Notes and Comments

Dirks v. SEC: New Guidelines for Tippee Liability under Rule 10b-5

I. Introduction

In *Dirks v. SEC*,[1] the Supreme Court held that a tippee,[2] when trading in securities, may knowingly[3] use material,[4] non-

1. 103 S. Ct. 3255 (1983).

2. The term "tippee" is used in *Dirks* to refer to "recipients of inside information." *Id.* at 3263. *Accord In re* Investors Management Co., 44 S.E.C. 633, 635 (1971) (defining tippees as persons "other than corporate insiders who receive nonpublic corporate information"). See *infra* note 6 for the definition of an insider.

3. Tippee liability for insider trading "is imposed only in circumstances where the tippee knows, or has reason to know, that the insider has disclosed improperly inside corporate information." *Dirks*, 103 S. Ct. at 3264 n.19. *Accord* Aaron v. SEC, 446 U.S. 680, 701-02 (1980). One of the conditions that determines culpability for inside trading is "the requirement that the violator must know, or at least have reason to know, that the information he is exploiting is not publicly available." Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322, 367 (1979).

The *Dirks* Court required that a tippee know or should know that an insider has breached his fiduciary duty before imposing insider trading liability on the tippee. *Dirks*, 103 S. Ct. at 3264. Later in the majority's opinion, however, the Court indicated that scienter is only a relevant element in some cases of tippee liability. *Id.* at 3265. The Court defined scienter as " 'a mental state embracing intent to deceive, manipulate, or defraud.' " *Id.* at 3265 n.23 (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976)).

4. The test developed by the Supreme Court to determine whether information is material is if "the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). *See also In re* Faberge, Inc., 45 S.E.C. 249, 255 (1968); *In re* Merrill Lynch, Pierce, Fenner & Smith, Inc., 43 S.E.C. 933, 937 (1968). *Cf.* Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54 (1972) ("All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of [his] decision.").

The fact that inside information is used to trade has been held to constitute a clear indication that such information was material. *See, e.g., In re* Investors Management Co., 44 S.E.C. at 646.

public[5] information that he receives from an insider[6] in a corpo-

5. "Information is nonpublic when it has not been disseminated in a manner making it available to investors generally." *In re* Investors Management Co., 44 S.E.C. at 643. *See also* SEC v. Texas Gulf Sulfur Co., 401 F.2d 833, 854 (2d Cir. 1968), *cert. denied sub nom.*, Coates v. SEC, 394 U.S. 976 (1969) (In order for information to be considered public it "must have been effectively disclosed in a manner sufficient to insure its availability to the investing public."); *In re* Faberge, Inc., 45 S.E.C. at 256 ("Proper and adequate disclosure . . . can only be effected by a public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group.").

In *Dirks*, the Court noted, with approval, the definition of nonpublic information developed in *In re Faberge, Inc. Dirks*, 103 S. Ct. at 3260 n.12 (quoting *In re* Faberge, Inc., 45 S.E.C. at 256). In addition, the *Dirks* Court explained that the public disclosure requirement does not impose an obligation simply to tell the SEC about fraud before trading. *Dirks*, 103 S. Ct. at 3265 n.21.

6. The term "insiders" has been applied to officers, directors, and employees who "almost by definition have a degree of knowledge that makes them culpable if they trade on inside information." SEC v. Monarch Fund, 608 F.2d 938, 941 (2d Cir. 1979). *See also In re* Cady, Roberts & Co., 40 S.E.C. 907, 911 (1961) ("An affirmative duty to disclose material information has been traditionally imposed on corporate 'insiders,' particularly officers, directors, or controlling stockholders.").

In re Cady, Roberts & Co., 40 S.E.C. at 912, and SEC v. Monarch Fund, 908 F.2d at 942, suggest that "tippees" are considered "insiders" under certain circumstances. *See infra* notes 183-87 and accompanying text.

Dirks distinguishes insiders from tippees by noting that insiders "have independent fiduciary duties to both the corporation and its shareholders [while] the typical tippee has no such relationship." *Dirks*, 103 S. Ct. at 3261. Certain outsiders, however, may be treated as insiders where the outsider has entered into a special confidential relationship with a corporation that expects the outsider to keep disclosed nonpublic information confidential and the outsider's relationship with the corporation implies a nondisclosure duty. *Id.* at 3261 n.14.

While § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1982), promulgated thereunder, do not explicitly mention insiders, the term is narrowly defined for purposes of § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (1982). Section 16(b) requires a *statutory insider* to surrender any profit realized by him for any purchase and sale, or sale and purchase of any equity security made within a six month period. *Id.* For purposes of § 16(b), a *statutory insider* is a "beneficial owner, director or officer" of the corporation. *Id.* A "beneficial owner" is defined as one who owns "more than 10 per centum of any class of equity security." 15 U.S.C. § 78p(a) (1982).

Additionally, the SEC has adopted Rule 14e-3, 17 C.F.R. § 240.14e-3 (1983), promulgated under § 14(e) of the Securities Exchange Act, 15 U.S.C. § 78n(e) (1982), which defines persons liable for trading on nonpublic information concerning a tender offer. Section 14(e) makes the use of manipulative, deceptive, or fraudulent practices "in connection with tender offers" unlawful. Rule 14e-3 applies § 14(e) to persons: (1) who know, or who have reason to know, that a tender offer is imminent; and (2) who derive this knowledge, directly or indirectly, from the officers, directors, or employees of the offering company or the target company or from others, acting for the offering company or the target company. For a discussion of the infirmities in Rule 14e-3, see Heller, *Chiarella, SEC Rule 14e-3 and Dirks: "Fairness" versus Economic Theory*, 37 Bus. Law.

ration as long as the insider does not personally benefit from supplying this information to the tippee.[7] The Court relied on the principle established in *Chiarella v. United States*[8] that a special relationship, based on common law fiduciary principles, must exist before trading on inside information constitutes a violation of the anti-fraud provisions of the federal securities laws.[9]

In *Dirks*, the Court determined that where the recipient of inside information has no pre-existing fiduciary duty to the shareholders, he does not automatically inherit the insider's duty to disclose or abstain.[10] The tippee's disclosure duty is derived from the insider's duty.[11] The insider must breach his fiduciary duty to the shareholders before a derivative breach can be attributed to the tippee.[12]

The new guidelines set forth in *Dirks* will be important to the investment community, because they delineate the circumstances under which a tippee may be held liable under section 10(b)[13] and Rule 10b-5[14] for trading on material, nonpublic in-

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517, 541-46 (1982). *See generally* Pelosa & Krause, *Trading on Inside Information*, 14 Rev. Sec. Regs. 941 (1981).

7. The test to determine if an insider has breached his fiduciary duty to the shareholders by supplying the tippee with confidential information is "whether the insider personally will benefit, directly or indirectly, from his disclosure." *Dirks*, 103 S. Ct. at 3265.

8. 445 U.S. 222 (1980).

9. *Dirks*, 103 S. Ct. at 3261.

10. *Id.* at 3261-62.

11. *Id.* at 3264.

12. *Id.*

13. Section 10(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails or any facility of any national securities exchange . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (1982).

14. Rule 10b-5 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a

formation. Before *Dirks*, the policy of the Securities and Exchange Commission (SEC) was to charge a tippee with inside trading because the tippee knowingly received and profited from inside information.[15] As a result of *Dirks*, tippee liability cannot be imposed unless the source of the information, the insider, received a benefit from supplying the information, thereby breaching his fiduciary duty to the shareholders.[16] Additionally, the tippee must have been aware, or had reason to be aware, of the insider's breach.[17] Consequently, the decision in *Dirks* increases the evidentiary burden on the SEC and limits the scope of tippee liability for insider trading.

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material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1982).

Rule 10b-5 was referred to throughout *Dirks* as the statutory basis for the SEC's insider trading rule because "Rule 10b-5 is generally the most inclusive of the three provisions on which the SEC rested its decision in this case." *Dirks*, 103 S. Ct. at 3260 n.11. This Casenote will similarly refer to Rule 10b-5 as the statutory basis for the SEC's insider trading rules.

15. *See* Brief of SEC in Opposition, *Dirks*, 103 S. Ct. 3255 (1983) (available from U.S. Gov't Printing Office, Pub. No. 383646-1144 (1982)).

The term "inside information" refers to material, nonpublic information. *See supra* notes 4-6. The Court in *Dirks* rejected the SEC's attempt to distinguish *Chiarella* from *Dirks* because *Chiarella* involved "market information" while *Dirks* involved "inside information." The Court noted " 'that § 10(b) and Rule 10b-5 by their terms and by their history make no such distinction.' " *Dirks*, 103 S. Ct. at 3262 n.15 (quoting Chiarella v. United States, 445 U.S. at 240 n.1 (Burger, C.J., dissenting)).

In *Chiarella*, Chief Justice Burger noted that academic writing has distinguished "market information" from "corporate information." "Market information" refers to knowledge about circumstances or events that affect the "market" for securities; while "corporate information" denotes information concerning a company's assets or earning power. Chiarella v. United States, 445 U.S. at 240 n.1 (Burger, C.J., dissenting). *See, e.g.*, Brudney, *supra* note 3, at 329-33; Fleischer, Mundheim & Murphy, *An Initial Inquiry Into the Responsibility to Disclose Market Information*, 121 U. PA. L. REV. 798, 799 (1973).

The term *insider* trading is a misnomer when applied to a *tippee* or an *outsider* since the Court distinguishes between trading done by an *insider* as opposed to a noninsider. Therefore, this Casenote will make a distinction between *insider* trading and *inside* trading. *Insider* trading will be used to refer to trading where the trader who is in possession of nonpublic, material information is a traditional insider. In contrast, *inside* trading will denote trading by an outsider or a tippee. For the definitions of tippee and insider, see *supra* notes 2 & 6.

16. *Dirks*, 103 S. Ct. at 3265.

17. *Id.*

Part II of this Casenote discusses the facts in *Dirks* and the development of the duty under Rule 10b-5 to publicly disclose material, inside information or to abstain from trading in the security. Part III presents the majority and the dissenting opinions in *Dirks*. Part IV analyzes the reasoning in the decision and considers its impact on the future enforcement of the disclose or abstain rule. Part V concludes that the "insider's personal gain test" will not significantly narrow the scope of tippee liability for inside trading if it is broadly construed by the courts.

II. Background

A. *The Law Before* Dirks: *Development of the Disclose or Abstain Rule*

Courts have emphasized that the legislative purpose behind the federal securities laws was to achieve a high standard of business ethics in the securities industry by replacing the philosophy of caveat emptor with a philosophy of full disclosure.[18] Accordingly, the SEC requires that material, inside information[19] be publicly disseminated before one can trade on the basis of this information. This prohibition against insider trading has become known as the disclose or abstain rule.[20]

The development of the disclose or abstain rule is a product of judicial and administrative construction of the general antifraud[21] provisions of the federal securities laws.[22] Specifically,

18. *See* Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963). *Cf. In re* Cady, Roberts & Co., 40 S.E.C. 907, 912 n.15 (1961) ("A significant purpose of the Exchange Act was to eliminate the idea that the use of inside information for personal advantage was a normal emolument of corporate office.").

See generally Jennings, *Insider Trading in Corporate Securities: A Survey of Hazards and Disclosure Obligations Under Rule 10b-5*, 62 Nw. U.L. Rev. 809, 812 (1968) ("A major purpose of the federal securities laws was to correct [the] deficiency in state corporation laws.").

19. See *supra* notes 4-5 for a definition of material, inside information.

20. *See* Brudney, *supra* note 3, at 322-23.

21. " 'Fraud . . . properly includes all acts, omissions and concealments which involve a breach of legal or equitable duty, trust, or confidence, justly reposed, and are injurious to another, or by which an undue and unconscientious advantage is taken of another.' " SEC v. Capital Gains Research Bureau, Inc., 375 U.S. at 194 (quoting Moore v. Crawford, 130 U.S. 122, 128 (1889)).

