Court would view the issue presented by the lawyer's trading on material non-public information entirely differently. For the Court, the lawyer's legal problems arise not from the unfairness to the purchasing lawyer's counter-party, but from the breach of the obligation of trust and confidence to her firm's client that was reflected in her pre-bid purchases.

Starting with the premise that the client necessarily had to invest significant resources in identifying the target company, researching the arbitrage opportunities associated with determining that the target was undervalued due to its poor management or its inability to avail itself of possible synergies by

---

[33] Jonathan R. Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9 (1984).

[34] Dennis W. Carlton & Daniel R. Fischel, The Regulation of Insider Trading, 35 STAN. L. REV. 857, 866-72 (1983); *see also* JONATHAN R. MACEY. INSIDER TRADING: ECONOMICS, POLITICS, AND POLICY 4 (1991) ("[T]he debate about insider trading is really a debate about how to allocate a property right within a firm.").

[35] *See* 17 C.F.R. 242.300(a) (defining "alternative trading system" as an organization or system that "constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities . . . and [t]hat does not . . . [s]et rules governing the conduct of subscribers . . . or [d]iscipline subscribers other than by exclusion from trading").

combining with another company, the Court's efficiency approach sees the harm done not to the trader's counter-party, who lacked any relationship with the trading lawyer, but to the bidding client. In other words, eschewing the SEC's fairness approach, the Court's efficiency approach seeks to protect the bidding firm's property rights in the information that the target company is undervalued, thereby presenting an arbitrage opportunity in the market for corporate control. From an efficiency standpoint, the harm caused by the insider's buying in advance of her client's bid is twofold. First the purchasing risks driving up the price of the target company's shares, thereby damaging the client by increasing the costs of its acquisition of the target. Second, the purchasing might attract the interest of market professionals, who are experts at "decoding" the signals sent by the insider's purchases, and who might well be able to determine that a bid for all of the shares of the target company is imminent.[36] If this happened, the price of the target company's stock could rise to such a high price that the arbitrage gains anticipated by the bidder would evaporate and the takeover would no longer be economically viable for the bidder. Damages in such a case would be in the billions.

Applying this approach it is easy to see that the SEC's "disclose to the market or abstain from trading" doctrine is not only unhelpful in protecting the property rights of the bidder, it is extremely counter-productive because it would entirely undermine the bidder's efforts to keep the information confidential. Protecting the bidder's property rights in information requires that the lawyer not only abstain from trading, but also refrain entirely from disclosing the information, and that is what the Court mandates in *Chiarella* and *Dirks*.

Basic issues such as standing to sue, damages calculations, and substantive legal requirements differ dramatically under the fairness approach and the efficiency approach. Under the SEC's fairness approach, logic requires that the shareholders in the target company who sold while the insider/lawyer was buying should have standing to sue because they were the group that was treated unfairly by the insider's buying. In contrast, from an efficiency perspective, the party damaged and whose financial interests are protected by the insider trading law is the lawyer's client, who risks losing the capacity to profit from its costly search in locating and evaluating the target company. In addition, failures to protect the bidder's property rights in information about

---

[36] *See* Paul Asquith & David W. Mullins, Jr., *Signaling with Dividends, Stock Repurchases, and Equity Issues*, 15 FIN. MGMT. 27, 41 n.18 (1986) (noting that traders routinely lower the price they are willing to pay when buying from sellers whom they suspect possess superior information, and raise their reservation price when selling to investors who may have superior information); Myron Scholes, *The Market for Securities: Substitution Versus Price Pressure and the Effects of Information on Share Prices,* 45 J. BUS. 179, 200 (1972) (asserting that sophisticated market participants can decode the signals contained in trades by informed investors).

the target also are inefficient in a broader sense because the economy as a whole improves when the target company's assets are reallocated to the bidder, who clearly values them more highly as evidenced by its willingness to pay a premium to acquire control of such assets. These broad efficiency gains are reflected in the premium that all of the target company's shareholders obtain when the bid is made, as well as the gains to the bidding company's shareholders if the target company's performance improves sufficiently (or synergies between the target and bidder are realized) after the takeover.

With respect to damages, under the fairness approach favored by the SEC, the damages caused by the above insider trading scenario are measured by the difference between the price at which the target company's shareholders sold their shares to the insider/lawyer and the price they would have received if they had been in possession of the same information about the impending takeover bid the insider/purchaser possessed. In contrast, under the efficiency approach, the private measure of damages would be the increase in the cost of acquiring the target caused by the increase in the target company's share price linked to the insider's purchases, the decrease in the number of shares that the bidder could acquire, and even the lost value of the deal if the insider trading resulted in the bidder having to withdraw its bid. As noted above, the substantive legal requirements imposed by the securities laws under the SEC's approach are satisfied merely by disclosure of the material non-public information. Under the efficiency approach, the law imposes the more rigorous obligation of confidentiality and abstention from trading.

From an economic point of view, judicial decisions have caused insider trading law to evolve from an amorphous concept that attempted to achieve the vague and (as will be shown below) unattainable objective of somehow making trading markets "fair" into a meaningful tool for controlling agency costs within a firm.[37] Trading by agents of the firm, whether they are actually employees of the company or "temporary insiders"[38] such as the attorney James O'Hagan, the defendant in *United States v. O'Hagan*, or the financial

[37] From an economic perspective, shareholders, like other participants in the corporate enterprise such as creditors and employees, define their relationship with the firm in contractual terms. Indeed, the very existence and survival of the corporate form of business organization can be explained by the gains associated with dividing the management and risk-bearing attributes of ownership into separate components through incorporation. *See* Fama, *Agency Problems and the Theory of the Firm,* 88 J. POL. ECON. 288, 291-93 (1980).

[38] This concept of a "temporary insider" derives from a footnote in the Supreme Court's opinion in *Dirks v. SEC*. The *Dirks* Court noted that insider trading liability could extend to non-employee outsiders who "have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes." The Court cited underwriters, accountants, lawyers, and consultants as examples of temporary insiders. Dirks v. SEC, 463 U.S. 646, 655 n.14 (1983).

printer Vincent Chiarella, the defendant in *Chiarella v. U.S.*, harms the shareholders of the company whose capacity to profit from their corporation's buying and selling in the capital markets is thwarted by insiders trading on knowledge of the corporation's plans.

The SEC's fairness approach is quite compelling at first blush, but it is logically infirm. From a fairness perspective, banning the insider/lawyer from trading accomplishes nothing. From the point of view of property rights in intellectual property, regulating insiders' ability to trade accomplishes a great deal in terms of efficiency.

In our hypothetical, banning insider trading from a fairness point of view accomplishes nothing because if the lawyer/insider is successfully barred from trading, the group that ostensibly would have been harmed by such trading (the target company's shareholders) simply will end up selling their shares to the lawyer's client, the acquirer. The target shareholders, of course, are indifferent between selling at the low, pre-bid price to the lawyer/insider and selling at the same low, pre-bid price to the acquirer/client. On the other hand, a successful prohibition on trading by the insider/lawyer has clear benefits from an efficiency point of view because it enables the putative acquirer to obtain an economic return on its investments in searching for and analyzing undervalued companies.[39]

In the preceding paragraph I used the example of a takeover bid at a premium over the target company's share price to illustrate the futility of achieving fairness through a "disclose or abstain" rule. Ultimately, the rule merely ends up substituting the company making the bid for the insider or temporary insider who would have traded if not prohibited from doing so by insider trading law. From the perspective of the uninformed selling shareholder,

---

[39] The SEC has curtailed, but not eliminated, the ability of acquirers to capture the full gains of their costly search and analysis by requiring them to disclose their identity and plans within ten days after acquiring a five percent stake in a publicly traded target company. Securities Exchange Act, Rule 13-d, Schedule 13D, 17 C.F.R. 240.13d-1, 240.13d-7 (1986). While in theory it is possible for a bidder to acquire 100% of a target company's stock within ten days of crossing the five percent threshold, as a practical matter, such a rapid flurry of purchases would drive the target company's share price prohibitively high. Jonathan R. Macey & Jeffry M. Netter, *Regulation 13D and the Regulatory Process,* 65 WASH. U. L. REV. 131 (1987); *see also* David D. Haddock, Jonathan R. Macey & Fred S. McChesney, *Resistance to Tender Offers and Optimal Property Rights in Assets,* 73 VA. L. REV. 701 (1987); Gregg A. Jarrell & Michael Bradley, *The Economic Effects of Federal and State Regulation of Cash Tender Offers,* 23 J.L. & ECON. 371 (1980) (observing that Regulation 13D and other regulations that require immediate disclosure of information about an acquirer's identity and plans have diluted acquiring firms' property rights in information and led to significant welfare losses by reducing searches for undervalued firms and reducing the incidence of wealth creating transactions, such as synergy-creating mergers, and hostile acquisitions that displace inefficient or corrupt management).

of course the "disclose or abstain" rule in no way creates a level playing field. The asymmetric information problem persists. Only the identity of the seller's counter-party changes.

This is not the only flaw in the fairness approach. There are three other, more significant flaws. First, the approach is only fair if one considers fairness from the narrow perspective of the selling shareholders. Once the shareholders of the bidding firm are taken into account one immediately sees that, even if one were to assume that the selling shareholders benefitted from disclosure by the trading insider, this benefit simply would represent a wealth transfer from the shareholders of the bidding firm, who would have enjoyed the benefits of a lower acquisition price, to the shareholders of the target firm, who would have enjoyed the benefits of a higher acquisition price.

