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OPINION

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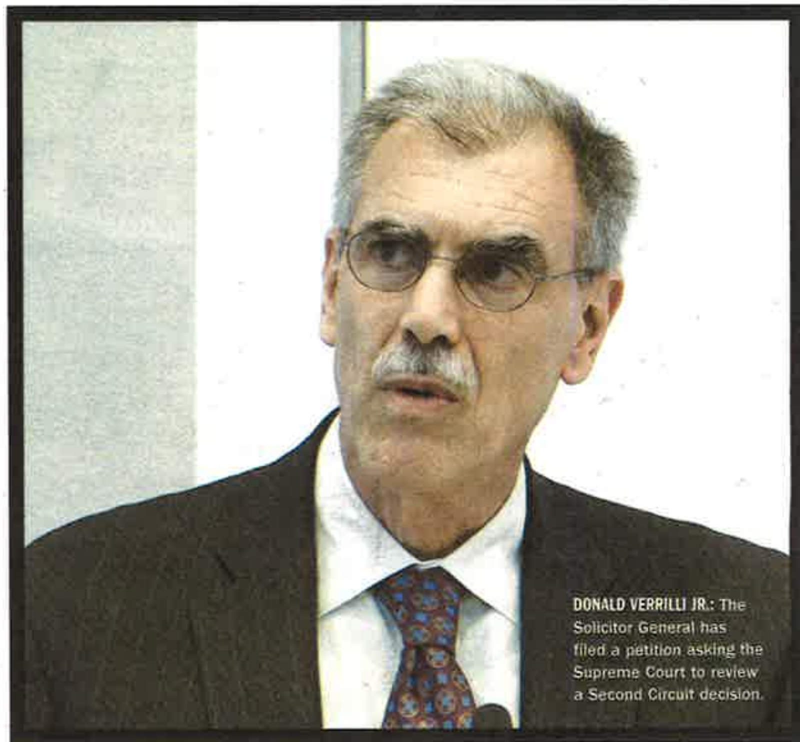

DONALD VERRILLI JR.: The Solicitor General has filed a petition asking the Supreme Court to review a Second Circuit decision.

DIEGO M. RADZINSCHI

Folly in Redefining Insider Trading

High court should revisit—and affirm—what constitutes a "personal benefit" for information.

BY BRUCE BARKET AND ALEXANDER KLEIN

Consider the following hypothetical scenario: A public company is selling mobile advertising space, earning ever-increasing profits as cellphone screens garner a larger and larger slice of people's attention spans.

One Sunday night, however, a senior executive of the public company—call her "Mobile Ad Tipper"—is out to dinner when she locks herself out of her car. So she hails a cab to take her downtown to her office, where she keeps a spare car key. When Mobile Ad Tipper arrives, she notices the firm's five top salesmen are already there—holding a secret meeting in the boardroom with the light off.

Without being seen, she hides behind a corner and listens in on what the star salesman are discussing. And to her surprise, she overhears that in two weeks the salesmen are going to quit the public company to start their own boutique, a coup that would utterly devastate her company's business.

The next morning, Mobile Ad Tipper gets a bright idea. She calls her friend—"Tippee Friend"—and offers her a deal: If Tippee Friend pays $20,000 cash, Mobile Ad Tipper will disclose inside information about her company's impending doom. With this information, Tippee Friend can bet against the company and get rich, and Mobile Ad Tipper herself can make money without leaving a paper trail. Everybody wins!

The problem, of course, is that such an agreement would constitute a federal crime through our nation's insider trading laws. Under established precedent from the U.S. Supreme Court, company insiders in possession of material nonpublic information commit insider trading when they "tip" other traders to this information in exchange for a "personal benefit." This standard makes sense, because it bars insiders from profiting off information at the expense of company shareholders. By giving secret and critical information to her friend in exchange for hard cash, in other words, Mobile Ad Tipper broke the law.

But what if Mobile Ad Tipper had not received (or asked for) any cash? Under the landmark 1983 U.S. Supreme Court decision in *Dirks v. SEC*, liability requires that the tipper receives a "personal benefit." But how is that defined in the context of a gift to a friend or relative?

DEFINING 'PERSONAL BENEFIT'

Last year, the U.S. Court of Appeals for the Second Circuit in *United States v. Newman* held that, when a tipper gifts inside information to a friend or relative, liability requires showing that the relationship between tipper and tippee "suggests a quid pro quo from the latter, or an intention to benefit the latter."

Last month, the U.S. government sought permission from the Supreme Court to appeal *Newman*. According to the government, *Newman* was wrongly decided. Instead of a case-by-case inspection of gift-givers to determine whether they personally benefit from their tips, the government seeks a one-size-fits-all approach whereby any gift to (trading) family members or friends would be sufficient to constitute insider trading.

In the government's words, a crime should arise even when the insider "freely gives a gift of information to a trading friend or relative without any expectation of receiving money or valuables as a result." This, it argues, is in accordance with *Dirks*. Even if Mobile Ad Tipper asked for nothing from Tippee at all, the government believes it should still be entitled to prosecute her for insider trading.

The Supreme Court would be wise to grant certiorari over this issue but, ultimately, it should affirm *Newman*. The government's view of the law would virtually eliminate the personal-benefit test altogether. If gifts to relatives or friends gave rise to insider trading automatically, after all, then the only time the personal-benefit test would have any teeth is when a company-insider gifts inside information to nonfriends and nonrelatives—or, in other words, to strangers and enemies.

This bizarre circumstance virtually never happens, and that is the point: The government wants to change the law to render it ever more difficult for people accused of insider trading to muster a defense. Although strategic, the government's position lacks common sense. Gifts are different from other transactions where the giver expects something in return. That is what makes a gift a gift—its underlying altruism. When a gift-giver expects value in return, it is not a "gift" at all; it's a "deal." The Supreme Court should not reimagine insider trading laws to merge these fundamentally different concepts.

To be sure, the government's position aims to level the playing field for investors. If the general public believes that friends of high-level financiers have access to inside information, people would be less likely to invest in the stock market in the first place. The government's appeal of *Newman* thus appears well-intentioned from a policy perspective. However, when insiders reveal information about their companies to outsiders, they reduce corporate secrecy and render the stock-market more transparent. If corporate executives had to worry that innocent disclosures to their analyst-friends were crimes, they would simply maintain secrecy from analysts and, thus, keep the market in general less informed. Insider trading laws do not, and should not, equalize market visibility by simply turning out the lights.

In the end, the personal-benefit test makes sense because it balances the need for market fairness with the need for investor transparency. The court should take this opportunity to reaffirm *Newman* and, in doing so, reject the government's attempt to render the test virtually obsolete.

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