22. For example, see *supra* notes 13-14 for the texts of § 10(b) and Rule 10b-5, and *infra* note 98 for the text of § 17(a).

section 10(b)[23] has been characterized as a " 'catchall clause to prevent manipulative devices.' "[24] Rule 10b-5, promulgated under section 10(b), prohibits "any person" from using "any device" that defrauds "any person, in connection with the purchase or sale of any security."[25] Section 10(b) and Rule 10b-5 prohibit inside trading only in so far as it constitutes fraud.[26] Recognizing the restricted definition given to fraud at common law,[27] the judiciary developed an expanded definition of fraud for the purpose of section 10(b).[28]

1. *Common law fiduciary duty and the special facts doctrine*

Under the common law, failure to disclose material information does not constitute fraud unless the informed party is under a duty to exercise reasonable care because of his fiduciary rela-

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23. 15 U.S.C. § 78j(b) (1982). See *supra* note 13 for the text of § 10(b).

24. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 202 (1976) (quoting Thomas G. Corcoran, a spokesman for the drafters of the Securities Exchange Act of 1934, *Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 115 (1934)).

25. 17 C.F.R. § 240.10b-5 (1982). See *supra* note 14 for the text of Rule 10b-5. Rule 10b-5 was written specifically for the purpose of addressing a misuse of inside information. *See* Ernst & Ernst v. Hochfelder, 425 U.S. at 212 n.32. For an account of the circumstances under which Rule 10b-5 was written, see *Conference on Codification of the Federal Securities Laws*, 22 Bus. Law. 793, 922 (1967).

26. The SEC did not specifically address the issue of nondisclosure when Rule 10b-5 was promulgated in 1942. Chiarella v. United States, 445 U.S. 222, 226 (1980). *See* Heller, *supra* note 6; Langevoort, *Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement*, 70 Calif. L. Rev. 1 (1982).

27. Under the common law principle of fraud, there is no general duty to disclose material information in an "arms length" commercial transaction. W. Prosser, Handbook on the Law of Torts § 106, at 695-96 (4th ed. 1971).

28. *See generally* Brudney, *supra* note 3. Brudney proposed that the disclose and abstain rule should prohibit trading where one party has an informational advantage that public investors may not lawfully overcome, regardless of their diligence or resources. Brudney reasoned that the congressional intent behind the securities laws was "to protect not merely those dealing with corporate insiders (and their tippees) but public investors generally against a variety of frauds by others, including exploitation of institutional informational advantages that they were unable to compete away." *Id.* at 357. Brudney concluded that even if the language of the legislature does not require such a broad disclosure duty, "its history suggests that in its effort to restore faith in the securities market, Congress concluded that such informational advantages should be denied." *Id. But see* Jennings, *supra* note 18, at 815. Jennings insisted that "to determine the scope and application of Rule 10b-5, one must first establish whether or not a fiduciary relationship exists between the parties to the purchase or sale." *Id.*

tionship with the other party.[29] The "special facts" doctrine, developed in *Strong v. Repide*,[30] declared that even if the relationship between corporate directors and shareholders was not of such a fiduciary nature as to give rise to an affirmative disclosure duty under traditional common law principles, "there are cases where, by reason of special facts, such a duty exists."[31] The rule developed that corporate directors, officers,[32] and controlling stockholders,[33] as fiduciaries of minority shareholders, owed an affirmative disclosure duty. Corporate insiders breached this fiduciary duty by using inside information for their personal advantage.[34] While subsequent cases ostensibly based the disclosure duty on either a fiduciary relationship or the "special facts" doctrine,[35] the theory developed that the fraud in inside trading derives from the "inherent unfairness" of exploiting one's infor-

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29. W. PROSSER, *supra* note 27, at 695-97; RESTATEMENT (SECOND) OF TORTS § 551(2)(a) & comment a (1977). *See generally* Note, *United States v. Newman: Misappropriation of Market Information By Outsiders*, 3 PACE L. REV. 311, 314-15 (1983) (discussing common law fraud in relation to Rule 10b-5). See *supra* note 21 for the definition of fraud.

30. 213 U.S. 419, 431 (1909).

31. *Id.*

32. *See, e.g.*, Kardon v. Nat'l Gypsum Co., 73 F. Supp. 798 (E.D. Pa. 1947). The four parties involved in *Kardon* each owned a one-fourth interest in two corporations. After the two defendants agreed to sell one of the corporations to an outsider, the defendants purchased all the plaintiffs' stock in the two corporations. *Id.* at 800-01. The court held that a proportionate share of the plaintiffs' profit should be restored because the defendants were officers and directors of the corporation and breached their duty by selling to an outsider "without disclosing the transaction to the plaintiffs or giving them an opportunity to participate in it." *Id.* at 802. The court reasoned that "[t]he broad terms of the [Securities and Exchange] Act [of 1934] are to be made effective in a case like the present one through application of well known and well established equitable principles governing fiduciary relationships." *Id.* at 803.

33. Speed v. Transamerica Corp., 99 F. Supp. 808, 829 (D. Del. 1951). The court held that the defendant corporation was under a duty to minority shareholders of a second corporation which it controlled, to disclose the second corporation's increased earnings and the increased value of its inventory, in light of the defendant's plan to purchase the minority shareholders' stock in the second corporation. *Id.* at 828-31. The court reasoned that "[o]ne of the primary purposes of the Securities Exchange Act of 1934 . . . was to outlaw the use of inside information by corporate officers and principal stockholders." *Id.* at 829.

34. 3 L. LOSS, SECURITIES REGULATION 1446-47 (2d ed. 1961) ("Under the . . . 'fiduciary' rule . . . corporate insiders are held to fiduciary standards in their dealings with stockholders and hence must make full disclosure of all material facts.").

35. Speed v. Transamerica Corp., 99 F. Supp. at 829.

mational advantage.[36]

2. *Expanding the disclosure duty: the special relationship test*

In the seminal case on inside trading liability, *In re Cady, Roberts & Co.*,[37] the Commission extended the disclosure duty beyond the common law concept by construing Rule 10b-5 as creating a duty of disclosure between persons who did not have a traditional fiduciary relationship.[38] The Commission held a tippee[39] liable for inside trading, because he sold securities on the basis of nonpublic information received from an insider.[40] The Commission reasoned that since the insider's relationship to the company clearly prohibited him from exploiting his position by profiting from inside information, "[b]y logical sequence, it should prohibit [the tippee], a partner of the registrant from [doing the same thing]."[41]

36. Dirks v. SEC, 103 S. Ct. 3255, 3261 (1983) (citing *In re* Merrill Lynch, Pierce, Fenner & Smith, Inc., 43 S.E.C. 933, 936 (1968) (fraud derives from "inherent unfairness")).

37. 40 S.E.C. 907 (1961).

38. *Id.* at 912. "[T]he anti-fraud provisions are phrased in terms of 'any person' and . . . a special obligation has been traditionally required of corporate insiders, e.g., officers, directors and controlling stockholders. These three groups, however, do not exhaust the classes of persons upon whom there is such an obligation." *Id.* Cady, Roberts, held that Gintel, a registered representative, violated Rule 10b-5 when he traded while in possession of nonpublic, inside information that he received from a director in the corporation.

39. See *supra* notes 2 & 6 for the definitions of tippee and insider. In *Cady, Roberts*, the Commission does not actually refer to Gintel as a tippee since this term is not used until subsequent cases.

40. *In re* Cady, Roberts & Co., 40 S.E.C. at 917-18.

41. *Id.* at 912. The Commssion in *Cady, Roberts* cites 3 L. Loss, *supra* note 34, at 1450-51, and RESTATEMENT OF RESTITUTION § 201(2) (1937), as authorities for assigning insider duty to Gintel, a tippee.

> Loss states that tippees should be held liable under Rule 10b-5 when they knew, or at least reasonably should have inferred, that an insider's tip was a "breach of trust." . . . Under the expanding concepts of fair dealing between corporate 'insiders' and stockholders, the courts would need little more excuse than the doctrine in the law of restitution: "Where a fiduciary in violation of his duty to the beneficiary communicates confidential information to a third person, the third person, if he had notice of the violation of duty, holds upon a constructive trust for the beneficiary any profit which he makes through the use of such information."

3 L. Loss, *supra* note 35, at 1451 (quoting RESTATEMENT OF RESTITUTION § 201(2) (1937)).

In *Cady, Roberts*, the Commission reasoned that since the anti-fraud provisions are phrased in terms of "any person," the disclosure obligation extends beyond traditional insiders such as officers, directors, and controlling shareholders.[42] The Commission held that the disclosure duty rests on two principal elements:

> [F]irst, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.[43]

Therefore, the disclosure duty attaches to "persons . . . in a special relationship with a company and privy to its internal affairs" and is based on "inherent unfairness."[44] The Commission did not delineate the circumstances under which a person who is not a director, officer, or controlling shareholder, but who has access to inside information, could be held liable for trading while in possession of inside information. As a result, its decision was unclear as to whether mere "access" to confidential information created a "special relationship." Therefore, the question left unresolved by *Cady, Roberts* was whether mere "access" to confidential information, evidenced by a person's trading while in possession of inside information, established a sufficient "special relationship" to trigger the disclosure duty.

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42. *In re* Cady, Roberts & Co., 40 S.E.C. at 912. In rejecting any distinction between sellers and purchasers under Rule 10b-5, the Commission stated:

> Whatever distinctions may have existed at common law based on the view that an officer or director may stand in a fiduciary relationship to existing stockholders from whom he purchases but not to members of the public to whom he sells, it is clearly not appropriate to introduce these into the broader anti-fraud concepts embodied in the securities acts.

Id. at 913-14. The Commission justified extending the scope of insider liability by noting that the securities laws "are broad remedial provisions aimed at reaching misleading or deceptive activities, whether or not they are precisely and technically sufficient to sustain a common law action for fraud and deceit." *Id.* at 910. This principle, that a fiduciary relationship exists between insiders and purchasers of their corporation's securities, was noted with approval in Chiarella v. United States, 445 U.S. 222, 227 n.8 (1980).

43. *In re* Cady, Roberts & Co., 40 S.E.C. at 912.

44. *Id.*

3. *The "possession" test*

The expansion of the disclose or abstain duty beyond the traditional common law concepts was given judicial imprimatur in *SEC v. Texas Gulf Sulphur Co.*.[45] The court held company officials and employees liable under Rule 10b-5 for purchasing shares in the company while in possession of reliable, nonpublic information that the company had made a successful copper strike.[46] The court refrained from determining whether the disclosure duty was predicated on traditional fiduciary concepts or on the "special facts" doctrine.[47] Instead, the court emphasized that "Rule [10b-5] is based on the justifiable expectation . . . that all investors . . . have relatively equal access to material information."[48] The court expanded the scope of inside trading liability by omitting the "special relationship" requirement set forth in *Cady, Roberts* and imposing a disclosure duty on "anyone in possession of material inside information."[49] In dicta, the

45. 401 F.2d 833 (2d Cir. 1968), *cert. denied sub nom.*, Coates v. SEC, 394 U.S. 976 (1969).

46. *Id.* at 864.

47. *Id.* at 848.

48. *Id.* The court stated that "[t]he core of Rule 10b-5 is the implementation of the congressional purpose that all investors should have equal access to the rewards of participation in securities transactions. It was the intent of Congress that all members of the investing public should be subject to identical market risks . . . ." *Id.* at 851-52. *Accord* Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787, 796 (2d Cir. 1969).

49. SEC v. Texas Gulf Sulphur Co., 401 F.2d at 848. After *Texas Gulf Sulphur*, some courts adopted the "possession" test. *See, e.g.*, Strong v. France, 474 F.2d 747, 752 (9th Cir. 1973); Radiation Dynamics, Inc. v. Goldmuntz, 464 F.2d 876, 887 (2d Cir. 1972). *But see* General Time Corp. v. Tally Indus., Inc., 403 F.2d 159 (2d Cir. 1968), *cert. denied*, 393 U.S. 1026 (1969).