Second, the wealth transfer described above would be accompanied by a dead weight social loss. The bidding firm, anticipating that the "disclose or abstain" rule would reduce the profitability of its search for undervalued targets, would invest less in such search. This, in turn, would have the inevitable consequence of leaving more companies in the hands of inept or dishonest management. The underperformance of these firms, with its concomitant drag on employment and productivity, represents an incalculable dead weight social loss.[40]

Finally, as David Haddock and I have shown in previous work,[41] if, as is universally the case, the shareholding populations of public companies are heterogeneous with respect to their ability to *process* the information disclosed to them by insiders, the "disclose or abstain" doctrine will not benefit all or even most target firm shareholders. Rather, the subset of a company's shareholders who are market professionals such as hedge fund operators and professional traders in investment banking firms, will be the first to synthesize public disclosures by insiders and to effectuate trades in the capital markets based on those disclosures. These trades will cause the price of the relevant firm to adjust to its new, "correct"[42] level, so that, yet again, the "true outsiders" who are the "very average investors" that the SEC purports to protect with its "disclose or abstain" rule end up selling their shares before the share price has adjusted to reflect the new information. Thus, the SEC's fairness approach,

---

[40] The loss is incalculable because there is no way to measure how many additional reallocations of underutilized assets would be effectuated if a more efficient set of rules was in place.

[41] *See generally* David D. Haddock & Jonathan R. Macey, *Regulation on Demand: A Private Interest Model, with an Application to Insider Trading Regulation*, 30 J.L. & ECON. 311 (1987); Jonathan R. Macey & David D. Haddock, *A Coasean Model of Insider Trading*, 80 NW. U. L. REV. 1449 (1986).

[42] Correct in the sense that it has adjusted to reflect the previously non-public material information upon which the insider trading was predicated.

reflected in the "disclose or abstain" doctrine does not actually make the markets fairer. It simply shifts the beneficiaries of the asymmetric information away from insiders and towards market professionals.

B. A Strange Turn in Doctrinal Development: The Personal Benefit Test

After reaffirming the property rights orientation of the Court that was established in *Chiarella*, the *Dirks* opinion takes a strange doctrinal turn. The test developed to determine when a tip is made in breach of a fiduciary duty is the personal benefit test. The personal benefit test, as its name implies, posits that it is impermissible for tipping and trading to occur when the tipper receives a personal benefit in exchange for the information. If a tipper receives a personal benefit, then the tip violates the tipper's fiduciary duty, and the tippee may not trade. Stranger still, by parity of reasoning, *Dirks* stands for the proposition that, if a tipper receives no personal benefit in exchange for his tip, then unconstrained trading on the basis of the tip is entirely permissible.

The SEC had long hoped to avoid a legal rule requiring a showing of an improper motive by a tipper or a trader.[43] But most believed that after the Court's decision in *Dirks*, "[a] finding of insider trading liability would thereafter turn, to a great extent, on the motive of the insider, on whether the 'insider personally benefited, directly or indirectly, from his disclosure,'"[44] which of course was precisely what the SEC had long hoped to avoid.[45]

The personal benefit test, however, is not a particularly accurate tool for discerning motive. Someone who receives a personal benefit for doing something can nonetheless have motives that are pure. An attorney who works as a paid public defender receives a pecuniary benefit (salary) for her work, and yet may be motivated primarily by a desire to do good. Ronald Secrist, Raymond Dirks' primary tipper, was deemed by the Court in *Dirks* to have had pure motives because he received no personal benefit for his tip. But this is not necessarily the case. Secrist might have been a disgruntled employee who had been passed over for a promotion, and was motivated purely by a desire for revenge. Likewise, if one imagines a hypothetical case that mimics the facts of *Dirks* exactly, except that in the hypothetical case the tipper gets cash in addition to the psychological satisfaction of putting an end to a massive fraud,

---

[43] *Fair to All People, supra* note 7.
[44] *Id*.
[45] *Id*.; *see also* A.C. Pritchard, *Justice Lewis F. Powell, Jr. and the Counterrevolution in the Federal Securities Laws*, 52 DUKE L.J. 841, 927-42 (2003) (discussing the Supreme Court's deliberation over the law behind insider trading and the role of motive in convicting an individual under the SEC's rules).

it is not clear why the tipper's receipt of cash should lead to liability. In sum, if the goal is to create a test capable of discerning the motivation of the tipper, the personal benefit test is a poor tool. It does not capture all instances of venal tipping, and it captures some tipping that is not entirely or even mostly venal.

It is, perhaps, more apt to view the personal benefit test not as a litmus test of the *motive*s of insiders who engage in tipping, but rather as an assessment of the *effects* that trading on the basis of such tipping has on capital markets. To the extent that some trading benefits capital markets by exposing fraud and making the prices of financial assets more accurate, it should be encouraged because the increased accuracy of stock prices improves allocative efficiency and increases societal wealth.

More accurate securities prices lead to greater allocative efficiency because, when companies with better prospects enjoy higher securities prices, they can access capital at a lower cost and reward the investors who have identified such firms, the entrepreneurs who founded such firms, and the managers whose efforts increased the value of such firms. Companies that have poor prospects will have more difficulty raising capital if prices are accurate.

On the other hand, other insider trading harms capital markets by depriving the companies who actually create such information from profiting from the costly investments that led to that information being created in the first place. The Supreme Court encountered just such a situation in *U.S. v. O'Hagan*,[46] in which a giant British food company, Grand Met, hired a Minneapolis law firm, Dorsey & Whitney, to advise it in its campaign to take over Pillsbury.[47] A lawyer at Dorsey & Whitney, James O'Hagan, got his hands on the material insider information that Grand Met was making a play for Pillsbury before Grand Met could begin buying shares in Pillsbury.[48] O'Hagan then made significant profits buying Pillsbury stock and stock options and other derivative instruments linked to the value of Pillsbury stock before Grand Met announced its bid, and then selling those securities post announcement of the bid.[49] *O'Hagan* legitimated the so-called "misappropriation" theory of insider trading, according to which insider trading is illegal when the trader commits fraud by misappropriating information that rightfully belongs to the source of the inside information.

The misappropriation theory posited that the information that Grand Met wanted to acquire Pillsbury shares at a significant premium over market belonged to the company that created that information: Grand Met. By trading

---

[46] United States v. O'Hagan, 521 U.S. 642 (1997).
[47] *Id*. at 648.
[48] *Id*.
[49] *Id*. (noting that after the announcement, O'Hagan "sold his Pillsbury call options and common stock, making a profit of more than $4.3 million").

on that information, O'Hagan was stealing (misappropriating) information from Grand Met that had been entrusted to the law firm where O'Hagan worked. As a partner in that firm, O'Hagan had a contractual duty, not to mention an ethical duty, to refrain from trading on the basis of information given to his firm in confidence by a client. By trading, O'Hagan breached his duty of trust and confidence. And he went to jail when he was caught.[50]

There is no question that defendant O'Hagan had venal motives when he purloined the information about Grand Met's impending bid for Pillsbury and traded on it. The harm in *O'Hagan*, however, was not caused by O'Hagan's quest for illicit trading profits. The harm was caused by the change in securities prices spawned by O'Hagan's purchases. The natural effect of O'Hagan's trading was to drive up the price of Pillsbury stock. Every cent by which Pillsbury's share price increased constituted an increase in the price that O'Hagan's client, Grand Met, would have to pay for those shares. Worse, this increase signaled to astute Wall Street stock watchers the existence of an impending tender offer for Pillsbury shares, which might have ruined Grant Met's plans entirely by rendering the acquisition of Pillsbury shares prohibitively expensive.

Thus from a capital markets perspective, O'Hagan's motives were irrelevant. Even if O'Hagan received no personal benefit, his conduct should have been deemed illegal. Suppose, for example, that O'Hagan had not traded on the information, but had instead passed it along to a trader. Under the personal benefit test developed in *Dirks*, O'Hagan's culpability would hinge on whether he received a personal benefit in exchange for his tip. But it is not at all clear why this should be the case. The harm to Grand Met and the damage to capital markets is still the same, regardless of whether O'Hagan breached his confidentiality obligation to his client by tipping for free or for something of value.

Thus, for the Supreme Court, the personal benefit test is the central focus of the inquiry into whether trading on the basis of an insider's tip is illegal, despite the fact that the personal benefit test is a rather crude test for determining motive. For its part, the SEC views the motive of the tipper as irrelevant because the SEC views the legal propriety of insider trading not through the lens of property rights and misappropriation, but from the point of view of "fairness," where fairness is defined as parity of information.

The rather simplistic approaches of both the SEC and the Supreme Court make it possible to illustrate the differences between the approach to tipper liability taken by the SEC and the Court in the following chart:

---

[50] O'Hagan was convicted of theft in state court, sentenced to thirty months' imprisonment, and fined. *See* State v. O'Hagan, 474 N.W. 2d 613, 615, 623 (Minn. App. 1991). The Supreme Court of Minnesota disbarred O'Hagan from the practice of law. *See In re* O'Hagan, 450 N.W. 2d 571 (1990).

TIPPEE LIABILITY		
Motive for Tip	**SEC**	**Federal Courts**
Personal benefit shown:	Yes	Yes
No proof of personal benefit shown:	Yes	No

Thus, the decades-long battle between the SEC and the federal courts stems from the fact that the SEC declines to countenance even the possibility that some instances of tipping on the basis of material non-public information might be permissible. Because the SEC takes the view that the only possible motivations for tipping are nefarious, it would categorically ban all trading following tips of material non-public information.

The Supreme Court has taken a decidedly different view. Federal courts are of the view that trading on the basis of insider tips about fraud, or on the basis of tips provided for some valid corporate purpose are beneficial, not harmful to markets and should be encouraged. The personal benefit test in *Dirks* reflects the Court's initial attempt to distinguish wrongful insider trading from beneficial insider trading that should be encouraged.

II. TIPPING: A MORE COMPLETE TAXONOMY

The simple taxonomy in the above chart does not cover every possible context in which trading on the basis of a tip from an insider might occur.

