
Robert T. Miller*

ABSTRACT: Professor Verstein suggests that we approach the awareness/use problem in insider-trading law by analyzing the mixed-motives of insider traders, and he argues that insider trading should be illegal only when the trader’s primary reason for trading involves proscribed material non-public information (MNPI). To reach this conclusion, he assumes what he calls the “Equal Profits Principle,” which holds that two traders alike in all respects except for their knowledge of MNPI should enjoy the same expected profits from trading. This Response argues that the Equal Profits Principle can be analyzed into the “No Greater Profits Principle” (traders with MNPI should not make more than other traders) and the “No Lesser Profits Principle” (traders with MNPI should not make less than other traders), and that while the No Greater Profits Principle is intuitively plausible, the No Lesser Profits Principle is not. In particular, both classical insiders and potential misappropriators are in contractual relationships with the sources of their MNPI, and the standard market practice is for such persons to agree with the source, in exchange for compensation, to refrain from trading while in possession of MNPI (not merely to refrain from using MNPI to trade). In fact, public companies and other firms regularly in possession of large amounts of MNPI typically adopt insider trading policies that not only prohibit their employees from trading when in possession of MNPI, but also go considerably further, imposing blackout periods (when all trading is prohibited) and pre-clearance rules (which require certain senior employees to pre-clear all their trades with a compliance officer, regardless of whether they are in possession of MNPI). Such policies are efficient in the sense that they produce benefits in excess of their costs, and since they are manifestly incompatible with the Equal

* F. Arnold Daum Chair in Corporate Finance and Law and Professor of Law, University of Iowa College of Law, and Fellow and Director of the Program on Organizations, Business and Markets at the Classical Liberal Institute at New York University Law School. I thank Alan J. Berkeley, Mihailis Diamantis, Joshua R. Cammaker, Kyle Drefke, Richard A. Epstein, Jennifer L. Miller, Saez Muzumdar, Seth Oranburg, David M. Silk, Sean Sullivan, and Glenn West for useful discussion and comments and Peter Sotos and Patrick Fontana for their invaluable work as my research assistants.
INTRODUCTION

Professor Verstein takes on the old problem of awareness versus use in insider trading law. Rule 10b-5 prohibits persons bound by a duty of confidentiality from trading securities on the basis of material, non-public information (“MNPI”). But just what does it mean to trade on the basis of such

---

2. More precisely, there is nothing illegal about trading on the basis of information that is material and not available to the public generally. Chiarella v. United States, 445 U.S. 222, 227-
A RESPONSE TO PROFESSOR VERSTEIN

information? Do you violate the rule if you trade merely while you are aware of MNPI, even though that MNPI played no causal role in your decision to trade (i.e., the awareness rule)? Or does a violation require that your awareness of MNPI figure in some significant way in your decision to trade (i.e., the use rule)? As Professor Verstein explains, in the 1990s, there was a circuit split on this issue, with the Second Circuit adopting the awareness rule, the Ninth Circuit adopting the use rule, and some other circuits adopting variations of one rule or the other.

In 2000, the Securities and Exchange Commission (the “Commission”) moved to settle the issue by promulgating Rule 10b5-1, which adopted the awareness rule, subject to a few limited affirmative defenses. Nevertheless, Rule 10b5-1 has not quite ended the awareness/use debate. For one thing, some observers think that the affirmative defenses that the rule provides partly undermine the awareness standard the rule otherwise embodies. For another, the courts have simply not enforced Rule 10b5-1 consistently. Some district courts, even in circuits that had earlier adopted the use rule, apply Rule 10b5-1 and the awareness standard it contains, but other district courts, even

28 (1980). What is illegal is trading on the basis of MNPI that the person trading has a duty to keep confidential, United States v. O'Hagan, 521 U.S. 642, 653–55 (1997), sometimes called “proscribed” MNPI. Since cases of people having MNPI that is not proscribed are rare (though not non-existent, see SEC v. Switzer, 590 F. Supp. 756, 765–66 (W.D. Okla. 1984)), in discussions of insider trading, it is common to refer to MNPI as if all MNPI were proscribed MNPI. I shall follow that usage except where the difference matters, and there I shall distinguish between “material non-public information” and “proscribed MNPI.”