Numerous authors have interpreted *Texas Gulf Sulphur* as expanding the scope of inside trading liability beyond the common law fiduciary principles. Referring to *Texas Gulf Sulphur*, Langevoort states: "[T]he court found it unnecessary to determine precisely who had been defrauded, apparently assuming that a fraud 'on the martketplace' was enough to support an SEC injunctive action." Langevoort, *supra* note 26, at 9. Jennings cites *Texas Gulf Sulphur* to support the principle that under Rule 10b-5 the Commission is not required to prove common law elements of fraud. Jennings, *supra* note 18, at 817. *See also* Comment, *Insider Trading—The Extension of the Duty to Disclose Material Inside Information*, 58 NOTRE DAME LAW. REV. 132, 135 (1982) ("*Texas Gulf Sulphur's* reasoning, in effect, extended the duty beyond those in confidential relationships with a corporation to anyone possessing material inside information."); Comment, *Fraud or No Fraud: The Unanswered Question in Chiarella v. United States*, 9 OHIO N.U.L. REV. 75, 83 (1982) ("[T]he court concluded that the trading in Texas Gulf stock by individuals aware of the undisclosed drilling results violated Rule 10b-5.").

court noted that tippees who trade on inside information could be equally as culpable as their insider source.[50]

The court in *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*[51] relied on the "possession test" announced in *Texas Gulf Sulphur Co.* to conclude that tippees were subject to the same disclose or abstain rule as traditional insiders. The tippees in *Shapiro* were clients of Merrill Lynch who sold shares in a company after being told by the insiders at Merrill Lynch that the company's earnings were expected to decline.[52] The court held both the nontrading insiders, who "tipped" the nonpublic information, and their tippees liable for damages to purchasers who acquired shares in the company during the period that the tippees sold their shares.[53] The court reasoned that since the tippees "knew or should have known that the revised earnings information came from a confidential corporate source and they knew this information was nonpublic, they were under a disclosure duty."[54] Thus, the tippees violated the disclosure duty by selling shares in a company with which they had no "special relationship," because they acted with actual or constructive knowledge that the information they received was nonpublic, inside information.[55]

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50. SEC v. Texas Gulf Sulphur Co., 401 F.2d at 853. The issue of tippee liability was subsequently confronted by the Commission in *In re* Investors Management Co., 44 S.E.C. 633 (1971). The Commission held that clients of Merrill Lynch violated Rule 10b-5 when they sold their shares in a company due to a "tip" supplied by Merrill Lynch. *Id.* at 647-48. The Commission reasoned that they acquired a *Cady, Roberts* duty when they received material, nonpublic information. *Id.* at 641. *Accord In re* Faberge, Inc., 45 S.E.C. 249 (1973). This case involved "indirect tippees": persons who received the information from a broker dealer firm as opposed to getting their information directly from an insider. *Id.* at 256. Nevertheless, the Commission held that the obligations of indirect tippees were "no less than those of the other parties merely because [they] did not receive the adverse information directly from [the insider]." *Id.* The Commission reasoned that it was unnecessary to show that the parties occupied a "special relationship" or that they "had actual knowledge that the information was disclosed in breach of a fiduciary duty." *Id.*

51. 495 F.2d 228, 237 (2d Cir. 1974). *Accord* Ross v. Licht, 263 F. Supp. 395, 410 (S.D.N.Y. 1967).

52. Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d at 231-34.

53. *Id.* at 241. A private right of action to enforce § 10(b) and Rule 10b-5 is well established. Superintendent of Ins. v. Bankers Life & Casualty Co., 404 U.S. 6, 13 n.9 (1971).

54. Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d at 238.

55. Under the "possession test" developed in *Texas Gulf Sulphur* and *Shapiro*, anyone in possession of inside information was under the same disclosure duty as tradi-

Concerned with the expansive scope of its previous pronouncement in *Texas Gulf Sulphur*,[56] the Second Circuit, in *SEC v. Monarch Fund*,[57] attempted to limit the boundaries of inside trading liability[58] by determining that not all "outsiders" who trade while in possession of inside information can be defined as "tippees." The *Monarch* court held that an investment advisor who bought shares in a company after discovering from an insider that institutional financing was imminent did not violate Rule 10b-5.[59] The court determined that the defendant was an outsider, not a tippee, for purposes of Rule 10b-5 and, therefore, was not subject to a disclosure duty.[60]

The *Monarch* court distinguished a "tippee" from an "outsider" by noting that unlike tippees, outsiders have no actual or constructive knowledge that they are trading on inside information and no special relationship with the company making them

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tional insiders. Common law fiduciary principles became secondary to the principle that inside trading was inherently unfair. Langevoort, *supra* note 26, at 10-11, contends:

> [O]nce the law of insider trading was expanded to include tippees, . . . the "fiduciary duty" source of the law was called into question. . . . While questions relating to the nature and the source of the duty and to whom it was owed remained troubling, this was secondary to the desire clearly expressed in the securities laws: to promote a fair and informed marketplace. Thus, the anti-fraud provisions of the federal securities laws were viewed as directly prohibiting unjust enrichment resulting from an unshared informational advantage, regardless of the nature of the relationship. The need to establish a *duty* in compliance with the requirements of common law fraud became subordinate to the desire to promote a fair and informed marketplace.

Id.

56. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968). *See supra* notes 51-52 and accompanying text.

57. 608 F.2d 938, 942 (2d Cir. 1979). In *Monarch*, the SEC sought an injunction and disgorgement of profits realized by selling securities after the inside information became public because the defendant "knew or had reason to know that the information was nonpublic and had been obtained improperly by selective revelation." *Id.* at 941. The court held that there had been no inside trading violation because the defendant: (1) had no reason to know that the information he received was confidential; (2) had no special, confidential relationship with the company; and (3) the information lacked specificity. *Id.* at 942-43.

58. The SEC initiated only 40 inside trading suits before 1978. The present rate of suits is appoximately 20 per annum. *See* Seligman, *An Economic Defense of Insider Trading*, FORTUNE, Sept. 5, 1983, at 47. This increased rate of litigation may be partially responsible for the judicially perceived need to create clearer guidelines for ascertaining insider liability. *See infra* notes 267-69 and accompanying text.

59. SEC v. Monarch Fund, 608 F.2d at 943.

60. *Id.* at 942-43.

privy to its internal affairs.[61] The court emphasized that an investment advisor's duty to his clients requires that he make inquiries to determine what securities have an "attractive investment potential."[62] Thus, the *Monarch* court was willing to distinguish prior case law[63] to maintain the role of investment advisors at the risk of allowing individuals to profit from nonpublic information.[64]

4. Chiarella: *The disclose or abstain duty restricted by the boundaries of common law fraud*

In *Chiarella v. United States,*[65] the Supreme Court relied on the common law concept of fraud to conclude that the duty to disclose or abstain arises only if a fiduciary duty or other relationship of trust and confidence exists between the parties. Chiarella, employed by a financial printer, was able to deduce names of target companies by examining documents given to his employer by the acquiring companies.[66] Chiarella used this information to purchase stock in the target companies before the tender offers had been publicly released.[67] He was convicted of violating section 10(b) and Rule 10b-5 because he willfully failed to inform the sellers of the target companies' securities of the imminent takeover bids that would increase the value of their stock.[68]

61. *Id.* at 942.

62. *Id.* at 943.

63. *E.g.*, Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1974); SEC v. Texas Gulf Sulfur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied sub nom.*, Coates v. SEC, 394 U.S. 976 (1969). For a discussion of these two cases, see *supra* notes 51-58 and accompanying text.

64. The *Monarch* court was concerned that affirming the lower court's conviction would impose an "affirmative duty on advisers to verify whether or not their information could be deemed public information." SEC v. Monarch Fund, 608 F.2d at 943.

65. 445 U.S. 222, 228 (1980).

66. *Id.* at 224.

67. *Id.*

68. United States v. Chiarella, 450 F. Supp. 95 (S.D.N.Y.), *aff'd*, 588 F.2d 1358 (2d Cir. 1978), *rev'd*, 445 U.S. 222 (1980).

The Second Circuit Court of Appeals "affirmed the conviction by holding that 'anyone — corporate insider or not — who regularly receives material, nonpublic information may not use that information to trade in securities without incurring an affirmative duty to disclose.'" Chiarella v. United States, 445 U.S. at 231 (quoting United States v. Chiarella, 588 F.2d at 1365).

Chiarella was convicted on 17 counts of violating § 10(b) and Rule 10b-5 because he

In reversing Chiarella's conviction, the Supreme Court reasoned that since Chiarella had no fiduciary or trust relationship[69] with the sellers of the target companies' securities, he was under no duty to disclose or abstain from trading.[70] While recognizing that section 10(b) was intended as "a catchall provision," the Court insisted that "what it catches must be fraud."[71] Consequently, the Court refused to extend liability for non-disclosure of inside information on the sole basis of possession, since "there can be no fraud absent a duty to speak."[72]

The *Chiarella* Court did not directly confront the issue of tippee liability, since Chiarella did not receive his information from an insider.[73] Nevertheless, in recognizing that the disclosure duty has not been limited to traditional insiders,[74] the Court noted that "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of fiduciary duty."[75] While this characterization suggests

received 17 letters confirming purchase of shares. Chiarella v. United States, 445 U.S. at 225 n.3. Section 32(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78ff(a) (1982), sanctions criminal penalties against any person who willfully violates the Act.

69. The *Chiarella* Court was unclear as to what constituted a "special relationship." In determining that Chiarella owed no duty to the sellers of the target companies' securities, the Court noted that Chiarella had no prior dealings with them and was not their agent. Chiarella v. United States, 445 U.S. at 232. The *Chiarella* Court distinguished its earlier decision in Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972), by explaining that if the defendants in *Affiliated Ute Citizens* had acted merely as transfer agents, no disclosure duty would have existed. Chiarella v. United States, 445 U.S. at 232. The *Chiarella* Court explained that because the bank in *Affiliated Ute Citizens* had assumed a duty to act on behalf of the shareholders which the shareholders relied on, the bank "could not act as market makers inducing the [shareholders] to sell their stock without disclosing the existence of a more favorable . . . market." *Id.* at 230. From this analogy it appears that the *Chiarella* Court determined that the following factors constituted a "special relationship": prior dealings, the assumption of a duty to represent shareholders' interests, and the shareholders' reliance.

70. Chiarella v. United States, 445 U.S. at 234-35.

71. *Id.* at 235.

72. *Id.*

73. *Id.* at 231.

74. In explaining the development of the disclose or abstain rule, the Court recognized several cases that did not limit the disclosure duty to traditional insiders. In *Cady, Roberts*, the defendant was liable because he received non-public information from a corporate issuer. *Id.* at 227 n.8. In *Shapiro*, the tippees were liable because they had a duty not to profit from inside information that they knew, or should have known, came from a corporate insider. *Id.* at 230 n.12. In *Affiliated Ute Citizens*, the defendants were liable because they assumed a duty to act on behalf of the shareholders. *Id.* at 230.

75. *Id.* at 230 n.12.

that a co-venture between the insider and the tippee plus a breach of the insider's fiduciary duty may be prerequisites for tippee liability,[76] the significance of this dicta[77] was not clarified until *Dirks v. SEC*.[78]

B. *The Facts*

Raymond Dirks was an investment analyst who specialized in advising institutional investors about the insurance industry.[79] In return for his advice, these investors would direct their brokerage business through Dirks' firm.[80] Secrist, a former officer of Equity Funding Corporation,[81] told Dirks that the corporation's assets were vastly overstated as a result of fraudulent corporate practices.[82] Secrist, the insider, urged Dirks, the tip-

76. Langevoort, *supra* note 26, at 28. Although Langevoort predicted the Supreme Court's holding in *Dirks*, he concluded that "[a] reading [of the *Chiarella* footnote] that requires the insider to benefit, however, would be unduly narrow." *Id.* at 29. Compare this with Dirks v. SEC, 681 F.2d 824, 839 n.16 (D.C. Cir. 1982), where the court interpreted footnote 12 in *Chiarella* as *not* requiring an insider's breach for tippee liability, but noted that the concurring opinion in *In re* Investors Management Co., 44 S.E.C. 633, 645 (1971), suggested that a breach by the insider should be required to hold a tippee liable.

77. Chiarella v. United States, 445 U.S. at 230 n.12. This footnote was not interpreted by subsequent cases as requiring an insider's breach as a prerequisite for tippee liability. *See, e.g.*, Staffin v. Greenberg, 672 F.2d 1196, 1202 (3d Cir. 1982); Feldman v. Simkins Indus., Inc., 679 F.2d 1299, 1304 (9th Cir. 1982); Elkind v. Ligget & Myers, Inc., 635 F.2d 156, 165 n.14 (2d Cir. 1980); O'Connor & Assoc. v. Dean Witter Reynolds, Inc., 529 F. Supp. 1179, 1187 (S.D.N.Y. 1981).