For example, in *United States v. Salman*,[51] U.S. District Judge Jed Rakoff of the Southern District of New York, sitting by designation on the U.S. Court of Appeals for the Ninth Circuit, indicated that tipping might occur not only for pecuniary gains (*O'Hagan*) or to expose fraud (*Dirks*), but also simply by accident or mistake. As Judge Rakoff observed, "whistleblowing quite aside, corporate insiders, in the many conversations they typically have with stock analysts, often *accidentally or mistakenly* disclose material information that is not immediately available to the public."[52]

While it seems obvious that Judge Rakoff is right in observing that insider trading sometimes occurs by accident or mistake, the tipping in the Salman case itself was done on purpose and not by accident or mistake, and the Supreme Court, in affirming Judge Rakoff's decision, does not expand on the issue.[53]

---

[51] 792 F.3d 1087, 1091 (9th Cir. 2015), *aff'd*, 137 S. Ct. 420 (2016).
[52] *Id.* (emphasis added).
[53] This point, however, was worth making because Justice Powell's decision in *Dirks* does not consider the possibility of accidental or mistaken tipping. What is strange about Judge

In stark contrast to *Salman*, in both *Dirks* and *U.S. v. Newman*,[54] federal courts have focused with laser-like precision on what they view as insider trading that serves a valid corporate purpose in ordinary corporate communications that does not involve whistleblowing or serendipitous mistake.

The historical record is quite clear that Justice Powell, who wrote the majority opinions in both *Dirks* and in its illustrious progenitor: *Chiarella v. U.S*,[55] expressed significant concern that without careful oversight from the Supreme Court, SEC regulation of insider trading "could impair market efficiency."[56] In particular, as Adam Pritchard trenchantly has observed, in *Chiarella*, Justice Powell "saw the SEC's efforts to impose a 'parity of information' rule as undermining 'incentives to perform market research in order to discover undervalued stocks and thereby bring about a more efficient allocation of resources.'"[57] According to Pritchard, Justice Powell "agreed with a student author in the *Harvard Law Review*: '[t]he courts must also recognize . . . the importance of preserving incentives for legitimate economic effort, such as gathering new information or perceptively analyzing generally available facts.'"[58]

In light of the important role played by efficiency analysis in the jurisprudence of insider trading, it is passing strange[59] that Judge Rakoff did not entertain the possibility that benign tipping by insiders could be done for a reason other than whistleblowing and accident or mistake.

Newman involved trading by Todd Newman, a portfolio manager at a hedge fund, Diamondback Capital Management, LLC, and Anthony Chiasson, a portfolio manager at another hedge fund, Level Global Investors, L.P., on the

---

Rakoff's decision is that it fails to recognize any contexts in which justifiable trading might occur *other than* whistleblowing to reveal fraud or other illegal activity. For Judge Rakoff, the "benign" category of insider trading, that which occurs for a valid business purpose, does not appear to exist.

54 773 F.3d 438 (2d Cir. 2014), *cert. denied*, 136 S. Ct. 242 (2015).

55 445 U.S. 222 (1980).

56 Pritchard, *supra* note 30, at 931.

57 *Id.* (quoting Bench Memorandum, *Chiarella v. United States,* to Justice Lewis F. Powell, Jr., at 7 (Sept. 28, 1979)).

58 *Id.* (quoting Justice Powell's handwritten notes on the margins of a photocopy of Case Comment, *The Application of Rule 10b-5 to "Market Insiders":* United States v. Chiarella, 92 HARV. L. REV. 1538, 1543 (1979)).

59 Here I use the term "passing strange" to mean exceedingly strange, which is how the term was used by William Shakespeare in *Othello* and John Milton in *Paradise Regained*, as distinct from "moderately strange," which is what the phrase has come to mean to some, including Chief Justice Roberts, in the 20th century. (In 1985, John Roberts wrote to another White House aide that, "[i]t strikes me as more than passing strange for us to tell Congress it cannot pass a law preventing courts from ordering busing when our own Justice Department invariably urges this policy on the courts.")

basis of tips from investor relations officers at two public companies, Dell and NVIDIA, who were casual acquaintances of analysts at the hedge funds who worked for the portfolio managers.[60] The defendants established that it was common for insiders at Dell to disclose "confidential quarterly financial information arguably similar to the inside information disclosed by [the Dell defendants] to establish relationships with financial firms who might be in a position to buy Dell's stock."[61] Significantly, in *Newman*, the Second Circuit fully embraced the concept that there are legitimate and benign reasons why corporate insiders might want to disclose material, non-public information to stock market analysts and other capital market participants who follow their companies' equity securities just as it had in *Dirks*. Unlike Judge Rakoff, the Second Circuit and the Supreme Court have recognized that such tipping might occur for reasons other than whistleblowing or accident or mistake. Specifically, in *Dirks*, the Court observed that:

> [I]mposing a duty to disclose or abstain solely because a person knowingly receives material non-public information from an insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market. It is commonplace for analysts to 'ferret out and analyze information,' and this often is done by meeting with and questioning corporate officers and others who are insiders. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation's securities. The analyst's judgment in this respect is made available in market letters or otherwise to clients of the firm. It is the nature of this type of information, and indeed of the markets themselves, that such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally.[62]

Likewise, in *Newman*, the Second Circuit built on the *Dirks* Court's point, which was that tipping that does not involve any theft or misappropriation of information, but that does move equity prices in the correct direction, is beneficial to markets and should be permitted. The court in *Newman* stressed in particular the testimony of one witness about how the corporate relations departments at public companies routinely operate. This witness:

---

[60] United States *v.* Newman, 773 F.3d 438, 443 (2d Cir. 2014), *cert. denied*, 136 S. Ct. 242 (2015).
[61] *Id*. at 454-55.
[62] Dirks v. United States, 463 U.S. 646, 658-59 (1983) (citations omitted).

> testified that he frequently spoke to investor relations departments to run his [valuation] model by them and ask whether his assumptions were 'too high or too low' or in the 'ball park,' which suggests analysts routinely updated numbers in advance of the earnings announcements. [Another witness from Dell's corporate relations department] confirmed that investor relations departments routinely assisted analysts with developing their models.[63]

Similarly, the Second Circuit found in *Newman* that "the evidence established that NVIDIA and Dell's investor relations personnel routinely 'leaked' earnings data in advance of quarterly earnings" announcements by the companies.[64] The *Newman* court viewed this evidence as exculpatory for the trading defendants because the disclosures were deemed by the court to have furthered the interests of the companies (NVIDIA and Dell) whose employees made the disclosures. Specifically, the court held that even if the trading defendants had been able to discern from the nature of the data conveyed to them by their analysts that the tips they received were from an insider, the information they were given:

> cannot, without more, permit an inference as to that source's improper motive for disclosure. That is especially true here, where the evidence showed that corporate insiders at Dell and NVIDIA regularly engaged with analysts and routinely selectively disclosed the same type of information.[65]

Following the economic framework suggested in *Dirks*, the Second Circuit's opinion in *Newman* indicates that, as a descriptive matter, insiders who work in corporate communications departments and in the office of the Chief Financial Officer in public companies, who often are tasked with communicating information to analysts who work with traders at hedge funds and other financial firms, should be allowed to make those communications of non-public information for valid corporate purposes, notwithstanding the prohibitions in Regulation FD.[66] The courts in *Dirks* and *Newman* explicitly recognize that such

---

[63] *Newman*, 773 F.3d at 454
[64] *Id*.
[65] *Id*. at 455
[66] While Regulation FD mandates that all publicly traded companies disclose material, non-public information to all investors at the same time, the sanctions are tepid, and it is not clear whether the Regulation has had much effect on corporate behavior. *See* Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Netflix,

tipping can serve legitimate corporate purposes such as promoting analyst coverage and or correcting misperceptions in the trading community that lead to mispricing of the company's shares. As an analytical matter, this tipping is done for a personal benefit, which is the tipper's remuneration. But such tipping has not only been permitted, it has been endorsed in both *Dirks* and *Newman.* The courts simply have not recognized that the tipping in these cases is done for a personal benefit in the form of the tippers' compensation. But the fact remains that the courts' endorsement of systematic tipping by insiders for a valid corporate purpose establishes that it does not constitute securities fraud.

Adding the fact that insider information can be transmitted by mistake or accident to: (a) the *Dirks* Court's recognition that tipping can be a form of whistleblowing; (b) the *Salman* Court's treatment of familial relationships; and (c) the *Newman* Court's appreciation of the salutary effects of insider trading allows us to develop a much more complete taxonomy of insider trading. The remainder of this section of the Article provides examples of the various contexts in which tipping, both legal and illegal, might occur.

A. Pecuniary Benefit

Most obviously, tipping can occur because a venal insider wants to monetize her special access to material non-public information about an event at the company for which she works. For example, in the late spring of 2016, the Securities and Exchange Commission and the U.S. Department of Justice charged an investment banker, Steven McClatchey—who had regular access to highly confidential non-public information about impending deals being pursued for his firm's investment bank clients—with providing this information to a plumber, Gary Pusey. Specifically, when Mr. McClatchey learned in the course of his investment banking work that a client company was going to acquire or be acquired by another company at a premium to market price, he would alert Mr. Pusey, who would then buy shares in the target company at the pre-acquisition price, making significant trading profits. Mr. Pusey, in return for this information, not only provided Mr. McClatchey with gym bags full of cash, but also with something money cannot buy: free plumbing services for Mr. McClatchey's bathroom remodeling project.[67]

Inc., and Reed Hastings, Securities Exchange Act Release No. 69,279, [2012-2013 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,972 (Apr. 2, 2013) (disapproving, but not sanctioning Netflix President Reed Hastings's use of his personal Facebook page to disclose important company news); *see also* Bruce A. Ericson, *Regulation FD After Siebel Systems: No Longer "The Hobgoblin of Little Minds"?*, SEC. LITIG. REPORT (Nov. 2005).

[67] Complaint, SEC v. Steven V. McClatchey, 1:16-CV-04029, 2016 WL 3078744 (S.D.N.Y. filed May 31, 2016).

There is no question in anybody's mind that this sort of trading is, and should be, illegal.

B. Family Relationship

United States v. Salman[68] is the classic case in which the personal benefit test of *Dirks* is met by a showing that the offending tip was made as a gift to a family member. In *Salman*, Maher Kara, who worked in the Citigroup healthcare investment banking group, tipped his older brother Mounir ("Michael") Kara, who became increasingly "brazen and more persistent in his requests for information."[69] In the midst of these conversations between brothers, Maher, the tipping brother, became engaged to the sister of one Bassam Salman, who got to know the family and became close friends with his future bother-in-law Michael. Michael began giving the information he got from his brother Maher to Salman, who traded on it in an account held in the name of yet another relative. So, Maher tipped his brother Michael, who tipped Maher's future brother-in-law Salman.