4. Id. at 1257; United States v. Teicher, 987 F.2d 112, 120–21 (2d Cir. 1993).
5. Verstein, supra note 1, at 1257; United States v. Smith, 155 F.3d 1051, 1069 (9th Cir. 1998).
6. Verstein, supra note 1, at 1257; see, e.g., SEC v. Adler, 137 F.3d 1325, 1337–39 (11th Cir. 1998) (adopting a variation of the use rule); SEC v. Lipson, 278 F.3d 656, 666–68 (7th Cir. 2002) (looking favorably upon a variation of the awareness rule).
9. See 17 CFR § 240.10b5-1(c). The adopting release makes clear that the affirmative defenses enumerated in Rule 10b5-1(c) are intended to be exclusive. Final Rule: Selective Disclosure and Insider Trading, Securities Act Release No. 7881, Exchange Act Release No. 43,154, Investment Company Act Release No. 24,599, 73 SEC Docket 3 (Aug. 15, 2000) at *21. In particular, the SEC considered and expressly decided against “a catch-all defense to allow a defendant to show that he or she did not use the information.” Id.
11. E.g., SEC v. Moshayedi, No. SACV 12-01179, 2013 WL 12172131, at *14 (C.D. Cal. Sept. 23, 2013) (stating “Smith was decided before the SEC's promulgation of Rule 10b5-1 in 2000, which specifically provides the definition for ‘on the basis of’ in insider trading cases,” and
some in circuits that had earlier adopted the awareness standard, apply a use rule, especially in criminal cases. In a display of how confused the law is in this area, one leading law firm unequivocally advises its clients that “[t]he government must prove that the trader was in possession of the material, non-public information . . ., not that the information necessarily served as the basis of the trade,” but then cites SEC v. Adler, a pre-Rule 10b5-1 case that adopted a form of the use rule, and ultimately concludes that, if the government can prove that the trader was in possession of MNPI, “[t]he trader would then bear the burden of proving that he did not use the material, non-public information as the basis for the trade.” In a final complication, some scholars have argued that Rule 10b5-1 exceeds the lawful rulemaking authority of the Commission under Section 10(b) of the Securities Exchange Act of 1934. Thus, even after Rule 10b5-1, the awareness/use debate persists, albeit in a somewhat changed form.

Professor Verstein approaches the debate in terms of mixed motives. Consistent with his impressive work on mixed-motive problems in other legal contexts, Professor Verstein would prohibit trades only if the trader’s
primary reason for trading involves the proscribed MNPI. In response to this difficult and fascinating Article, I shall make two main points. First, at least in the context of insider trading, the phrase “mixed motives” is ambiguous, and Professor Verstein does not distinguish the different meanings the phrase may have. Often, this does not matter, but sometimes it does, and I shall try to point out where distinguishing the various senses of the phrase “mixed motives” may make a difference to the argument. Second, while Professor Verstein suggests a normative principle to resolve mixed-motive insider trading cases (the Equal Profits Principle, discussed below), I think this principle is too abstract. When it is applied to concrete cases of the kinds that commonly arise in insider trading law, the principle is sometimes plausible, sometimes implausible, and sometimes just irrelevant. I agree with Professor Verstein, however, that we need some normative principle to resolve the awareness/use debate, and I shall ultimately suggest such a principle that arises from common market practices related to the handling of MNPI.

I. THE AMBIGUITY OF THE PHRASE "MIXED MOTIVES" IN INSIDER TRADING CASES

For purposes of insider trading law, there are two different kinds of traders who can sensibly be said to have “mixed motives” for their trading activity. One type of trader has multiple different ends-in-view for undertaking a trade. For example, believing a stock is overvalued, a person may want to sell the stock to avoid a loss (one end-in-view for trading: to avoid a financial loss), while simultaneously needing to raise funds to pay a gambling debt to his bookie (a second end-in-view for trading: to pay a pressing debt). Call this kind of person a “multiple-ends trader.”