78. 103 S. Ct. 3255 (1983).

79. "In 1973, Dirks was an officer of a New York broker-dealer firm that specialized in providing investment analysis of insurance company securities to institutional investors." *Id.* at 3258.

80. Dirks v. SEC, 681 F.2d at 829.

81. "Secrist . . . had recently been fired from his job with Bankers National, a New Jersey life insurance company that had been acquired by Equity Funding four years earlier." *Id.*

The Supreme Court assumed that Secrist was an insider and did not address the issue of the period of time that must elapse before an employee who has been fired loses his status as an insider in the corporation where he previously worked.

82. *Id.* "Secrist had neither personal knowledge nor documentation to support any of his charges . . . ." *Id.* at 830. Additionally, some of Secrist's charges eventually proved false. *Id.*

Secrist reported his suspicions to New York insurance regulators on March 7, the same day he contacted Dirks. *Id.* at 832 n.6. "They immediately assured themselves that Equity Funding's New York subsidiary had sufficient assets to cover its outstanding policies and then passed on the information to California regulators who in turn informed Illinois regulators." *Dirks*, 103 S. Ct. at 3268 n.2 (Blackmun, J., dissenting).

pee, to investigate and to publicly disclose the fraud.[83]

During the following three weeks, Dirks corroborated the credibility of Secrist's allegations by speaking with employees at Equity Funding, who told him that the corporation's computer files contained large blocks of bogus policies.[84] Throughout his investigation, Dirks urged *The Wall Street Journal* to publish the story[85] and continuously told investors about his suspicions.[86] Some of these investors succeeded in liquidating over $16 million in Equity Funding securities before the company's fraudulent practices were publicly disclosed.[87] When the price of Equity Funding stock fell from twenty-six dollars per share to less than fifteen dollars per share, the New York Stock Exchange halted trading.[88] On the same day, Dirks presented his information to the SEC, which suspended trading on the following day.[89] Subsequently, the SEC filed a complaint against Eq-

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83. *Dirks*, 103 S. Ct. at 3258.

84. *Id.* The first two phases of Dirks' investigation, examining publicly available data and contacting people in the investment community, were generally fruitless. Dirks also telephoned the chairman of Equity Funding, "who denied that there was any fraud . . . and invited Dirks to visit the company's headquarters in Los Angeles." Dirks v. SEC, 681 F.2d at 830. Dirks flew to Los Angeles and through his conversations with corporate employees, he discovered the phony policies. *Id.* at 830-31.

85. *Dirks*, 103 S. Ct. at 3258. "On March 12, [Dirks] left a message for Herbert Lawson, the San Francisco bureau chief of *The Wall Street Journal*. Not until March 19 and 20 did he call Lawson again, and outline the situation." *Id.* at 3269 (Blackmun, J., dissenting).

Dirks urged William Blundell, *The Wall Street Journal's* Los Angeles bureau chief, to write the story. Blundell declined because he did not believe "that such a massive fraud could go undetected . . . [and] feared that publishing such damaging hearsay might be libelous." *Id.* at 3258.

86. *Id.* at 3269 (Blackmun, J., dissenting). "On March 12, eight days before Dirks flew to Los Angeles to investigate Secrist's story, he reported the full allegations to Boston Company Institutional Investors, Inc., which on March 15 and 16 sold approximately $1.2 million of Equity securities." *Id.* (Blackmun, J., dissenting). The investors whom Dirks spoke to after March 20, the time by which he had substantially verified key portions of Secrist's allegations, sold "approximately $15.5 million in Equity Funding stock and $1 million in convertible debentures." Dirks v. SEC, 681 F.2d at 831.

87. *Dirks*, 103 S. Ct. at 3258. Some of these investors promised Dirks a commission in return for his information. *Id.* at 3258 n.2.

88. *Id.* at 3258. The initial halt in trading was prompted by Salomon Brothers who "lodged a complaint of 'disorderliness' in the market for the stock." Dirks v. SEC, 681 F.2d at 832.

89. Dirks v. SEC, 681 F.2d at 832. In addition to the insurance regulatory authorities' knowledge of Equity Funding employees suspicions,

> [a]s early as 1971, the SEC had received allegations of fraudulent accounting

uity Funding,[90] and *The Wall Street Journal* published the story.[91]

The SEC charged Dirks and five of his institutional clients, who sold their Equity Funding stock during Dirks' investigation, with violating the anti-fraud provisions of the federal securities laws.[92] An administrative law judge imposed a censure[93] on four institutions and suspended[94] Dirks from associating with any registered broker-dealer for sixty days.[95]

On appeal, the Commission endorsed the Enforcement Division's position that Dirks violated Rule 10b-5 by communicating material inside information to third parties who were likely to sell their stock in Equity Funding before the fraud was publicly disclosed.[96] Accordingly, the Commission held[97] that Dirks was guilty of aiding and abetting violations of section 17(a) of the Securities Act of 1933,[98] section 10(b) of the Securities Exchange

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> practices at Equity Funding. Moreover, on March 9, 1973, an official of the California Insurance Department informed the SEC's regional office in Los Angeles of Secrist's charges of fraud. Dirks himself voluntarily presented his information at the SEC's regional office beginning on March 27.

Dirks, 103 S. Ct. at 3259 n.3.

90. *Dirks*, 103 S. Ct. at 3259. As a result of the SEC complaint filed against the corporation, 22 persons, including many corporate officers and directors, were indicted and found guilty. *Id.* at 3259 n.4.

91. *Id.* at 3259. The front page story written by Blundell was based largely on information assembled by Dirks. *Id.*

Blundell was nominated for the Pulitzer Prize for his story in *The Wall Street Journal* that exposed the scandal. Dirks became the object of a disciplinary proceeding. Dirks v. SEC, 681 F.2d at 832.

92. Dirks v. SEC, 681 F.2d at 832-33.

93. The SEC has the authority, under 15 U.S.C. § 78o(b)(4)(D) (1982), to censure, and to suspend for a maximum period of 12 months, any broker or person associated with a broker, who violates the federal securities laws, if it is in the public interest.

94. *Id.*

95. Dirks v. SEC, 681 F.2d at 833.

96. *Id.*

97. *Id.*

98. *Id.* Section 17(a) provides:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly —
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

Act of 1934,[99] and Rule 10b-5.[100] In recognition of the important role that Dirks played in exposing the massive fraud,[101] however, the Commission reduced the sanction imposed on Dirks from suspension to a censure.[102]

The United States Court of Appeals for the District of Columbia affirmed Dirks' conviction, endorsing the SEC's position.[103] The Supreme Court granted a writ of certiorari to define the circumstances under which a tippee acquires the insider's disclose or abstain duty.[104]

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(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. § 77q(a) (1982).

99. 15 U.S.C. § 78j(b) (1982). For the text of § 10(b), see *supra* note 13.

100. 17 C.F.R. § 240.10b-5 (1982). For the text of Rule 10b-5, see *supra* note 14.

101. Dirks v. SEC, 681 F.2d at 833. "Largely thanks to Dirks one of the most infamous frauds in recent memory was uncovered and exposed . . . ." *Dirks*, 103 S. Ct. at 3259 n.8 (citing Dirks v. SEC, 681 F.2d at 829).

102. "Censure is the mildest remedy available to the Commission in an administrative proceeding; it imposes no restrictions on a respondent's activities." Brief of SEC in Opposition at 2 n.1, *Dirks*, 103 S. Ct. 3255 (1983) (available from U.S. Gov't Printing Office, Pub. No. 383646-1144 (1982)).

Despite the fact that the SEC imposed no fines on Dirks, as a result of the Equity Funding controversy, Dirks lost his $40,000 a year job. Dirks reported that he spent $500,000 in legal fees since the litigation against him began in 1973. N.Y. Times, July 2, 1983, at 1, col. 1.

In an unrelated, subsequent action against Dirks, the SEC alleged that Dirks caused securities to be sold pursuant to a materially misleading prospectus. SEC v. Scott, 565 F. Supp. 1513, 1515 (S.D.N.Y. 1983). The court found that Dirks violated the anti-fraud provisions of the securities laws, but refused to issue an injunction "because of the SEC's failure to establish a reasonable likelihood that he [would] commit future violations." *Id.* at 1516.

103. Dirks v. SEC, 681 F.2d at 846. The SEC's policy was that the selective dissemination of inside information to investors constituted a fraud on the general investing community. *Id.* at 834. The court of appeals reasoned that although *Chiarella* held that a disclose or abstain duty could not be imposed absent a pre-existing fiduciary duty, *Chiarella* did not hold that breach of the fiduciary obligations was a prerequisite for a Rule 10b-5 violation. *Id.* at 838-39. Therefore, despite the fact that the insiders in *Dirks* did not breach their fiduciary duty, *id.* at 838, Dirks inherited the insiders' fiduciary duty and was subject to the disclose or abstain rule. *Id.* at 839.

Additionally, the court held that Dirks' position as an employee of a registered broker-dealer gave rise to an independent disclose or abstain duty. *Id.* at 840. Since the SEC did not argue the merits of this theory, the Supreme Court did not address this "novel theory." *Dirks*, 103 S. Ct. at 3267 n.26.

104. *Dirks*, 103 S. Ct. at 3260.

III. The Decision

A. *Majority Opinion*

Justice Powell, writing for the majority in *Dirks v. SEC*,[105] reaffirmed the principle set forth in *Chiarella v. United States*[106] that the disclosure duty under section 10(b)[107] arises "from the existence of a fiduciary relationship" and not "from the mere possession of nonpublic market information."[108] The Court rejected the SEC's theory that a tippee "inherits" the insider's disclosure duty whenever he receives inside information.[109] Instead, the Court reasoned that the tippee's disclosure duty derives from the insider's fiduciary duty to the shareholders.[110] The insider must breach his fiduciary duty *and* the tippee must be aware of the insider's breach before a tippee acquires a duty to disclose or abstain.[111]

The SEC attempted to distinguish the facts in *Dirks* from those in *Chiarella* by noting that Chiarella was an outsider because he received information without the direct involvement of an insider, while Dirks received his information from an insider.[112] Thus, the SEC maintained, Dirks was a tippee and automatically "inherited" the insider's disclosure duty when he knowingly received and benefited from the nonpublic information.[113]

The Court interpreted this theory of tippee liability as "rooted in the idea that the anti-fraud provisions require equal information among all traders"[114] and noted that the Court had previously rejected this "equal information theory" in *Chiarella*.[115] The majority in *Dirks* emphasized that the duty to disclose

105. 103 S. Ct. 3255 (1983) (6-3 decision).

106. 445 U.S. 222 (1980).

107. 15 U.S.C. § 78j(b) (1982). For text of section 10(b) see *supra* note 13.

108. *Dirks*, 103 S. Ct. at 3261 (quoting Chiarella v. United States, 445 U.S. at 227-35).

109. *Dirks*, 103 S. Ct. at 3261-62.

110. *Id.* at 3264.

111. *Id.*

112. *Id.* at 3262 n.15. For a discussion of the definition of an insider, see *supra* note 6.

113. *Dirks*, 103 S. Ct. at 3261-62.

114. *Id.* at 3262.