In his defense at trial, Salman argued that evidence of a friendship or familial relationship between tipper and tippee is insufficient to demonstrate that the tipper received a benefit, absent evidence of a "personal benefit" conferred upon the tipper Maher by his tippee Michael.[70] This argument is clearly wrong as a matter of law because the Supreme Court explicitly held in *Dirks* that a violation of the law occurs "when an insider makes a gift of confidential information to a trading friend relative."[71]

A gift is, by definition, "something voluntarily transferred by one person to another without payment."[72] It cannot be the case that the government must show that the tipper received a benefit, but that apparently is what *Salman* argued in his unsuccessful appeal to the Ninth Circuit. As Judge Rakoff observed in his opinion in the case, the law of insider trading is crystal clear

---

[68] 792 F.3d 1087 (9th Cir. 2015), *aff'd,* 137 S. Ct. 420 (2016).
[69] *Id.* at 1088-89.
[70] *Id*. at 1090. In *Salman*, Michael Kara, the tippee, in turn, tipped the defendant, Salman, but the court did not confront the issue, decided in Newman, of whether the government must prove that such a remote tippee had knowledge of the personal benefit that the insider-tipper received for disclosing inside information to the tipper because the jury in *Salman* was instructed that Salman "knew that Maher Kara personally benefitted in some way, directly or indirectly, from the disclosure of the allegedly inside information to Mounir ('Michael') Kara." *Id*. at 1091 n.2 (quoting *Newman*, 773 F.3d at 450).
[71] Dirks v. SEC, 463 U.S. 646, 664 (1983).
[72] MERRIAM-WEBSTER, SIMPLE DEFINITION OF GIFT, http://www.merriam-webster.com/dictionary/gift (last visited Sept. 3, 2016).

that a familial relationship such as that permeating the facts of *Salman* is sufficient to satisfy *Dirks*'s personal benefit test. As Judge Rakoff noted, personal benefit is broadly defined to include "not only pecuniary gain, but also, *inter alia*, . . . the benefit one would obtain from simply making a gift of confidential information to a trading relative or friend."[73]

Thus, there is no doubt that it is illegal to trade on the basis of a tip from a relative or close friend. Establishing that a defendant traded on the basis of a tip from a relative should be enough. The argument that the government must prove *both* a familial connection and a quid pro quo in order to obtain an insider trading conviction is both odd and untenable. As the Supreme Court held in *Salman v. United States*, "[t]o the extent that 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, *Newman* . . . we agree with the Ninth Circuit that this requirement is inconsistent with *Dirks*."[74] Insider trading on the basis of a tip from a close friend or relative is illegal all by itself.

C. *Accidents, Mistakes and Intentional Tipping with No Personal Benefit*

1. Accidents and Mistakes

As noted above, Judge Rakoff in *Salman* condones insider trading on the basis of tips that are passed along by mistake. The basis for condoning trading on the basis of accidental or mistaken tips is found in in *Dirks*. Where a tip is passed along by happenstance, prosecutors are unable to obtain a conviction because they are unable to meet the personal benefit test in *Dirks*.

The strange fact that it is legal to trade on the basis of a tip that is passed along as a result of carelessness on the part of the tipper reflects poorly on the personal benefit test. The most fundamental tenet of Supreme Court jurisprudence on insider trading is that there can be no liability for trading on the basis of material non-public information unless such trading is in breach of a fiduciary duty. To the extent that the personal benefit test is inconsistent with the fiduciary duty element of insider trading law, the test is suspect.

Trading on the basis of material non-public information is wrong when there is an abuse of a "relationship affording access to inside information intended to be available only for a corporate purpose" and not for the personal benefit of anyone, due to the "unfairness of allowing a corporate insider to take advantage of [insider information] by trading without disclosure."[75]

---

[73] *Salman*, 792 F.3d at 1093.
[74] Salman v. United States, 137 S. Ct. 420, 428 (2016) (internal citation and alteration omitted).
[75] Chiarella v. United States, 445 U.S. 222, 227 (1980) (citing *In re* Cady, Roberts & Co., 40 S.E.C. 907, 912, 912 n.15 (1961)).

Where an insider trades on information she has received as the result of a mistake on the part of the tipper, and the insider *knows* that the information is in her possession because of a mistake on the part of the insider/tipper, then it stands to reason that the trader inherits the insider's fiduciary obligation to keep the information confidential. As *Dirks* made clear, a trading "tippee's duty to disclose or abstain is derivative from that of the insider's duty" to keep the information confidential.[76] In other words, an insider is in a relationship affording access to information intended for a corporate purpose and not for the personal benefit of anyone just as much when she tips by mistake as when she tips for cash. And trading by a tippee on the basis of information obtained by mistake is plagued by as much "inherent unfairness" when the information was received because of a mistake on the part of the tipper as when the information is received in exchange for cash or some other personal benefit.

Turning to the issue of fiduciary duties in instances of tipping by accident or mistake as distinct from tipping in return for a personal benefit, there is a transparent breach of the insider's fiduciary duty when an insider "sells out" by disclosing in exchange for cash or other emoluments. The particular duty violated in this case is the fiduciary duty of loyalty. But the fiduciary duty of loyalty is not the only fiduciary duty. There also exists a fiduciary duty of care, which obligates fiduciaries to act with the care of a reasonably prudent person in the discharge of their responsibilities. Just as the fiduciary duty of loyalty is the appropriate test when traders and tippers put their own personal interests ahead of the firm's, the fiduciary duty of care is the applicable test when a tipper fails to act reasonably to manage the confidential information entrusted to their care and a trader exploits the tipper's carelessness by trading on the information.

The argument for employing a negligence perspective to trading on the basis of accident or mistake seems particularly strong when an insider's responsibilities require interacting with stock market analysts at hedge funds and other trading operations, as was the case in *Newman*.[77] In this context,

---

[76] *Dirks*, 463 U.S. at 659.

[77] An issue that must be confronted in imposing liability for negligent tipping is whether negligence is sufficient to trigger the applicable scienter requirement for liability. Certainly a strong argument can be made that public policy favors liability for negligent securities fraud. *See* Aaron v. SEC, 446 U.S. 680, 690 (1980) (holding "that allegations of simple negligence [can] not sustain a private cause of action for damages under § 10(b) and Rule 10b-5"). The rejection of negligence as a suitable form of scienter is based on the language of § 10(b), which uses the terms "manipulative," "device," and "contrivance," purportedly evincing a "a congressional intent to proscribe only 'knowing or intentional misconduct.'" *Id.* at 690 (citations omitted). Nonetheless, Justice Blackmun has argued that public policy favors liability for negligent securities fraud. *Id.* at 716-17 (Blackmun, J., concurring in part

acting reasonably requires the insider to use appropriate care in safeguarding the information entrusted to her. Oddly missing from defenses of tippers who "mistakenly" or "accidentally" provide hedge fund managers and other investment professionals with material non-public information, including Judge Rakoff's in *Salman*, is any consideration of the fact that the tip reflects a breach of the fiduciary duty of care on the part of the insider.

A particularly notorious case of accidental tipping involved former Dallas Cowboys football coach Barry Switzer.[78] At the time of the insider trading incident, Mr. Switzer was a college football coach in Norman, Oklahoma. On June 6, 1981, Mr. Switzer, along with several hundred other spectators, attended a high school track meet being held at a field on the University of Oklahoma campus. Mr. Switzer, who was there to watch his son compete in an event, arrived at the track between 10:00 a.m. and 10:30 a.m. George and Linda Platt, who also had a son competing at the track event, arrived just before Switzer, sometime between 9:00 a.m. and 10:00 a.m. Mr. Platt was the Chairman of the Board of Directors of a publicly held oil exploration and development enterprise called Texas International Company, and he and his wife were acquaintances of Mr. Switzer. At the time of the track meet, Texas International owned over fifty percent of the shares in another energy exploration and development business, Phoenix Resources Company, and had just decided two days before the track meet to retain the investment bank Morgan Stanley to initiate a sale of Phoenix.

---

and dissenting in part) (citations omitted) ("[W]hen misinformation causes loss, it is small comfort to the investor to know that he has been bilked by negligent mistake rather than by fraudulent design . . . . [I]njunctions against negligent dissemination of misinformation play an essential role in preserving market integrity and preventing serious financial loss."); *see also* SEC v. Coven, 581 F.2d 1020, 1027-28 (2d Cir. 1978) (observing that "impressive policies" support SEC authority to seek relief against securities fraud caused by negligence). Moreover, recklessness appears to satisfy the scienter requirement of section 10(b) and Rule 10b-5. Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) did not address "the question whether, in some circumstances, reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b-5." *Id.* at 193 n.12. Nonetheless, it did note that several circuits had held that "reckless disregard for the truth" could constitute scienter in a securities fraud action. *Id.* Moreover, the Second Circuit has held that "reckless conduct satisfies the scienter requirement." Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 46 (2d Cir. 1978) (citations omitted). The court "recognized that recklessness may serve as a surrogate concept for willful fraud," given that the "common law tort of fraud has adopted a recklessness standard as one means of satisfying the requisite intent element of that cause of action." *Id.* (citations omitted). Although recklessness may not meet the willfulness requirement for criminal liability (*see* 15 U.S.C. § 78ff(a) (predicating liability upon a showing that the individual "willfully" or "willfully and knowingly" violated this provision)), it is sufficient to meet the scienter test for civil liability.

[78] SEC v. Switzer, 590 F. Supp. 756 (W.D. Okla. 1984).