The multiple-ends trader is different from the person who trades securities with only one end-in-view but who has multiple reasons for thinking that the trade will serve that end. For example, a person may be buying a stock with one and only one end-in-view—to profit financially—and nevertheless may have multiple reasons for thinking that the trade will be profitable: e.g., the company’s R&D department is close to making an important technological breakthrough, the company’s new inventory management system will improve its operating margins, and the company is an attractive takeover target. Call this kind of person a multiple-reasons trader. Notice that, while different, having multiple ends and having multiple reasons are not mutually exclusive. With respect to one and the same trade, a person can be both a multiple-ends trader and, with respect to each of one or more of those ends, a multiple-reasons trader as well.

It is important, however, to consider not only what is possible but what is probable, i.e., what happens in general and for the most part. Here, the first thing to see is that the multiple-ends trader is a rare bird. Being a multiple-ends trader depends on a fortuitous confluence of circumstances whereby a person can serve two different ends by one and the same action—the

19. See Verstein, supra note 1, at Part VI.
proverbial killing of two birds with one stone. In the great majority of cases, people trade securities for one and only one end—to maximize their wealth, either by buying securities they think are undervalued or selling securities they think are overvalued. The end of profit seeking will in practice be coupled with other ends only occasionally. Thus, we can imagine cases when someone buying securities to make a profit also has another end for the purchase, such as to show support for a company for which he has some special affection, but surely such cases are unusual. Investors do often sell securities for reasons other than profit, as when they sell to pay debts or fund expenses, and in such cases the investor would naturally choose to sell first any securities he thinks are overvalued (in order to avoid a loss, thus becoming a multiple-ends trader), but if he really thought the securities were significantly overvalued, he would likely have sold them already. When people sell securities, it is usually either for the end of avoiding a loss or for some other end, not usually for both ends at the same time.

But while multiple-ends traders are rare, multiple-reason traders are the norm. That is, whenever a sophisticated investor trades securities for the end of making a profit, the investor virtually always has made a considered judgment based on many different reasons for thinking that the trade will be profitable. If the investor is purchasing shares, it may be, for example, because the company has a dominant market position, because that position is protected by significant barriers to entry, because the company’s management has a strong record of increasing revenues and earnings, and so on. Even most unsophisticated investors trading in order to make a profit generally have multiple reasons for thinking their trades will be profitable.

In what follows, we shall see that both multiple-end traders and multiple-reason traders appear in characteristic ways in insider trading contexts. Insiders who have accumulated significant numbers of shares of the company as compensation often want to sell some of these shares for diversification or cashflow purposes (one end for trading), but when they are in possession of negative MNPI, they may also want to sell in order to avoid a loss as well (a second end for trading). They thus become multiple-ends traders, probably the most common kind of this otherwise rare breed. As to multiple-reason traders, they appear in insider trading contexts mostly in the form of sophisticated investors who are also tippees: That is, they have only one end for trading (to make a profit), but they have many reasons for thinking a trade will be profitable, with one of these reasons being MNPI that has been shared with them by an insider.

II. PROFESSOR VERSTEIN IS RIGHT THAT WE NEED A NORMATIVE BASIS TO RESOLVE THE AWARENESS/USE DEBATE

In my view, the most insightful point in Professor Verstein’s careful and thought-provoking Article is his observation about why prior attempts to
resolve the awareness/use debate have failed. 21 He points out that such attempts have generally focused on how difficult various rules make it for the government to convict defendants in mixed-motives cases without first addressing the logically prior question of when defendants in such cases should be convicted. 22 That is, the use rule clearly makes it harder, and the awareness rule clearly makes it easier, for the government to convict defendants in mixed-motive cases, 23 but unless we have first determined when such defendants should be convicted, the practical effects of one rule or the other tell us nothing about whether the rule is a good rule or a bad one. In other words, if most defendants in mixed-motives cases should be convicted, then there is a strong argument for the awareness rule and against the use rule, but if most such defendants should not be convicted, then the situation is reversed and there is a strong argument for the use rule and against the awareness rule. As Professor Verstein aptly puts it, “We lack a basis for deciding, in the abstract, how practically difficult it should be for prosecutors to convict mixed motives traders until we decide whether such traders ought to be convicted.” 24