115. *Id.*

or abstain does not arise from a mere duty to comply with the general anti-fraud proscriptions in the federal securities laws.[116] To support this conclusion the Court explained that it had previously decided in *Chiarella* that "formulation of an absolute equal information rule 'should not be undertaken absent some explicit evidence of congressional intent.' "[117]

The Court further justified its position by observing that the adoption of the equal information theory in this case could negatively affect market efficiency by inhibiting the role of market analysts.[118] It noted that Congress has exempted other market professionals from similar statutory prohibitions because they contribute to a "fair and orderly marketplace."[119] Therefore, the Court reasoned that the market analyst's contribution should not be judicially inhibited absent clear congressional intent.[120] Notwithstanding the need to insulate market analysts from an overly broad interpretation of Rule 10b-5,[121] the Court recognized that "the need for a ban on *some* tippee trading is clear."[122] The Court explained that if the disclosure duty attached only to insiders, the insiders could indirectly exploit shareholders by tipping information to third parties.[123]

Turning to the issue of how a tippee acquires the insider's duty to disclose or abstain, the Court cited Justice Blackmun's dissenting opinion in *Chiarella* to support the proposition that the tippee's duty is derived from the insider's duty.[124] The Court explained that the tippee's obligation arises " 'from his role as a participant after the fact in the insider's breach of a fiduciary duty.' "[125] An insider's disclosure duty, the Court reasoned, attaches to the tippee only when such information has been improperly supplied to the tippee.[126] It concluded that the tippee

116. *Id.* at 3263.
117. *Id.* at 3262 n.16 (quoting Chiarella v. United States, 445 U.S. at 233).
118. *Dirks*, 103 S. Ct. at 3263.
119. *Id.* at 3262 n.16.
120. *Id.* at 3262.
121. 17 C.F.R. § 240.10b-5 (1982). For for the text of Rule 10b-5, see *supra* note 14.
122. *Dirks*, 103 S. Ct. at 3263 (emphasis added).
123. *Id.*
124. *Id.* at 3264.
125. *Id.* (quoting Chiarella v. United States, 445 U.S. at 230 n.12). *See supra* notes 73-78 and accompanying text.
126. *Dirks*, 103 S. Ct. at 3264.

assumes a disclosure duty only when the *insider* has violated his "*Cady, Roberts* duty" by breaching his fiduciary duty to the shareholders.[127] Consequently, a tippee acquires an insider's duty to disclose or abstain only when the insider has breached his fiduciary duty by supplying the information to the tippee and the tippee is aware of this breach.[128]

According to the majority, there can be no tippee liability "absent a breach by the insider."[129] Therefore, the threshold question in determining tippee liability is whether the insider has breached his fiduciary duty. The Court stated that this test depends primarily on the insider's purpose for supplying the information: "The test is whether the insider personally will benefit, directly or indirectly, from his disclosure."[130] This is a question of fact.[131] In determining whether the insider has received a personal benefit from the disclosure, the majority directed courts to "focus on objective criteria . . . such as pecuniary gain or a reputational benefit that will translate into future earnings."[132] The relationship between the insider and the recipient of the information may also give rise to the inference of a quid pro quo transaction or an intention to benefit the recipient.[133] The majority added that the insider's breach is assumed when the recipient is a relative or friend.[134]

Before applying these guidelines to the facts in *Dirks*, the Court addressed the issue of whether Dirks' guilt could be predicated on grounds independent from his role as a tippee. The Court gave the following reasons for concluding that Dirks' guilt could not be based on any alternative theory arising from a fact or relationship independent from his role as a tippee:

1. he had no pre-existing fiduciary duty to the shareholders of Equity Funding;
2. he did not induce the shareholders or officers of Equity Funding to repose their trust or confidence in him;

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127. *Id.*
128. *Id.*
129. *Id.* at 3265.
130. *Id.*
131. *Id.* at 3266.
132. *Id.*
133. *Id.*
134. *Id.*

3. Dirks' sources did not expect him to keep their information in confidence;

4. he did not misappropriate or illegally obtain the information.[135]

Therefore, since Dirks' only legal obligation to disclose arose from his status as a tippee, the Court concluded that he assumed a duty to disclose only if the insiders breached their fiduciary duty.[136]

Applying the "insider's personal gain test" to Secrist and the other employees at Equity Funding, the Court determined that they did not breach their fiduciary duty to the shareholders.[137] The Court maintained that the following facts and inferences supported this determination: first, these insiders did not receive any monetary or personal benefit for revealing Equity Funding's secrets; and second, their purpose was not to make a gift of valuable information to Dirks.[138] Since these insiders did not breach their fiduciary duty to the shareholders, no derivative breach could be attributed to Dirks.[139] Therefore, the insider's duty to disclose or abstain did not attach to Dirks. Consequently, the Court concluded that Dirks did not violate Rule 10b-5 by trading on material, nonpublic information.[140]

B. *Dissent*

Justice Blackmun,[141] writing for the dissent, took issue with the majority's introduction of a test that required a showing of the "insider's improper purpose" as a prerequisite for establishing a tippee's disclosure duty.[142] The dissent contended that limiting tippee liability to instances where the insider is motivated

135. *Id.* at 3266-67.

136. *Id.* at 3267.

137. *Id.*

138. *Id.* at 3267-68.

139. *Id.* at 3268.

140. *Id.*

141. Justice Blackmun also wrote the dissent in Chiarella v. United States, 445 U.S. 222 (1980).

142. *Dirks*, 103 S. Ct. at 3268 (Blackmun, J., dissenting). "The device employed in this case engrafts a special motivational requirement on the fiduciary duty doctrine. This innovation excuses a knowing and intentional violation of an insider's duty to shareholders if the insider does not act from a motive of personal gain." *Id.* (Blackmun, J., dissenting).

by an improper purpose is against legislative intent,[143] has no basis in law,[144] and is against public policy.[145]

The dissent reasoned that since Secrist himself could not trade on his inside information,[146] he could "not do by proxy what he was prohibited from doing personally."[147] According to the dissent, Secrist allowed Dirks to disseminate information to clients, who in turn dumped their stock, thereby exploiting unknowing purchasers.[148] Since Secrist's act resulted in injury to the purchasers,[149] Secrist breached his fiduciary duty to them.[150] Dirks' knowledge of Secrist's breach made "him liable as a participant in the breach after the fact."[151]

The dissent rejected the majority's position that Secrist did not breach his fiduciary duty because he was not motivated by personal gain. The dissent contended that "[p]ersonal gain is not an element of the breach of [insider] duty."[152] To support this conclusion, the dissent relied on *Mosser v. Darrow*,[153] analogizing the trustee relationship in *Mosser* to the relationship between an insider and shareholders.[154] In *Mosser*, a trustee, who

143. *Id.* at 3268 n.1 (Blackmun, J., dissenting). Justice Blackmun notes the Supreme Court trend "to limit the protections provided investors by § 10(b)." *Id.* at 3268 (Blackmun, J., dissenting). He concludes that "[t]his trend frustrates the congressional intent that the securities laws be interpreted flexibly to protect investors." *Id.* at 3268 n.1 (Blackmun, J., dissenting). *Accord* Tomera v. Gath, 511 F.2d 504, 510 (7th Cir. 1975). "The fundamental purpose of section 10(b) is to achieve a high standard of business ethics. This purpose is taken seriously and is broadly construed." *Id. See also supra* note 48 and accompanying text.

144. *Dirks*, 103 S. Ct. at 3272 (Blackmun, J., dissenting) ("The improper purpose requirement . . . has no basis in the law . . . ."). The dissent refers to the requirement as imposing "a new, subjective limitation on the scope of the duty owed by insiders to shareholders." *Id.* at 3270 (Blackmun, J., dissenting).

145. *Id.* at 3273 (Blackmun, J., dissenting) (contending that the majority actually rewards Dirks for his aiding and abetting).

146. *Id.* at 3269 (Blackmun, J., dissenting).

147. *Id.* at 3270 (Blackmun, J., dissenting).

148. *Id.* (Blackmun, J., dissenting).

149. *Id.* (Blackmun, J., dissenting).

150. *Id.* at 3272 (Blackmun, J., dissenting).

The principle that an insider owes a fiduciary duty to stock purchasers, as well as to sellers, was introduced in *In re* Cady, Roberts, 40 S.E.C. 907, 912 (1961) and confirmed in Chiarella v. United States, 445 U.S. at 227 n.8. For a further discussion of the impact of *In re Cady, Roberts*, see *supra* note 42.

151. *Dirks*, 103 S. Ct. at 3270 (Blackmun, J., dissenting).

152. *Id.* at 3271 (Blackmun, J., dissenting).

153. 341 U.S. 267 (1951).

154. *Dirks*, 103 S. Ct. at 3271-72 (Blackmun, J., dissenting).

allowed his two employees to profit from their inside position, was held liable to the estate for the personal gain that accrued to his employees.[155] The dissent explained that the trustee in *Mosser* breached his fiduciary duty despite the fact that his motives were selfless and he did not personally benefit from his employees' inside trading.[156] The dissent contended that under the principle illustrated in *Mosser*, the motive of personal gain is not essential to a trustee's liability.[157] Instead, "the breach consists of taking action disadvantageous to the person to whom one owes a duty."[158] Therefore, the dissent reasoned that the breach of an insider's duty, like the breach of a trustee's duty, results from the consequences of the insider's actions, not from his motives.[159] Applying this reasoning to the facts in *Dirks*, the dissent concluded that Secrist breached his fiduciary duty to the shareholders when he acted in a manner that injured them, regardless of the fact that he was not motivated by an improper purpose.[160]

The dissent contended that in addition to having no basis in law, the majority's improper purpose requirement implicitly rested on poor policy.[161] It accused the majority of basing its decision on the policy that "the end justifies the means":[162] the general benefit achieved from Secrist's violating his duty to shareholders outweighed the harm to those shareholders.[163] Although the dissent considered Secrist's motive laudable, it took issue with the means he chose to expose the fraud.[164] Additionally, the dissent argued that Dirks and his clients should not be permitted to profit from inside information, since Dirks' failure to report the fraud was unethical and against public policy.[165] The majority opinion was criticized as being "deficient in policy terms," because it rewarded Dirks for aiding and abetting.[166]

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155. Mosser v. Darrow, 341 U.S. at 269-72.
156. *Dirks*, 103 S. Ct. at 3272 (Blackmun, J., dissenting).
157. *Id.* (Blackmun, J., dissenting).
158. *Id.* (Blackmun, J., dissenting).
159. *Id.* (Blackmun, J., dissenting).
160. *Id.* at 3271 (Blackmun, J., dissenting).
161. *Id.* at 3272 (Blackmun, J., dissenting).
162. *Id.* at 3273 (Blackmun, J., dissenting).
163. *Id.* (Blackmun, J., dissenting).
164. *Id.* (Blackmun, J., dissenting).
165. *Id.* (Blackmun, J., dissenting).
166. *Id.* (Blackmun, J., dissenting).

Justice Blackmun recognized that disclosure would have been difficult in this case, and criticized the SEC because it "tells persons with inside information that they cannot trade on that information unless they disclose; [but] refuses . . . to tell them how to disclose."[167] Nevertheless, the dissent concluded that Dirks and Secrist were under a duty to disclose or abstain, and chided the majority for rewarding inside trading "by opening a hole in the congressionally mandated prohibition on insider trading."[168]

IV. Analysis

A. *The Equal Information Theory*

The majority in *Dirks v. SEC*[169] rejected the SEC theory of tippee liability as being "rooted in the idea that the antifraud provisions require equal information among all traders."[170] The *Dirks* Court reaffirmed *Chiarella v. United States*[171] as repudiating any notion that all traders must enjoy equal information before trading,[172] and reiterated the conclusion announced in *Chiarella* that the "information theory" should not be accepted "absent some explicit evidence of congressional intent."[173]

Although the rejection of the "equal information" theory is consistent with the precedent established in *Chiarella*, the majority in *Dirks* appears to contradict itself in trying to reconcile its rejection of the "equal information" theory with pre-*Chiarel-*

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167. *Id.* (Blackmun, J., dissenting).

168. *Id.* at 3274 (Blackmun, J., dissenting).

169. 103 S. Ct. 3255 (1983).

170. *Id.* at 3262.

171. 445 U.S. 222 (1980).

172. *Dirks*, 103 S. Ct. at 3262.

173. *Id.* at 3262 n.16.