The district court found the information that Texas International planned to liquidate Phoenix and to retain an investment banking firm to assist in the transaction was non-public information that "a reasonable investor would consider important."[79]

According to the trial court, at some point during the track meet,

> Switzer laid down on a row of bleachers behind the Platts . . . While Switzer was sunbathing, he overheard [George] Platt talking to his wife about . . . . Morgan Stanley and his desire to dispose of or liquidate Phoenix. . . . Switzer also overheard that an announcement of a 'possible' liquidation of Phoenix might occur the following Thursday.[80]

The district court also seemed to accept testimony that Mr. Platt was not aware that Mr. Switzer was within earshot when he was chatting with his wife about the sale of his company's subsidiary,[81] indicating that the court was entirely convinced of the veracity of Mr. Platt's testimony.

Immediately after the track meet, Mr. Switzer went home, looked up the share price of Phoenix and met with Sedwyn Kennedy, a friend of Switzer with whom he invested through a partnership called SKS. Mr. Switzer told Mr. Kennedy that he had overheard a conversation about the possible liquidation of Phoenix and that the transaction was likely either to occur or be announced within a few days. Mr. Switzer revealed to Mr. Kennedy that his source for this stock tip was a "gentlemen who was an executive with TIC."[82] According to the trial court, Switzer and Kennedy were "close friends" who had known one another for a long time.[83] Messrs. Switzer and Kennedy agreed that buying Phoenix stock would be a good idea.

Mr. Switzer purchased 35,000 shares of Phoenix stock through a variety of partnerships with various friends and made significant trading profits. According to the trial court, TIC's Mr. Platt did not receive any "direct or indirect pecuniary gain nor any reputational benefit likely to translate into future earnings due to Switzer's inadvertent receipt of the information regarding Phoenix."[84] While this may be the case, it seems doubtful. Mr. Platt and Mr. Switzer knew each other well. Mr. Platt's company was a sponsor of Mr.

---

[79] *Id*. at 760.
[80] *Id*. at 762.
[81] *Id*. ("G. Platt was not conscious of Switzer's presence on the bleachers behind him that day, nor that Switzer had overheard any conversation.").
[82] *Id*.
[83] *Id*.
[84] *Id.* at 764.

Switzer's football television show, "Play Back."[85] Mr. Platt was described by the trial court as "a supporter of Oklahoma University football" who had "met Switzer at a few social engagements prior to June of 1981."[86] Mr. Switzer had given autographs to Mr. Platt's children, and had upgraded Mr. Platt's season tickets to football games.[87] Mr. Switzer had called Mr. Platt to importune him to continue to sponsor his television program.[88] These personal relationships are far more extensive than those identified by the government in *Newman*.

Without explanation or embellishment, the trial court simply concluded that "[Mr.] Platt did not breach a fiduciary duty to stockholders of Phoenix for purposes of Rule 10b-5 liability nor § 10(b) liability when he disclosed to his wife at the track meet of June 6, 1981, that there was going to be a possible liquidation of Phoenix."[89] It is true that Mr. Platt did not breach his fiduciary duties by telling his wife about the upcoming sale of Phoenix. He had a good reason for passing the information along: apparently, Mr. Platt discussed the transaction with his wife "for the purpose of informing her of his up-coming business schedule so that arrangements for child care could be made."[90]

But the fact that passing along information to one's spouse does not automatically represent a breach of one's fiduciary duties does not mean that the manner in which such information is passed along is a matter of complete indifference from a legal point of view. It seems clear that, at some point, disclosure of material non-public information by "accident" or by "mistake" reflects such a degree of recklessness and disregard for the importance of protecting the confidentiality of such information that it constitutes a breach of fiduciary duty. Imagine, for example, that Mr. Platt had communicated the information by accidentally clicking the "Reply All" tab in a message from his assistant, causing the message to be sent to a large group of people outside of his company. It seems to me that, at some point, disclosure by "accident" or "mistake" reflects such a failure to take reasonable steps to protect the confidentiality of information entrusted to an insider that it violates the insider's fiduciary duty of care.

This point becomes stronger in light of the fact that safeguarding proprietary confidential information is an important part of the professional responsibilities of corporate officers and directors and the professionals they hire, particularly at public companies. Significant resources are devoted to

---

[85] *Id.* at 761.
[86] *Id*.
[87] *Id.*
[88] *Id.*
[89] *Id.* at 766.
[90] *Id*.

protecting the confidentiality of all sorts of corporate information.[91] Formal protocols govern the way that confidential and proprietary information is handled within companies and government.[92] Casual, public conversations about confidential information, such as the one that resulted in the information leak in *Switzer*, are inconsistent with minimal standards of good corporate practice. As one large employer informed its supervisory employees: "Integrity requires congruence between your professional life and your personal habits. Conversations overheard, chats by the coffee pot, and information that comes to you accidentally needs to be treated with the same caution as a letter or e-mail correspondence that lands on your desk."[93]

Despite the fact that ordinary and customary business practice and good corporate governance require that significant care be taken to guard against mistaken or accidental disclosure of confidential information, the district court in *Switzer* flatly held that "Rule 10b-5 does not bar trading on the basis of information inadvertently revealed by an insider."[94] This assertion seems wrong, particularly when the inadvertent disclosure of material non-public information reflects recklessness or negligence.

From an economic standpoint, imposing civil liability on inadvertent tippers would be efficient. Inadvertent disclosure of proprietary non-public information can potentially lead to the collapse of deals that are significantly welfare enhancing not only because they generate change-in-control premia for target company shareholders, but also because they lead to business combinations that increase the returns on the assets of both the acquirer and the acquired company by creating synergies and reducing costs. In contrast to these potentially significant welfare gains, the costs of requiring that insiders act with reasonable care in safeguarding information they obtain in the course of their work appear minimal.

While complete security is not possible, taking steps to use encrypted files and secure connections and limiting conversations and other oral communications to appropriately secure locations has become routine and would not create significant additional costs for companies. For example, it is ordinary and customary practice for lawyers and investment bankers communicating

---

91 Jonathan Rosenoer, *Safeguarding Your Critical Business Information*, HARV. BUS. REV. (2002).

92 Of course these protocols are not always followed. It is widely known that Hillary Clinton, while she was Secretary of State, used a personal email system with an account kept on a server located at her personal residence in Chappaqua, New York, in violation of State Department protocols. Michael S. Scmidt, *Hilary Clinton Used Personal Email Account at State Dept., Possible Breaking Rules*, N.Y. TIMES (Mar. 2, 2015), https://nyti.ms/2kcy22m.

93 Susan Davis, *Leading Edition E-newsletter for Purdue University Supervisors*, PURDUE UNIVERSITY, http://www.purdue.edu/hr/LeadingEdition/LEdi_104_confidentiality.html (last visited Aug. 20, 2016).

94 *Switzer*, 590 F. Supp. at 766.

about mergers and acquisitions to eschew cell phones and to limit their conversations to land lines. Code names rather than the actual names of companies are routinely used in such deals.

As such, the assumption reflected in *Switzer* and Judge Rakoff's *Salman* opinion, that trading on the basis of an inadvertent tip is automatically legal, should be reexamined in light of the fact that such tips can be due to the negligence of the tipper, and the tippee who exploits the information may be well aware that the information is confidential and meant only for use for a valid corporate purpose. On the other hand, it is less clear that trading on the basis of an inadvertent tip can result in criminal as opposed to civil liability. This will depend on whether the inadvertent tip by an insider was sufficiently reckless such that the recklessness can satisfy the mens rea element of the relevant statute.

2. Intentional Tipping in Cases in Which There Is No Personal Benefit to the Tipper

Stunningly, even when someone tips another person intentionally, but does not receive a personal benefit, neither the tipper nor the tippee has violated Rule 10b-5's prohibition on insider trading because there is no personal benefit to satisfy *Dirks*' personal benefit test.[95] In *SEC v. Maxwell*,[96] David Maxwell, a senior executive at Worthington Foods, passed material, non-public information about Kellogg Co.'s impending purchase of Worthington Foods Inc. to Elton Jehn, his longtime barber, while receiving a haircut. Mr. Jehn bought Worthington stock and, though he had never purchased options previously in his life, he also bought 205 call options (purchasing some of these with a credit card). Mr. Jehn started buying Worthington stock and options on September 22, 1999, completing his purchases a week later on September 27th. On the morning of October 1, 1999, when Worthington and Kellogg issued a press release announcing the deal, Worthington's stock price rose by 61.4%, to $8.75. Mr. Jehn made a total of $192,000 in trading profits by selling after the announcement.[97]

[95] The exception to the general rule permitting trading on the basis of intentional tips for which one received no personal benefit is SEC Rule 14e-3, passed in response to the Supreme Court's decision in *Chiarella v. United States*. Rule 14e-3 prohibits insiders of either a bidding firm or a target firm from tipping confidential information about a tender offer. This rule thereby prohibits "exactly the kind of tippee information the Supreme Court in *Chiarella* had found not to be a Rule 10b-5 violation." *Fair to All People*, s*upra* note 7. Rule 14e-3 also prohibits any person who possesses material information relating to a tender offer from trading in target company securities if the bidder has already taken substantial steps towards commencement of the bid. *Id*.

[96] 341 F. Supp. 2d 941 (S.D. Ohio 2004).

[97] Complaint, SEC v. Maxwell (S.D. Ohio 2003), https://www.sec.gov/litigation/complaints/comp17944_64.htm. Mr. Jehn started buying Worthington stock on Sept. 22, 1999, the same day that

There seems to be no doubt that Mr. Maxwell violated a duty of trust and confidence to Worthington. As the SEC pointed out in its complaint, Mr. Maxwell "was well aware of Worthington's well-established policy and prohibitions against insider trading. He understood that he was prohibited from trading Worthington stock while in possession of material, non-public information and that he was prohibited from tipping others about that information."[98] In fact, when Dale Twomley, Worthingon's CEO told Maxwell about the Company's negotiations with Kellogg, "he explicitly instructed Maxwell to keep the information confidential."[99] And, as is typical in public companies, Worthington had an insider trading policy that prohibited employees from trading in Worthington's securities or tipping others while in possession of material, non-public information.[100] According to the district court, Mr. Worthington was aware of this policy.[101]

Rather slavishly following *Dirks*, and rejecting a litany of possible benefits that tipper-Maxwell could have received, the district court declined to find a personal benefit and, based on the lack of such a benefit, decided that the tipping did not violate the tipper's fiduciary duties. Because the liability of tippees is "derivative" of tippers' liability, Mr. Jehn also avoided liability.[102]

It is true that *Dirks* stands for the proposition that trading on the basis of a tip that did not involve a breach of fiduciary duty on the part of the tipper is legal. But in the insider trading context, the existence of fiduciary duties is coterminous with the existence of a relationship of trust and confidence. Mr. Maxwell clearly had such a duty. And he clearly breached this duty when he violated his obligation not to disclose the confidential and proprietary information entrusted to him by his company. In this context, imposing at least civil liability on Mr. Maxwell is consistent with the law. Imposing such liability also would be economically efficient, because such liability would be a low-cost mechanism for providing enhanced protections for companies' property rights in information, which is precisely what the insider trading laws are designed to do.[103]

---

he was tipped by Mr. Maxwell. *Id.* Mr. Jehn started buying call options a week later on Sept. 27, 1999. *Id.* On Oct. 1, defendant Jehn liquidated his position in Worthington securities, selling 205 call options. He sold ninety Oct. 15 calls for a profit of $64,774.50, sixty-five October 12 calls for a profit of $67,944.22, and fifty October 12 calls for a profit of $52,242. *Id.* He sold 1,500 shares of Worthington stock for a profit of $15,915.60, bringing his total realized profits to $191,954.57.

[98] *Id*. ("Maxwell breached his duty of trust and confidence to Worthington and its shareholders by disclosing material non-public information to defendant Jehn.").

[99] *Maxwell*, 341 F. Supp. 2d at 944.

[100] *Id*.

[101] *Id*.

[103] Macey, *supra* note 18, at 60 (explaining that the Supreme Court's opinion in *Chiarella v. United States* is grounded in the theory that insider information is a form of intellectual

D. *Tipping as Whistleblowing*

While the extant law of insider trading does not impose liability readily enough in cases in which tips occur by accident or mistake, current law imposes liability far too readily for tipping and trading in the whistleblowing context.

On August 12, 2011, armed with authority conveyed on it in the Dodd-Frank Wall Street Reform and Consumer Protection Act,[104] the Securities and Exchange Commission finalized the rules for a new, significantly enhanced whistleblower program.[105] Under the new whistleblower program, a whistleblower is anyone who voluntarily provides the SEC with "original information that leads to the successful enforcement by the SEC of a federal court or administrative action in which the SEC obtains monetary sanctions totaling more than $1 million."[106] Whistleblowers fill out an online form to become eligible for bounty, which can be substantial. Often whistleblowers are represented by counsel to make sure they successfully navigate the steps necessary to enable them to obtain a reward.

The SEC clearly believes that financial incentives will motivate more insiders to come forward as whistleblowers when they have material non-public information about fraud in companies subject to SEC regulation. And, of course, the SEC is right; financial incentives provide an additional (and sometimes the only) motivation for insiders to engage in whistleblowing.

The use of financial incentives to motivate whistleblowing is starkly at odds with the Supreme Court's policy, articulated in *Dirks*, of banning insider trading that is motivated by financial incentives. In fact, the entire purpose of *Dirks*' personal benefit test is to distinguish between legally permissible insider trading, which is trading on the basis of tips of material non-public information that were not motivated by the receipt of any personal benefit, from illegal insider trading, which is trading on the basis of tips motivated not by a benevolent desire to ferret out fraud, but by some share in the trading profits or other pecuniary gain provided by the tippee/trader.

The SEC's bounty program for whistleblowers appears to be working. In May 2014, the SEC awarded over $30 million to an anonymous tipper who made a tip about a company whose identity remains unknown. "I was very concerned that investors were being cheated out of millions of dollars and that

---

property, and that the goal of SEC Rule 10b-5's prohibition on insider trading is to protect property rights in information).

104 Dodd-Frank Act, Pub. L. No. 111-203, § 922, 124 Stat. 1376 (2010).

105 17 C.F.R. §§ 240, 249.

106 Press Release, SEC, SEC Adopts Rules to Establish Whistleblower Program (May 25, 2011), https://www.sec.gov/news/press/2011/2011-116.htm.

the company was misleading them about its actions," said the whistleblower in a press release issued by the law firm retained to represent him/her in obtaining the award.[107] The law firm itself noted that its "client exposed extraordinarily deceitful and opportunistic practices that were deeply entrenched and well hidden,"[108] also noting that "[f]ederal regulators never would have known about this fraud otherwise, and the scheme to cheat investors likely would have continued indefinitely."[109]

The SEC long had received tips from whistleblowers before enacting its bounty, but the SEC claims that the new bounties lead to higher quality information from whistleblowers.[110] It is anomalous that the SEC encourages whistleblowing, while prosecuting tipping about ongoing frauds at public companies. As I have observed in previous work, there is little if any analytic or functional distinction between whistleblowing—especially when done for a bounty—and insider trading.[111]

To the extent that there are differences between whistleblowing and insider trading, insider trading is, in several ways, superior to whistleblowing as a mechanism for revealing fraud and other sorts of illegality in public companies. Specifically, insider trading has three distinct advantages over whistleblowing as a means for ferreting out fraud.

First, unlike whistleblowing, those trading on the basis of material non-public information do not have to convince a bureaucrat at the SEC that their claims are worth pursuing. Dirks himself was unable to interest the SEC about the scandal at Equity Funding. Raymond Dirks engaged in both trading and whistleblowing, but only the trading actually worked, as the SEC and business journalists at outlets such as the Wall Street Journal chose to ignore Dirks' tipping. The history surrounding the fraud at Equity Funding, which was the subject of the SEC's enforcement action against Raymond Dirks for insider trading in *Dirks*, reveals that whistleblowing was wholly unsuccessful in

---

107 Press Release, Phillips & Cohen LLP, Largest SEC Whistleblower Reward Goes to Phillips & Cohen Client—More than $30 Million (Sept. 22, 2014), http://www.phillipsandcohen.com/2014/SEC-awards-Phillips-Cohen-whistleblower-client-30-million-to-35-million-largest-reward-yet.shtml.

108 *Id*.

109 *Id*.

110 Press Release, SEC, *supra* note 91 (quoting SEC Chairman Mary L Schapiro, who asserted that "[w]hile the SEC has a history of receiving a high volume of tips and complaints, the quality of the tips we have received has been better since Dodd-Frank became law. We expect this trend to continue, and these final rules map out simplified and transparent procedures for whistleblowers to provide us critical information.").

111 *See generally* Jonathan R. Macey, *Getting the Word Out About Fraud: A Theoretical Analysis of Whistleblowing and Insider Trading*, 105 MICH. L. REV. 1899 (2007).

ferreting out the fraud at Equity Funding. Mr. Dirks attempted to tip not only the SEC, but also state insurance commissioners, as well as Equity Funding's outside auditors.[112]

Whistleblowing directed at exposing the fraud at Equity Funding began in 1971, but the fraud at Equity Funding was not revealed until 1973, when Dirks began trading. The CEO of Equity Funding and one of the main culprits of the fraud testified that before the insider trading prompted by Secrist's tipping he had "received no questions from auditors, state regulatory authorities, or federal regulatory authorities that suggested that 'they suspected there was a fraud at Equity Funding.'"[113]

Of course the Equity Funding scandal is only one in a long list of frauds that the SEC and other financial regulators failed to uncover. Perhaps the most well-known example of the SEC ignoring a credible tip from a whistleblower is Harry Markopolos's efforts to alert the SEC to the massive securities fraud being perpetrated by Bernie Madoff at his investment firm, Bernard L. Madoff Investment Securities. "[M]y team and I tried our best to get the Securities and Exchange Commission [SEC] to investigate and shut down the Madoff Ponzi scheme with repeated and credible warnings," Markopolos said during his testimony before the Financial Services Subcommittee on Capital Markets.[114] He said he submitted an eight-page document listing red flags and mathematical proof of a major fraud to the SEC's Boston Regional Office in May of 2000. Mr. Markopolos resubmitted his evidence to SEC offices in 2001, 2005, 2007, and 2008, without attracting the attention of the regulators.[115] It was not until the financial markets crashed in 2008 and liquidity-strapped investors attempted to cash-in their investments in large numbers that the fraud was revealed, when the business simply collapsed as the number of new "investors" sharply declined and current clients began clamoring for their money in large numbers. Madoff's fraud caused losses of approximately $17 billion[116] among his firm's 4,800

---

[112] *See id.* at 1917-19 (discussing the various attempts to engage in whistleblowing concerning the fraud at Equity Funding).

[113] Brief for the United States as Amicus Curiae in Support of Reversal, *Dirks v. SEC*, 463 U.S. 646 (1983) (No. 82-276).

[114] *Assessing the Madoff Ponzi Scheme and Regulatory Failures: Hearing Before the Subcomm. on Capital Mkts., Ins., and Gov't Sponsored Enter. of the H. Fin. Servs. Comm.*, 111th Cong. (2009) (statement of Harry Markopolos, CFA, CFE, Chartered Financial Analyst and Certified Fraud Examiner).

[115] Dick Carozza, *Chasing Madoff: An Interview with Harry Markopolos*, FRAUD MAGAZINE (2009), http://www.fraud-magazine.com/article.aspx?id=313.

[116] Jordan Maglich, *Madoff Ponzi Scheme Five Years Later*, FORBES (Dec. 9, 2013), https://www.forbes.com/sites/jordanmaglich/2013/12/09/madoff-ponzi-scheme-five-years-later/.

clients,[117] including the author and Holocaust survivor Elie Wiesel, Yeshiva University, Tel Aviv's Technion University, the North Shore-Long Island Jewish Health System pension fund, and the Korea Teachers Pension fund.[118]

While the Madoff fraud reveals one significant advantage of insider trading over whistleblowing as a vehicle for exposing fraud, it also reveals that insider trading has a structural defect as a mechanism for revealing fraud. Specifically, while insider trading has the virtue of revealing fraud that government officials choose to ignore, insider trading can only occur in companies with shares that trade on public stock markets. Thus, insider trading was not available as a means to reveal the fraud at Bernard L. Madoff Investment Securities because the company was privately held and there was no public market on which its stock could be shorted or for which derivative securities such as put options could be created.