The "equal information" theory, as explained in *Chiarella*, proposed that inside trading was fraudulent because such traders gained an unfair advantage over the less informed. Chiarella v. United States, 445 U.S. at 232. This broad theory would impose inside trading liability on anyone who traded while in possession of material, nonpublic information. See *supra* notes 47-59 and accompanying text for a discussion of the "possession test." *See also* Heller, *supra* note 6, at 538-41. *Chiarella* explicitly rejected the "equal information" theory by contending that "not every instance of financial unfairness constitutes fraudulent activity under § 10(b)." Chiarella v. United States, 445 U.S. at 232. The *Chiarella* Court concluded that silence is not fraudulent absent a duty to speak. *Id.* at 235.

la case law.[174] Initially, the majority stated that the fraud in an inside trading case *derives* from the " 'inherent unfairness involved where one takes advantage' of 'information intended to be available only for a corporate purpose.' "[175] Subsequently, the majority stated that the tippee's duty derives from the insider's duty.[176] If the fraud arising from inside trading derives from "inherent unfairness," it is difficult to rationalize why a tippee who exploits shareholders by using inside information, does not commit fraud absent a breach of duty by the insider.[177] The majority's rejection of the "equal information" theory, however, cannot be equated with a judicial endorsement of market behavior that is "inherently unfair."[178] As the facts in *Dirks* illustrate, judicial adoption of the "equal information" theory would create an imprecise proscription against any trading on nonpublic in-

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174. Prior to *Chiarella*, cases that endorsed the "possession test" indicated a trend toward adopting the "equal information" theory. *See, e.g.*, Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 235 (2d Cir. 1974) (stating that cases have repeatedly held that the purpose behind § 10(b) is to protect *all investors* by promoting full disclosure).

175. *Dirks*, 103 S. Ct. at 3261 (quoting *In re* Merrill Lynch, Pierce, Fenner & Smith, Inc., 43 S.E.C. 933, 936 (1968)). *See supra* note 52.

176. *Dirks*, 103 S. Ct. at 3264.

177. Justice Blackmun noted in his dissent in *Chiarella* that the "duty to abstain or disclose arose, not merely as an incident of fiduciary responsibility, but as a result of the 'inherent unfairness' of turning secret information to account for personal profit." Chiarella v. United States, 445 U.S. at 249 (Blackmun, J., dissenting).

178. The majority rejected the rule adopted by the SEC to impose inside trading liability on Dirks because such a rule "would have no limiting principle." *Dirks*, 103 S. Ct. at 3266. The Court noted that "[w]ithout legal limitations, market participants are forced to rely on the reasonableness of the SEC's litigation strategy, but that can be *hazardous*, as the *facts of this case* make plain." *Id.* at 3266 n.24 (emphasis added). The majority suggests that without a "limiting principle," inside trading liability may be imposed in situations, such as the situation in *Dirks*, where the profit derived is not a product of unjust enrichment, and thus, is not "inherently unfair."

Although the majority felt that Dirks' profit was not "inherently unfair," *id.*, it acknowledged that there may be "significant distinctions between actual legal obligations and ethical ideals." *Id.* at 3264 n.21. Insofar as "inherent unfairness" can be equated with unethical behavior, therefore, the majority implies that, without legislative clarification, it will permit inside trading that is unfair, if there is no specific statutory or administrative proscription making such unfair behavior unlawful. *See* Freeman, *The Insider Trading Sanctions Bill — A Neglected Opportunity*, 4 PACE L. REV. 221 (1984). Additionally, the *Chiarella* Court stated that since financial unfairness does not necessarily constitute fraud, not every case of inside trading that is "unfair" is made unlawful by § 10(b). Chiarella v. United States, 445 U.S. at 232.

formation, even when such trading is not "inherently unfair,"[179] and despite the fact that it actually promotes "market efficiency."[180]

B. *Market Efficiency*

The majority's main concern with adopting a general disclosure duty was the inhibiting influence the adoption of such an imprecise rule might have on the role of market analysts.[181] As the facts in *Dirks* illustrate, a market analyst who has immediate financial incentives and a reputation at stake will often uncover fraud before administrative agencies or the press.[182] Without the analyst's investigatory efforts, corporate fraud would continue to victimize investors.[183] Thus, the majority was correct in concluding that rather than inhibiting market efficiency, as the dissent contended,[184] Dirks actually promoted an efficient market by uncovering the fraud expeditiously.

The majority position was urged by the United States Government in an amicus brief in support of reversing Dirks' conviction.[185] The Government maintained that the "erroneous imposition of liability"[186] in *Dirks* would lead to a situation where "[f]ew analysts will be willing to devote substantial resources

179. *Dirks*, 103 S. Ct. at 3266 n.24. *See also supra* note 175.

180. The author of Rule 10b-5, Milton Freeman, in noting its broad application, commented: "I tend to think that judges do not extend principles that do not appeal to their basic sense of fairness and equity." *Conference on Codification of the Federal Securities Laws*, 22 BUS. LAW. 793, 922 (1967). The majority decision indicates that the facts of *Dirks* illustrated the unfairness and inequity in applying Rule 10b-5 to Dirks. *Dirks*, 103 S. Ct. at 3266 n.24. *See supra* note 178.

181. *Dirks*, 103 S. Ct. at 3263 n.17.

182. *Id.* at 3259 n.8 (discussing the important role that Dirks played in expeditiously uncovering the corporate fraud). *Contra id.* at 3273 n.15 (Blackmun, J., dissenting) (criticizing the majority for uncritically accepting Dirks' own view of the important role he played in uncovering the fraud).

183. *Id.* at 3267 n.27. Even the lower court in *Dirks* recognized that construing Rule 10b-5 so as to prevent analysts from contacting employees and asking them about crimes or frauds "may not, in the end, serve the public interest." Dirks v. SEC, 681 F.2d 824, 839 (D.C. Cir. 1982).

184. *Dirks*, 103 S. Ct. at 3273 n.15, 3274 (Blackmun, J., dissenting).

185. Brief for the United States as Amicus Curiae in Support of Reversal, *Dirks*, 103 S. Ct. 3255 (1983) (available Feb. 20, 1984, on LEXIS, Genfed library, Brief file).

186. *Id. See generally* Fleischer, *supra* note 15, at 816 (discussing the "fairness approach," which would permit limited inside trading where the profit is not a product of unjust enrichment).

and expose themselves to personal danger . . . if they are forbidden to utilize the information" until the investing public has been fully apprised.[187] Although opposed to the majority position, the SEC also recognized the role of market analysts as being "necessary to the preservation of a healthy market."[188]

Further analysis of the consequences of the majority rule serves to illustrate the soundness of the majority's and the Government's position. As the majority pointed out, the facts in *Dirks* indicate no causal connection between "the inside trading and the outsider's losses."[189] The dissent, however, argued in favor of liability, focusing on the losses sustained by the purchasing shareholders.[190] Yet in light of the expeditious manner in which Dirks' private efforts uncovered the fraud, there is, as the majority contended, "little legal significance to the dissent's argument that Secrist and Dirks *created new 'victims'* by disclosing information to persons who traded."[191] Although the early disclosure caused by Dirks' efforts shifted the loss occassioned by Equity's fraud to *different* parties, it served the public interest by precluding injury to *new* victims, once trading in the stock was halted.

The dissent criticized the majority for justifying Secrist's and Dirks' actions on the theory that "the general benefit derived . . . outweighed the harm caused to [the] shareholders."[192] It argued that the majority's position was similar to the theory that "insider trading should be permitted because it brings relevant information to the market."[193] According to the dissent, failure to convict Dirks was "a disservice to this country's attempt to provide *fair* and *efficient* capital markets."[194] This conclusion fails to recognize that Dirks contributed to market effi-

187. Brief for the United States as Amicus Curiae in Support of Reversal, *Dirks*, 103 S. Ct. 3255 (1983) (available Feb. 20, 1984, on LEXIS, Genfed library, Brief file).

188. *Dirks*, 103 S. Ct. at 3263 n.17. The majority concluded that due to the nature of the securities market and the nature of analysts' information "such information cannot be simultaneously available to all of the corporation's stockholders or the public generally." *Id.* at 3263.

189. *Id.* at 3267 n.27.

190. *Id.* at 3270 (Blackmun, J., dissenting).

191. *Id.* at 3267 n.27 (emphasis added).

192. *Id.* at 3272-73 (Blackmun, J., dissenting).

193. *Id.* at 3273 n.14 (Blackmun, J., dissenting).

194. *Id.* at 3274 (Blackmun, J., dissenting) (emphasis added).

ciency by pursuing his investigation in a more zealous manner than the administrative agencies and the press, who were also privy to the allegations of corporate fraud.[195] In addition, the dissent failed to give sufficient weight to the fact that any benefit Dirks received was largely a product of his own investigative efforts, and thus was not inherently unfair.[196]

The disagreement between the majority and dissenting opinions reflects the tension between two purposes of the securities laws: a protective function aimed at ensuring public confidence by eliminating disparities in information,[197] and an efficiency function aimed at "creating a flow of information which will enable investment decisions systematically to reflect relevant facts and expectations."[198] The dissent's position reflected the theory that because inside trading permits disparities in information, it destroys the public's confidence that all investors have an equal chance to profit, thereby contributing to the public's reluctance to invest in the stock market.[199] The majority, on the other hand, emphasized the important role that analysts play in bringing information to the public's attention, thereby expediting the free flow of information to the public by preventing the available information from being "grossly inaccurate."[200]

The dissent attempted to distort the majority's "market efficiency" rationale in its accusation that by allowing tippees to trade on inside information, the majority was effectively adopting an extreme position:[201] all bans on inside trading should be lifted.[202] This accusation is unfounded. The majority opinion

195. *See supra* note 89.

196. *See generally* Fleischer, *supra* note 15, at 816 (discussion of the "fairness approach").

197. Seligman, *An Economic Defense of Insider Trading*, FORTUNE, Sept. 5, 1983, at 47. As quoted in this article, John M. Fedders, head of the SEC's Enforcement Division, equates the use of inside information with stealing and feels that a total ban is justified due to "unfairness." *Id.* at 47-48.

198. Brudney, *supra* note 3, at 334. *See also* Heller, *supra* note 6, at 521.

199. *Dirks*, 103 S. Ct. at 3274 (Blackmun, J., dissenting).

200. *Id.* at 3263 n.18.

201. *Id.* at 3273 n.14 (Blackmun, J., dissenting).

202. *See generally* H. MANNE, INSIDER TRADING AND THE STOCK MARKET 59-75, 93-169 (1966). Manne contends that the SEC should not attempt to stop insider trading. Instead, the prohibition should be left up to corporations who would be free to establish their own procedures for monitoring the flow of information. The rationale for this radical position is that when insiders trade on their information, they make the market more

cannot be construed as removing all restrictions on inside trading.[203] It leaves intact tippee liability when the insider breaches his fiduciary duty, but protects the role of analysts by limiting their potential inside trading liability to situations where the analyst knows or should have known that the insider supplying him with information was motivated by personal gain.[204] The majority's position seeks to strike a balance between the two extreme views: all inside trading is unfair and must be prohibited because it destroys public confidence, and all inside trading must be permitted because it enhances market efficiency.

C. *The Insider's Personal Gain Test*

Although the majority rejected the SEC's position that a tippee automatically inherits the insider's disclosure duty[205] because such a rule has "no limiting principle,"[206] the majority recognized that "[t]he need for a ban on some tippee trading is clear."[207] The Court observed that after *Chiarella*, it was unclear how a tippee who has no special relationship with the shareholders acquires the insider's disclosure duty.[208] Relying on *Chiarella*, the majority noted that the tippee's obligation arises from his role as a participant after the fact in the insider's breach of a fiduciary duty and concluded that a tippee assumes the insider's disclosure duty only when the tippee is aware that the insider

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efficient because the price of stocks immediately adjust to changes in underlying realities. Outsiders, by noting the movement of the price of the stock, will therefore get a better opportunity to judge the intrinsic value of the stock. In effect, Manne is saying that since the SEC cannot effectively control insider trading, the public would benefit from an end to the pretense that undisclosed information does not presently affect stock prices by allowing all insiders to trade.

According to a recent article in *Fortune*, Manne's idea is endorsed by a growing number of economists. Seligman, *supra* note 197, at 47. *See also* Friedman, *Efficient Market Theory and Rule 10b-5 Nondisclosure Claims: A Proposal for Reconciliation*, 47 Mo. L. Rev. 745 (1982).

203. Moreover, removing all restrictions on inside trading would not necessarily promote market efficiency, since an insider who could legally profit from nondisclosure would have no incentive to make inside information public.

204. *Dirks*, 103 S. Ct. at 3264.

205. *Id.* at 3261.

206. *Id.* at 3266.

207. *Id.* at 3263.

208. *Id.* at 3261.

has breached his fiduciary duty to the shareholders.[209] The test developed by the majority to determine when an insider has breached his fiduciary duty is "whether the insider will benefit, directly or indirectly, from his disclosure."[210]

The majority quoted *In re Cady, Roberts & Co.*[211] out of context when it interpreted *Cady, Roberts* as identifying the standard for the majority's premise that a breach of duty largely depends on "the purpose of the disclosure."[212] *Cady, Roberts* merely reiterated that the purpose of the Exchange Act was to eliminate the notion that exploiting inside information was a "normal emolument of corporate office";[213] it did not support the majority's position that the *insider's* improper purpose was a prerequisite for establishing tippee liability.[214] On the contrary, in *Cady, Roberts* the Commission held that the tippee violated the disclosure duty *despite* their finding that the insider was not motivated by an improper purpose.[215]

Moreover, while the majority's insistence that tippee liability can be predicated only upon the tippee's knowledge of the insider's breach is consistent with dicta from *Chiarella*,[216] its conclusion that a "breach of duty . . . depends in large part on the purpose of the disclosure"[217] goes beyond established fiduciary principles, as the dissent emphatically pointed out. The dissent contended that personal gain is not an element in determining an insider's breach and that therefore, the majority imposed "a new, subjective limitation on the scope of the duty owed by insiders to shareholders."[218] The dissent correctly noted that

209. *Id.* at 3264.

210. *Id.* at 3265.

211. 40 S.E.C. 907 (1961).

212. *Dirks*, 103 S. Ct. at 3265.

213. *In re* Cady, Roberts & Co., 40 S.E.C. at 912 n.15.

214. *Dirks*, 103 S. Ct. at 3265 (emphasis added).

215. *In re* Cady, Roberts & Co., 40 S.E.C. at 917.

The Commission in *Cady, Roberts* found that the insider probably assumed that the information he supplied to the tippee had already been publicly disseminated. *Id.* Applying the insider's personal gain test set forth in *Dirks*, 103 S. Ct. at 3265, to the facts in *Cady, Roberts*, one could conclude that there should have been no tippee liability in *Cady, Roberts* since the insider was not motivated by an improper purpose.

216. Chiarella v. United States, 445 U.S. at 230 n.12. For a discussion of this dicta in *Chiarella*, *see supra* notes 73-78 and accompanying text.

217. *Dirks*, 103 S. Ct. at 3265.

218. *Id.* at 3270 (Blackmun, J., dissenting).

under the *Mosser v. Darrow*[219] principle,[220] the fact that the trustee's motives were "completely selfless" was irrelevant to the Court's determination that the trustee breached his fiduciary duty.[221] By analogizing a trustee's fiduciary duty to that of an insider, the dissent observed that the insider's duty should be addressed to the consequences that his actions have upon the shareholders and not to the insider's motives.[222] Consequently, the dissent's conclusion that Secrist breached his fiduciary duty when he acted in a manner disadvantageous to the shareholders, regardless of his motivation,[223] is consistent with established fiduciary principles, while the majority's insistence that there is no breach unless the insider was motivated by the anticipation of gain is inconsistent with these principles.[224]

Despite the validity of the dissent's criticisms, to equate a trustee with an insider is overly simplistic. Applying common law fiduciary principles and precedents to modern securities transactions involving corporate insiders is an anachronism. In *Mosser*, the trust beneficiaries were readily identifiable and had parity of interests.[225] In contrast, when Secrist told Dirks about the suspected fraud, as an insider he owed a duty to both present *and future* Equity Funding shareholders. Unlike the situation in *Mosser*, these two groups had conflicting interests: the present shareholders benefited by Secrist's attempt to expose the fraud, while the investors who purchased shares from Dirks' clients were injured. The dissent emphasized that Secrist breached his duty by acting in a manner that injured prospec-

219. 341 U.S. 267 (1951).

220. Both the majority and the dissent cite *Mosser* as standing for the principle that third parties who knowingly participate in a fiduciary's breach are as culpable as the fiduciary. *Dirks*, 103 S. Ct. at 3263; *id.* at 3272 (Blackmun, J., dissenting). In *Mosser*, the Court held a trustee liable for breaching his fiduciary duty to the estate because he allowed his employees to use their inside positions to the detriment of the trust. Mosser v. Darrow, 341 U.S. at 275.

221. *Dirks*, 103 S. Ct. at 3272 (Blackmun, J., dissenting) (citing Mosser v. Darrow, 341 U.S. at 275).

222. *Dirks*, 103 S. Ct. at 3271 (Blackmun, J., dissenting).

223. *Id.* (Blackmun, J., dissenting).

224. *Cf. supra* note 41.

225. The *Mosser* Court explained that while the employees' dealing "did not directly extract any amount from the till of the trustee," Mosser v. Darrow, 341 U.S. at 272, "the prohibition is not merely against injuring the estate — it is against profiting out of the position of trust." *Id.* at 273.

tive purchasers,[226] but ignored the fact that Secrist owed a duty to present shareholders.[227]Assuming, arguendo, that the dissent was correct in stating that Secrist breached his fiduciary duty regardless of his motivation, Secrist's action, while disadvantageous to some investors, ultimately benefited the majority of the people to whom Secrist owed a fiduciary duty.

The dissent's most valid criticism of the majority's imposition of an "insider's personal gain test" is that "the requirement adds to the administrative and judicial burden in Rule 10b-5 cases."[228] The majority conceded that this test will be difficult for the courts to apply, but justified this added burden by asserting the need for a "guiding principle" to govern market activities.[229] The majority failed to recognize that because the test it adopted will be difficult for the courts to apply, it will be a less effective "guiding principle" for investors, who must now determine whether using a "tip" constitutes a "personal gain" to the insider who supplied the information.

From the guidelines set forth in *Dirks*, it appears that the relationship between the insider and the tippee may be the determinative factor in establishing the insider's gain. Where the insider and tippee are unrelated, it appears that the insider must receive a pecuniary or reputational benefit as a result of the disclosure.[230] Such a benefit, however, can be inferred where the facts suggest a quid pro quo relationship.[231] Additionally, if the tippee is a "friend" or "relative," the insider's gain is presumed.[232] Under a broad interpretation of these guidelines, the insider's personal gain appears to be a rebuttable presumption once it can be established that the insider and the tippee are friends, relatives, or have a mutually beneficial relationship. Although the majority insisted that the insider's motivation can be determined by objective criteria, the dissent correctly suggested that under the test adopted by the majority, it remains unclear

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226. *Dirks*, 103 S. Ct. at 3272 (Blackmun, J., dissenting).

227. For a discussion on how the fiduciary relationship was expanded to include the purchasers of securities, see *supra* note 42.

228. *Dirks*, 103 S. Ct. at 3272 n.13 (Blackmun, J., dissenting).

229. *Id.* at 3266.

230. *Id.*

231. *Id.*

232. *Id.*

whether Secrist breached his fiduciary duty. The majority stated that an insider breaches his duty when he makes a gift of inside information to a friend.[233] The dissent pointed out that "Secrist surely gave Dirks a gift of the commissions that Dirks made on the deal in order to induce him to disseminate the information."[234] Additionally, one can argue that by exposing the fraud, Secrist received "a reputational benefit that [would] translate into future earnings."[235] Therefore, under a liberal interpretation of the personal gain test, Secrist breached his fiduciary duty.

If courts take a broad view as to what constitutes a tipper's personal benefit, insider liability may be imposed in the future in situations similar to that in *Dirks*. Further administrative and judicial explanation and refinement of the "personal gain" concept must occur before the "insider's personal gain test" can become the guiding principle the majority intended. Since the guidelines set forth in *Dirks* are unclear, the majority opinion actually raises more uncertainties than it resolves.

D. *Unresolved Issues Raised by* Dirks

The *Dirks* majority created a new category of insiders by noting, in dicta, that under certain circumstances outsiders may become fiduciaries of the shareholders and may be treated more properly as tippers than as tippees.[236] Under this theory, recipients of inside information, such as underwriters, lawyers, and accountants, who legitimately receive corporate information because of their working relationship with a corporation, are to be considered insiders and not tippees.[237] They assume this "tem-

233. *Id.*

234. *Id.* at 3272 n.13 (Blackmun, J., dissenting). Actually, the majority's criteria indicates that a "gift" will be presumed only if the insider is a friend or relative of the tippee. *Id.* at 3266. Under such a test, Dirks would inherit Secrist's duty if Secrist was his "friend."

235. *Id.* at 3266.

Since Secrist had been fired by Equity Funding shortly before he communicated his suspicion to Dirks (*see supra* note 81), he could be viewed as a spurned employee, who sought to vindicate his own reputation by exposing Equity Funding's fraudulent practices.

236. *Id.* at 3261 n.14.

237. Underwriters have previously been held liable for inside trading. *See, e.g.*, Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 241 (2d Cir. 1974)

porary insider" status only if the corporation expects the non-public information to remain confidential and their relationship with the corporation suggests a duty of confidentiality.[238]

The language used by the majority suggests that the "misappropriation theory" that was developed but left unresolved in *Chiarella*[239] may be adopted in the future. In determining that Dirks had no disclosure duty independent from his role as a tippee, the Court noted that Dirks did not "misappropriate or illegally obtain the information about Equity Funding."[240] It can be inferred from this reasoning that the misappropriation theory may be a future basis for establishing a fiduciary duty.[241] Under the appropriate circumstances, the "temporary insider" theory,[242] the "misappropriation" theory,[243] or a combination of

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(underwriter of corporate securities issues).

238. Two district courts, interpreting footnote 14 in *Dirks*, have used the phrase "temporary insider" to establish a disclose or abstain duty under § 10(b) and Rule 10b-5 for persons who are not traditional insiders. SEC v. Musella, No. 83-342, slip op. (S.D.N.Y. Jan. 26, 1984) (available Mar. 3, 1984, on LEXIS, Genfed library, Dist. file); SEC v. Lund, 570 F. Supp. 1397, 1403 (C.D. Cal. 1983).

The *Mussella* case involves an office manager of Sullivan & Cromwell who allegedly told a variety of people of nonpublic takeover plans. Although the case is pending, the court granted the SEC's request for a preliminary injunction barring two defendants from future violations of §§ 10(b) and 14(e) and a temporary freeze on their profits allegedly gained from the office manager's "tips" to them. The court reasoned that the office manager could be viewed as a "temporary insider" because "*Dirks* gives Supreme Court imprimatur to the notion that outsiders, under certain defined circumstances, may become insiders with corollary fiduciary obligations." SEC v. Musella, No. 83-342, slip op. (S.D.N.Y. Jan. 26, 1984).

In *Lund*, the court held the defendant liable under § 10(b) for trading on the basis of information he learned because he was a source of potential funding for a corporate venture. The court reasoned that the defendant became a "temporary insider" and assumed an insider's disclose or abstain duty "by virtue of a special relationship with the corporation." SEC v. Lund, 570 F. Supp. at 1403. *But cf.* Walton v. Morgan Stanley & Co., 623 F.2d 796, 798-99 (2d Cir. 1980) ("temporary insider" status may not be applicable where the parties deal at arms length).

239. Chiarella v. United States, 445 U.S. at 243-45 (Burger, C.J., dissenting).

240. *Dirks*, 103 S. Ct. at 3267.

241. The Second Circuit has used the "misappropriation" theory to impose Rule 10b-5 liability. *See, e.g.*, United States v. Newman, 664 F.2d 12 (2d Cir. 1981), *cert. denied*, 104 S. Ct. 193 (1983); O'Connor & Assoc. v. Dean Witter Reynolds, Inc., 529 F. Supp. 1179 (S.D.N.Y. 1981). For a discussion of *Newman* and the "misappropriation" theory, see Note, *supra* note 29.

242. *See, e.g.*, SEC v. Lund, 570 F. Supp. at 1402-03. For a discussion of *Lund*, see *supra* note 238. *See also* Fogelson & Stein, *Inside Trading After 'Dirks'*, N.Y.L.J., Dec. 12, 1983, at 29, col. 3.

243. *See, e.g.*, United States v. Newman, 664 F.2d at 16, 17.

both[244] may be used by the SEC and the courts as the basis of establishing inside trading violations. Such an approach would circumvent the necessity of establishing the "insider's personal gain," a prerequisite for tippee liability.