A second advantage of insider trading over whistleblowing is the elimination of false positives. Government agencies, media outlets and others who receive tips from whistleblowers must verify those tips because there is no assurance that the information provided by whistleblowers will be accurate. Whistleblowers may be mistaken, or they may be purposefully inaccurate, as when they engage in whistleblowing for motives such as revenge or bounty. It is of course true that those engaging in insider trading on the basis of knowledge of hidden fraud also are likely to have all sorts of selfish motives. But unlike with whistleblowing, with insider trading there is a cost to providing erroneous information. It is costly to those trading on the basis of material non-public information about an ongoing fraud to be mistaken because, when one trades, one loses money on one's mistakes.

A third advantage of insider trading over whistleblowing is that while there is no guarantee that there will be any follow-up to a whistleblower's tip, if the inside information on which a trader bases her trading is not revealed, then the share price of the company to which the information pertains will not change and neither the insider nor her tippee will make trading profits. Profiting from material non-public information about a fraud in a company requires that an insider sell shares short (or purchase derivative securities such as put options or swaps whose value increases when the value of the underlying assets declines) and then cover the short position at some point in the future

---

117 Robert Frank, Amir Efrati, Aaron Lucchetti, & Chad Bray, *Madoff Jailed After Admitting Epic Scam*, WALL ST. J., Mar. 13, 2009.

118 *Madoff's Victims*, WALL ST. J., http://s.wsj.net/public/resources/documents/st_madoff_victims_20081215.html (last updated Mar. 6, 2009); *see also* Exhibit A, "Client List," http://online.wsj.com/public/resources/documents/madoffclientlist020409.pdf (document listing all of Madoff's clients); Harold A. Pollack, *Why Were So Many Madoff Victims Jewish*?, ATLANTIC (Feb. 8, 2016), http://www.theatlantic.com/business/archive/2016/02/madoff-jewish-affinity-fraud/460446/.

when the company's share price declines. In the context of fraud, the insider's profit-making opportunity does not arise unless and until the fraud at the company is revealed. Unless the fraud is revealed somehow, such as by the announcement of an investigation or litigation by a regulatory agency, or in a news report, the company's share price may remain stable or even increase in value, leaving the trader with a costly position to unwind.

All seem to agree that whistleblowing, even for entirely venal reasons such as revenge, should be encouraged and rewarded. But insider trading, even to reveal a massive fraud in a public company, cannot be done for profit, but only for altruistic reasons. Even in situations, like Madoff and *Dirks*¸ in which insiders tried and failed to inform regulators of corporate fraud, insider trading to reveal such fraud is impermissible if the tipper seeks a "bounty" in the form of a personal benefit in exchange for the information.

One response to the argument that insider trading based on fraud is equivalent to whistleblowing is that, in the insider trading context, the trading comes at the expense of investors, while in whistleblowing, the remuneration for the information reduces the recovery for all shareholders and therefore is more fairly distributed. There are two answers to this objection to insider trading about fraud on fairness grounds. First, any unfairness associated with insider trading that reveals fraud is merely a problem of allocating the gains and losses of an unambiguously socially desirable outcome: the revelation of fraud. While it may be more desirable for fraud to be revealed by whistle-blowing than by tipping by insiders followed by trading by tippees, history in the form of the Madoff and Equity Funding scandals shows that fraud will go undetected if we rely solely on whistleblowers. As such, insider trading to reveal fraud as occurred in *Dirks* may, as the Supreme Court indicated, be the only way to uncover some instances of fraud.

Second, from the perspective of the counterparty who trades with someone with material non-public information, there is no difference between *Dirks*-style insider trading, which is done for free, and insider trading that is done for some kind of pecuniary benefit. The counterparty's losses are the same, and therefore, the permissible trading in *Dirks* is not distinguishable from a fairness point of view from trading based on the same underlying information about fraud that is motivated by a financial incentive.

Finally, there is reason to believe that those who trade with tippees may be in a better position to bear the losses associated with such trading than other investors. Research on insider trading reveals an important distinction between "price function" traders who are motivated to trade by perceived arbitrage opportunities presented by price distortions and "time function" traders, whose trading is not based on an informed view of the value of securities relative to their prices, but on external factors, particularly changing demands for savings and liquidity over the course of a family's life cycle.[119] Price-function traders are the arbitragers, floor traders, investment bankers, and hedge funds who invest in finding value. When an insider sells on the basis of a tip, the temporary decline in the price of the stock sold will be perceived by these price function traders as an arbitrage opportunity, because the low price makes the stock look like a bargain based on these price-function traders' models. In contrast, the insider trading will have no effect on time function traders whose trading is not motivated by price. In contrast to price function traders, who are professionals (or day traders who think that they are professionals), time function traders are not motivated by short-term fluctuations in securities prices, so insider trading will not deleteriously affect them. This point is particularly strong in light of the fact that, unlike price function traders, rational time function traders will hold diversified portfolios of securities that make them immune to the effects of insider trading because, statistically speaking, they will be trading alongside insiders as often as they will be trading against insiders.[120]

E. Beyond Fraud: Tipping for the Good of the Company

As the Courts in both *Dirks* and *Newman* recognized, insider trading can be consistent with a tipper's fiduciary duties. When tipping is done to further a legitimate corporate purpose, it is permissible. In addition to revealing corporate fraud, valid corporate purposes include correcting misinformation about securities pricing and attracting a more attentive and extensive range of coverage by financial analysts. Thus, while it is illegitimate to exploit material non-public information for personal gain, it is legitimate to pass along the same information to others who profit from it, as long as the motive does not involve a personal benefit.

Under current law, a corporate insider can provide a tip to a trader at a hedge fund, and as long as the insider does not receive a personal benefit, the insider is not legally responsible for providing the tip, regardless of the harm the tip causes to the corporation. This strange result is due to the fact that under the personal benefit test established by the *Dirks* Court, the test of whether an insider's tip is in breach of a fiduciary duty is not whether the tip furthers the corporation's interests, but whether the insider refers a personal benefit from providing the tip.

Corporations should have the right to determine when their employees and agents trade on the basis of the proprietary information they receive in the course of their official duties, but the personal benefit test effectively deprives

---

[119] Haddock & Macey, *supra* note 26.

[120] Kenneth Scott, *Insider Trading: Rule 10b-5, Disclosure and Corporate Privacy*, 9 J. LEGAL STUD. 801 (1980).

them of this in two ways. First, the personal benefit test does not require a tipper to obtain the consent of her company—or even to provide notice to the company—prior to tipping, even in cases in which it clearly is in the best interests of the corporation and its shareholders to keep such information confidential, as in the case of an impending tender offer for the shares of another company. Regardless of the content of the information, as long as the tipper does not receive a personal benefit from her tip, the tipping and subsequent trading are legal.

Second, and perhaps even more bizarrely, according to a separate line of Supreme Court reasoning developed in *O'Hagan*, where a corporate insider directly engages in trading on the basis of material non-public information, such trading does not violate the securities laws as long as the trading insider notifies the company of her intention to trade.[121] In *O'Hagan*, in the course of deciding that James O'Hagan was criminally liable for trading on the basis of material non-public information about an impending tender offer for the outstanding shares of Pillsbury, the Court indicates that Mr. O'Hagan could have avoided liability entirely if he had simply notified Grand Met, the bidder, and Dorsey & Whitney, his law firm, of his intention to trade. The Court's reasoning is that Mr. O'Hagan's duty was not to maintain the confidentiality of the information entrusted to him, but instead either to abstain from trading or to disclose his intention to trade to the source of the information.[122]

The rather tortured logic that brings the Court to this odd result is described in one of the more interesting footnotes in the annals of securities regulation. This footnote, number 9 of the opinion, begins with the premise that the element of fraud required to establish a violation of Section 10(b) of the Securities Exchange Act requires a showing of deception, and that the "requirement of deception precludes § 10(b) liability when a person trading on the basis of non-public information has disclosed his trading plans to, or obtained authorization from, the principal."[123]

Footnote 9 justifies its finding that an insider is entitled to a "get out of jail free card" if she discloses her intention to trade before actually trading by indicating that as soon as a disloyal agent discloses his imminent intention to trade, her principal "may seek appropriate equitable relief under state law."[124] The "appropriate equitable relief" to which the Supreme Court refers in footnote 9 is injunctive relief. After being notified by an insider trader of her intent to trade, a corporation or law firm or other guardian of the confidentiality of the information on which the insider wishes to trade can go to court and seek an injunction barring the insider from trading.

---

[121] United States v. O'Hagan, 521 U.S. 642 (1997).
[122] *Id*. at 654-55, 655 n.6.
[123] *Id*. at 654-55, 659 n.9.
[124] *Id*.

The "appropriate equitable relief" may not be sufficient relief for two reasons. First, there is no requirement that the insider delay her trading after disclosing her intention to trade until after the corporation has had an opportunity to obtain an injunction. It is likely that in most cases an insider will be able to disclose and trade before injunctive relief can be obtained. Second, a corporation may be reluctant to seek equitable relief for fear of not being able to maintain the confidentiality of the information in the hearing on the injunction. While it may be possible to conduct the hearing in complete confidence, there is no assurance that confidentiality can be successfully maintained. Any third party observing the court proceeding or even learning about it would be free to trade as long as she lacked a preexisting relationship of trust and confidence with the source of the information. Moreover, establishing the irreparable harm necessary to obtain an injunction would require revealing the nature of the information, thereby thwarting the whole object of the exercise: keeping the information from becoming reflected in the share price of the company to which it pertains.

The point here is not that disclosure by insiders of material non-public information should be categorically banned, as the SEC would like. Rather the point is that, having determined that it is permissible for a corporation through its agents to disclose material non-public information to traders when doing so serves a legitimate corporate purpose, it is necessary to determine: (a) what constitutes a legitimate corporate purpose that permits such disclosure and trading, and (b) how the use of material non-public information should be controlled as a matter of internal corporate governance of companies whose shares are publicly traded.