The Court also failed to resolve numerous issues raised by the nature of the information received by Dirks. Under the rationale in *SEC v. Monarch Fund*,[245] Dirks' initial information lacked the element of specificity necessary to constitute "material facts."[246] The lower court in *Dirks*, however, considered the fact that "some of Secrist's charges eventually proved false" to be irrelevant and concluded that "by the end of Dirks' investigation there [was] no doubt that the information he possessed and passed on to his clients had enough specificity to satisfy Rule 10b-5."[247] The majority declined to clarify guidelines for determining when Secrist's unverified allegations reached the degree of reliability to elevate them from the status of a "rumor" to material, inside information.[248] Even under the "equal information" theory endorsed by Justice Blackmun in his dissenting opinion in *Chiarella*,[249] the information obtained by Dirks could not be considered inside information, since it was legally available to the public.[250]

The Court did not address[251] the merit of the Solicitor Gen-

244. SEC v. Musella, No. 83-342, slip op. (S.D.N.Y. Jan. 26, 1984) (available Mar. 3, 1984, on LEXIS, Genfed library, Dist. file).

245. 608 F.2d 938 (2d Cir. 1979).

246. *Id.* at 942. In holding that the defendant's information lacked specificity the *Monarch* court reasoned that "the ability of a court to find a violation . . . diminishes in proportion to the extent that the disclosed information is so general that the recipient thereof is still 'undertaking a substantial economic risk that his tempting target will prove to be a white elephant.' " *Id.* (quoting United States v. Chiarella, 588 F.2d 1358, 1366-67 (2d Cir. 1979)). *See generally* Heller, *supra* note 6, at 548.

247. Dirks v. SEC, 681 F.2d 824, 843 n.24 (1982).

248. *Dirks*, 103 S. Ct. at 3266 n.25.

249. Chiarella v. United States, 445 U.S. at 251 (Blackmun, J., dissenting) ("I would hold that persons having access to confidential material information that is not legally available to others generally are prohibited by Rule 10b-5 from engaging in schemes to exploit their structural informational advantage through trading in affected securities.").

250. Brief for the United States as Amicus Curiae in Support of Reversal, *Dirks*, 103 S. Ct. 3255 (1983) (available Feb. 20, 1984, on LEXIS, Genfed library, Brief file). The Solicitor General argued that the information supplied to Dirks was not inside information because it was "legally available to others" through the exercise of "diligence or acumen." *Id.* (quoting Chiarella v. United States, 445 U.S. at 251, 252 n.2).

251. *Dirks*, 103 S. Ct. at 3266 n.25.

eral's contention that the information supplied to Dirks was evidence of a crime and, therefore, could not be characterized as "inside information."[252] The Solicitor General reasoned that such information "is not the private property of anyone . . . [and] any effort to disseminate such information is encouraged by law, while efforts to preserve its secrecy are strictly forbidden."[253] Accordingly, the Solicitor General concluded that there was no basis for viewing the "tips" supplied to Dirks as "improper disclosure[s]" of " 'confidential' information or [as constituting] a breach of fiduciary duty." Therefore, under the theory advanced by the Government, Dirks could not be characterized "as a participant after the fact in the insider's breach of a fiduciary duty."[254]

By adopting these alternative theories, the Court could have declined to characterize the information supplied to Dirks as "inside information," thereby avoiding the necessity for developing the "insider's personal gain test." Since this test will undoubtedly prove to be difficult to enforce and may possibly inhibit the SEC's ability to control inside trading, the Court should have opted for one of these alternative theories to resolve with the special problem presented by *Dirks*.

E. *Evaluation*

The "insider's personal gain test" developed in the *Dirks* decision places an additional burden on the SEC in regulating inside trading.[255] Before *Dirks*, tippee liability could be estab-

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252. Brief for the United States as Amicus Curiae in Support of Reversal, *Dirks*, 103 S. Ct. 3255 (1983) (available Feb. 20, 1984, on LEXIS, Genfed library, Brief file).

253. *Id.*

254. *Id.* An effect of not classifying allegations of fraud as inside information, not mentioned by the Solicitor General, would be to permit an insider, like Secrist, to lawfully trade while in possession of such information.

255. Most instances of inside trading involve information *legitimately* obtained but *illegitimately* used. Morrison, *Silence is Golden: Trading on Nonpublic Market Information*, 8 SEC. REG. L.J. 211, 224 (1980). Insofar as the insider's personal gain test set forth in *Dirks* requires the SEC to prove that inside information has been *illegitimately* obtained, it increases the enforcement burden on the SEC.

Even prior to the *Chiarella* and *Dirks* mandate, which requires the SEC to prove a fiduciary or special relationship between the parties before imposing Rule 10b-5 liability, inside trading was ubiquitous. George Benston of the University of Rochester has analyzed the relationship between the price changes in securities and the publication of SEC-required accounting data. He concluded that the corporate information contained

lished by applying a three pronged test: first, the insider possessed material, nonpublic information; second, the insider communicated this information to a third party prior to its public dissemination; and third, the tippee traded while in possession of this information before it was publicly disclosed.[256] As a result of *Dirks*, the SEC has an additional burden. It must prove that the insider personally benefited, directly or indirectly, by supplying the tippee with inside information, *and* that the tippee knew, or should have known, that the insider breached his fiduciary duty.[257]

While the test developed in *Dirks* imposes a burden on SEC enforcement, the practical impact of the decision will be limited by the fact that few insiders are motivated to supply information to third parties for reasons other than personal gain. Since the test encompasses a variety of activities, courts will probably define what constitutes an insider's "personal benefit" liberally. In addition, the evidentiary burdens may be circumvented by characterizing the recipient of inside information as a "temporary insider" as opposed to a tippee.[258] Recognizing this potential, the SEC's General Counsel has expressed the opinion that because the "temporary insider" theory creates the basis for new enforcement approaches, *Dirks* represents a net gain for the SEC's program to combat insider trading.[259]

Nevertheless, the *Dirks* decision raises the question as to whether Congress should define what constitutes unlawful inside

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in the data is almost invariably reflected in the price of the securities *before* the information is published. Seligman, *supra* note 197, at 48.

Despite the SEC's increased efforts to enforce inside trading violations, the nature of the offense makes discovery and the gathering of evidence complex and difficult. John M. Fedders, enforcement chief of the SEC, explained: " 'It's difficult to make the evidentiary link from tipper to tippee to remote tippee. No one writes a memorandum about insider trading. Instead of putting together pieces of paper, you're linking together the circumstantial evidence of whispers.' " *Market Leaks: Illegal Insider Trading Seems to Be on Rise; Difficulty of Tracking Tips and Courts Hobble SEC*, Wall St. J., Mar. 2, 1984, at 12, col. 5 (quoting John M. Fedders).

256. *Dirks*, 103 S.Ct. at 3262 (quoting 21 S.E.C. Docket, at 1410 n.42).

257. *Dirks*, 103 S. Ct. at 3264.

258. *See supra* notes 236-38 and accompanying text.

259. Fogelson & Stein, *supra* note 242, at 37 n.23 (citing address by DeGoelzer, Alive and Well — S.E.C. Insider Trading Enforcement After Dirks, District of Columbia Bar Ass'n, Sept. 28, 1983).

trading. The proposed Insider Trading Sanctions Act,[260] which provides for an increased civil penalty of up to three times the profit gained or loss avoided as a result of an unlawful purchase or sale of securities,[261] suggests a legislative intent to facilitate the SEC's increased effort to prevent insider trading violations.[262] The House passed the bill without defining insider trading, adopting the SEC's position that "if the *Dirks* decision is properly and narrowly construed by the courts, the Commission's insider trading program will not be adversely affected."[263] There is some indication, however, that the Senate's version of the bill may include a definition of insider trading.[264] While proposals to incorporate such a definition are based on legitimate concerns,[265] a codified definition of insider trading, broad enough to anticipate all the creative ways of using inside information to exploit the public,[266] would probably do little to clarify the scope of insider trading liability. Viewed in this light, the flexibility of the "insider's personal gain test" may prove more

260. H.R. 559, 98th Cong., 1st Sess. (1983).

261. In addition, the bill would increase criminal fines for certain violations from the current maximum of $10,000 to $100,000. *Id.*

262. The number of SEC actions alleging insider trading violations has steadily increased from 6 actions in 1978 to 24 actions in 1983. *Market Leaks: Illegal Insider Trading Seems to Be on Rise; Difficulty of Tracking Tips and Courts Hobble SEC*, Wall St. J., Mar. 2, 1984, at 1, col. 6.

263. H.R. REP. No. 355, 98th Cong., 2d Sess. 1, 14-15 (1983). The Committee relied on an SEC report which reviewed 34 insider trading cases brought in the last two years and found that only one of these cases may have been affected by the *Dirks* decision. *Id.* at 15. Realizing that "the impact of *Dirks* depends on future judicial interpretations," the Committee directed the SEC to "monitor the effects of *Dirks* for at least two years and report back to the Committee at the end of each year." *Id.*

264. Sen. Alfonse D'Amato, chairman of the Senate Banking, Housing and Urban Affairs subcommittee on securities which will propose its version of the Act, "would like to incorporate in the Senate bill what the House bill lacks - a definition of insider trading broad enough to encompass accountants, lawyers, consultants and other 'outsiders.'" *Market Leaks: Illegal Insider Trading Seems to Be on Rise; Difficulty of Tracking Tips and Courts Hobble SEC*, Wall St. J., Mar. 2, 1984, at 12, col. 6.

265. *See, e.g.*, Freeman, *supra* note 178, at 222-23 (1984). *Accord* Block & Barton, *Securities Litigation*, 10 SEC. REG. L.J. 350, 367-68 (1979); Brodsky, *Some Clarification Needed on Who is an "Inside Trader"*, N.Y.L.J., Apr. 28, 1983, at 1, col. 2.

266. The House Report declined to include a definition of insider trading in the proposed legislation, agreeing with Arnold S. Jacobs who testified: "As with any broad anti-fraud remedy, the fringes of what constitutes the prohibited act are occasionally fuzzy. This, however, does not justify placing a definition in the bill; unscrupulous traders would skirt around any definition constructed." H.R. REP. No. 355, 98th Cong., 2d Sess. at 13.

advantageous than a legislative definition, since it enables administrative and judicial tribunals to develop additional rules and precedents as new situations arise.

V. Conclusion

Chiarella v. United States[267] and *Dirks v. SEC*[268] represent the Supreme Court's most recent efforts to harmonize the sweeping proscription embodied in section 10(b) and Rule 10b-5 with the policies of securities regulation and the variety of conduct encompassed by the letter of the law.[269] Deferring to the policy in favor of promoting market efficiency, the *Dirks* Court correctly concluded that tippee liability cannot be predicated on the mere possession of inside information. Such a test, as *Dirks* illustrates, would impose liability on a tippee who brings relevant corporate information to the public, yet is not unjustly enriched by his possession of the information. The Court, therefore, achieved a just result and in doing so formulated a flexible test to determine tippee liability.

In formulating the "insider's personal gain test," the Court chose not to define what constitutes "personal gain." Given the creative variety of schemes designed to exploit the public's ignorance of inside information, the test correctly enables administrative and judicial tribunals to adapt the test to prohibit conduct that is inherently unfair and in contravention of the policies of the securities laws.

Yet this flexibility has its costs. By leaving to the lower courts the task of defining what consitutes "personal gain" and "improper purpose," the test fails to achieve the majority's objective: to develop a "guiding principle" by which tippee liability can be gauged. Furthermore, by conditioning tippee liability on the *insider's* breach of fiduciary duty, the "insider's personal gain test" incorrectly bases tippee liability on the *source* of the nonpublic information, instead of on whether the tippee has

267. 445 U.S. 222 (1980).

268. 103 S. Ct. 3255 (1983).

269. *See also* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 749 (1975) ("We are dealing with a private cause of action which has been judicially found to exist, and which will have to be delimited one way or another unless and until Congress addresses the question.").

used an undeserved informational advantage to exploit the less informed public.

Nevertheless, these weaknesses in the *Dirks* decision can be overcome by the judiciary's use of the "temporary insider" theory, suggested in dicta in *Dirks*, and the "misappropriation" theory. These theories may counterbalance the potentially limiting effect of *Dirks* on the scope of tippee liability.

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