The Supreme Court invented the personal benefit test in *Dirks* as the tool to be used to make these determinations. If a tip of material non-public information is done for no personal benefit, then, in the Court's view, the tip: (a) serves a legitimate corporate purpose (i.e. the tip is consistent with the tipper's fiduciary duties); and (b) the tipper gets to control the use of the material non-public information, and is free to use the information to tip professional traders, thereby enabling them to profit from the information.

The Court is correct that it should be permissible for a corporation through its agents to disclose material non-public information to traders when doing so serves a legitimate corporate purpose. But the personal benefit test is a strange tool for determining what tipping and trading is legitimate and what is not. Similarly, the "disclose or abstain" rule as articulated in *O'Hagan* is an odd mechanism for controlling the disclosure of material non-public information. Insiders in possession of material non-public information should not be able to legitimize their use of such information by disclosing their trading intentions before trading. Corporations with legitimate material non-public information that they wish to keep confidential should not have to seek an injunction to protect such information.

The personal benefit test should be replaced by a rule that allows corporations to control the use of the information they have created. The issue of whether it is permissible to tip material non-public information should depend simply on whether such tipping is or is not consistent with the tippers' fiduciary duties. While the receipt of a personal benefit may occasionally provide some insight into the fiduciary duty analysis, the personal benefit test should no longer be dispositive. For example, where the information in question concerns a major fraud at a company, then there is no breach of fiduciary duty for disclosing such information, regardless of whether the tipper receives a pecuniary benefit from such disclosure.[125]

Further, where the person who engages in the tip is acting within the scope of their employment and within areas of their discretion, tipping should be permitted. Thus for example, where the Chief Financial Officer of a corporation tips analysts in order to promote analyst coverage or when a corporate communications officer briefs analysts in order to correct some misunderstanding about a company's operations or financial reporting, such tipping should be presumptively permissible.

III. Shortcomings of the Personal Benefit Test and How to Improve It

The analysis in this Article can be summarized in the following chart, which also depicts the differences between the approach to tipping and trading presented here and the contrasting approaches of the Court and the SEC:

TIPPEE LIABILITY			
Tipping Correlated or Caused by:	**Tippee Liability?**		
	SEC / DOJ	Federal Courts	Efficiency
Pecuniary / Non-Pecuniary Benefit to Tipper	Yes	Yes	Yes (unless tip involves corporate fraud)

[125] The receipt of a personal benefit might have relevance even in the case of tipping about an ongoing corporate fraud. For example, the amount of the personal benefit should be deducted from any whistleblower bounty the tipper may be entitled to receive.

Familial Relationship – Intentional[126]	Yes	Yes	Yes
Tip to Unrelated Party – No Personal Benefit to Tipper	No[127]	No	Yes
Mistake / Negligent –Tip to Family Member[128]	Yes	Yes	Yes
Mistake / Negligent –Tip to Analyst[129]	Yes	No	Yes
Mistake / Negligent –Tip to Stranger[130]	Yes	No	Yes
Legitimate Business Purpose for Tip[131]	Yes	No (unless personal)	No (even if personal)

As the chart indicates, the differences indicated by the current approach arise in three contexts. First, the efficiency approach advocated here would lead to a less strict application of insider trading laws in situations in which tipping

[126] United States v. Salman, 792 F.3d 1087 (9th Cir. 2015), *aff'd,* 137 S. Ct. 420 (2016).
[127] While there is no liability in general for intentional tipping and trading where the tipper receives no personal benefit and has no familial or close personal relationship with the tippee, the executive branch and the federal courts do impose liability if the insider trading is done in connection with a tender offer, under special authority granted to the SEC pursuant to Section 14(e) of the Williams Act, 15 USC. §§ 78(a)-(lll) (1976). SEC Rule 14e-3 imposes a duty to disclose (or abstain from trading on) material non-public information on any person in possession of such information, regardless of whether that person is an insider or in a position of trust and confidence with the source of the information. 45 Fed. Reg. 60,410-60, 413 (1980) (Rule 14e-3 is applicable to "any person" irrespective of their relationship to the source of the information).
[128] Michael S. Schacter, *The Accidental Tipper: Personal Benefit Requirement for Insider Trading*, 244 N.Y. L.J. (Sept. 27, 2010), http://www.willkie.com/~/media/Files/Publications/2010/09/The%20Accidental%20Tipper%20Personal%20Benefit%20Requireme__/Files/TheAccidentalTipperpdf/FileAttachment/The-Accidental-Tipper.pdf.
[129] Here I am assuming that the tippee was aware that the tip was negligently or mistakenly made by the tipper and the tippee traded on it anyway. *See Salman*, 792 F.3d 1087.
[130] SEC v. Sabrdaran, Case No. 14-CV-04825-JSC, 2015 WL 901352 (N.D. Cal. Mar. 2, 2015); SEC v. Maxwell, 341 F. Supp. 2d 941 (S.D. Ohio 2004); SEC v. Switzer, 590 F. Supp. 756 (W.D. Okla. 1984).
[131] Dirks v. SEC*,* 463 U.S. 646 (1983); United States v. Newman*,* 773 F.3d 438 (2d Cir. 2014).

or trading on the basis of inside information about corporate fraud. Currently, such trading is illegal if the tipper receives any sort of personal benefit from the tipping. Efficiency, which strongly favors ferreting out fraud, would condone trading or tipping by those in possession of inside information about a fraud even if they personally benefit by such trading or tipping.

Second, the efficiency approach advocated here leads to a stricter application of insider trading laws in situations in which insider information is disclosed by a tipper negligently, whether by accident or mistake. The approach advocated here also will result in the application of Rule 10b-5's prohibitions on tipping and trading when done intentionally but without any personal benefit inuring to the tipper. Such trading currently does not violate the law because the personal benefit test forecloses liability in situations in which the tipper receives no personal benefit. In contrast, the efficiency approach advocated here would impose liability on tippers who negligently reveal material non-public information because of the fiduciary duty of care owed by insiders by virtue of their relationship of trust and confidence with the company, and the strong economic rationale for maintaining the confidentiality of legitimate, non-public information whose value to its creator will be destroyed if it is revealed before it can be acted upon.

Finally, unlike current approaches, the efficiency approach advocated here would not impose liability on those who disclose material non-public information for a legitimate corporate purpose, even if they receive a personal benefit for such disclosure.

CONCLUSION

In adopting the personal benefit test, the Court in *Dirks* essentially drew a statistical inference about the correlation between the receipt of a personal benefit by a tipper and the breach of fiduciary duty by the tipper. The personal benefit test indicates that tipping for a personal benefit is perfectly correlated with behavior that reflects the breach of one's fiduciary duties, while tipping without receiving a personal benefit is perfectly correlated with behavior that is consistent with one's fiduciary duties.

One implication of the analysis in this Article is that the correlation between the receipt of a personal benefit and the breach of fiduciary duties is far from perfect. A tipper who receives no personal benefit can nonetheless harm the company that has entrusted her with material non-public information. After all, if a tipper informs a perfect stranger of an impending tender offer for another company that her company is on the verge of announcing without receiving any attendant personal benefit, then under the personal benefit test the insider would not have breached any fiduciary duty. On the other hand, if an insider passes along a tip about an ongoing fraud and does receive a personal benefit, then such tipping is a crime, notwithstanding the fact that there is no fiduciary duty to maintain the confidentiality of an ongoing fraud and notwithstanding the significant social benefits associated with uncovering corporate fraud.

Current insider trading doctrine as reflected in the personal benefit test is too lenient on insider trading in certain circumstances (i.e. where negligent behavior leads to a tip by mistake) and too strict in other circumstances (i.e. where the tip alerts the tippee to fraud). This Article sets the stage for a more nuanced approach to insder trading law, one in which a personal benefit is considered a possible symptom of punishable insider trading, instead of a certain diagnosis.

The personal test, notwithstanding the flaws elucidated in this Article, was a major advance in the application of economic theory to legal doctrine. Specifically, the personal benefit test advances the theory enunciated in *Chiarella* that material non-public information about a company is a valuable asset in the form of intellectual property, and that, as such, the fundamental purpose of insider trading law is to protect property rights in information.

Dirks is noteworthy for its recognition of the fact that protecting property rights in information requires rules that do more than simply prohibit the use of material non-public information by the "wrong people," i.e. those who have abused their positions of trust and confidence to purloin the information from the company that created it. In addition to prohibiting the wrong people from using material insider information, the law should enable the "right people," i.e. those who created the material non-public information to profit from their discovery and development of such information.

The contribution of the personal benefit test developed in *Dirks* is that it acknowledges not only the need to prohibit some trading on the basis of material non-public information, but also the desirability, from a social welfare perspective, of encouraging other trading motivated by such information. The personal benefit test is based on the premise that those who reveal (tip) material non-public information and the tippees who trade on that information, should be punished if and only if their tips were motivated by venality in that they were provided in exchange for a personal benefit. Those who tip such information without receiving a personal benefit, together with their tippees, should be permitted to trade under the personal benefit test because the test specifies that only trading in which the tipper receives a personal benefit from the tipper is illegal.

While the test often works well, as it did in *Newman*, it is far from perfect. Socially undesirable trading such as that done by professional traders on the basis of information that was mistakenly or accidentally revealed should be banned and those who negligently disclose such information should be punished, at least civilly. Socially desirable trading, such as that done to reveal an ongoing corporate fraud should be permitted, even where the person who tips this information receives a personal benefit. Tippers should be allowed to profit from revealing corporate fraud and other corporate malfeasance just as whistleblowers are encouraged to seek bounties from the government in exchange for their tipping.

The argument in favor of allowing tippers to profit from their tips by trading is particularly strong in light of the evidence from events such as the Madoff Ponzi scheme and the Equity Funding fraud described in this Article indicating that whistleblowers often are ignored by regulators. Without the ability to tip in exchange for a personal benefit, frauds can go undetected for decades.