This is an illuminating point, and Professor Verstein builds on it by suggesting a normative principle to ground an argument about which mixed-motives defendants should be convicted and which should not. That principle is the Equal Profits Principle, which Professor Verstein formulates as follows: “Two traders alike in all respects except for their knowledge of proscribed information should enjoy the same expected profits from trading.” 25 Professor Verstein does not attempt to justify this principle; rather, he hopes his readers will accept it as “ecumenical, intuitively plausible, and broadly compatible with all normative positions.” 26 This is where Professor Verstein and I part company. In my view, the principle is in some respects plausible and in other respects implausible. More important, however, is that in almost all cases in which the principle might apply, market participants have agreed to rules for handling MNPI that are quite different from the Equal Profits Principle. To my mind, this is a strong argument against the principle.

III. THE EQUAL PROFIT PRINCIPLE ABSTRACTS FROM IMPORTANT DISTINCTIONS

The Equal Profits Principle provides that if “[t]wo traders [are] alike in all respects except for their knowledge of proscribed [MNPI],” then they “should enjoy the same expected profits from trading.” 27 The principle is logically equivalent to the conjunction of two simpler principles: (1) traders with MNPI should not make more money from trading than traders without

21. See Verstein, supra note 1, at 1257.
22. Id.
23. Id. at 1270.
24. Id. at 1257.
25. Id. at 1279 (emphasis omitted).
26. Id. at 1278.
27. Id. at 1279.
MNPI (the No Greater Profits Principle), and (2) traders with MNPI should not make less money from trading than traders without MNPI (the No Lesser Profits Principle). These two halves of the Equal Profits Principle do not enjoy equal plausibility. On the one hand, the No Greater Profits Principle has great intuitive appeal. Indeed, it articulates the normative intuition\(^{28}\) that has undergirded hostility to insider trading from the beginning: Most people think that insiders should not be permitted to profit from inside information. The No Lesser Profits Principle, on the other hand, is problematic. Most people have probably never thought about whether insiders should do worse trading securities than outsiders do, for the possibility that insiders might do worse than outsiders has likely never occurred to most people. Probably, most people lack strong normative intuitions, whether one way or the other, about the No Lesser Profits Principle. Thus, as I see it, whatever plausibility the Equal Profits Principle has, it gets from the No Greater Profits Principle not the No Lesser Profits Principle.

Furthermore, the Equal Profits Principle abstracts from a basic distinction in insider trading law, the distinction between (a) persons who come into possession of MNPI through a contractual (often a fiduciary) relationship with the source of the information, such as employees or agents (i.e., classical insiders and potential misappropriators),\(^{29}\) and, (b) persons who are not in a contractual relationship with the source of the information but somehow acquire proscribed MNPI (i.e., tippees). Persons in the first class have assumed a contractual obligation not to trade on the basis of the source’s MNPI, and—critically—are compensated by the source of the MNPI for fulfilling this obligation. Persons in the second class, who are not in a contractual relationship with the source of the MNPI, of course have no contractual obligation not to trade on the basis of the source’s MNPI: Any duty they have not to trade arises from their knowing that they have received MNPI through an improper disclosure by an insider or misappropriator. Naturally, persons in the first class (classical insiders and potential misappropriators) are more numerous and more important in insider trading law, for the insider trading of those in the second class (tippees) always derives from MNPI originating from persons in the first class. Below, I shall argue that market practices related to persons in this first class (classical insiders and potential misappropriators) show that the No Lesser Profits Principle in fact

---

28. In the text I speak of normative “intuitions,” but I do so without any intention of implying some form of moral intuitionism as that term is used in moral philosophy. In my view, a better term than “intuition” would be “pre-theoretical moral belief,” meaning a judgment about a particular issue that arises from the person’s background moral beliefs. Indeed, the complexity and artificiality of the situations in which questions of insider trading arise shows clearly that such beliefs are not intuitions in any plausible sense of the term.

29. A classical insider is a person, such as an employee or agent, in a relationship of trust or confidence with the issuer of the securities that the person trades (e.g., an employee of a public company who trades the company’s stock). A misappropriator is a person, again such as an employee or agent, in a relationship of trust or confidence with a party who has MNPI about a security but is not the issuer of that security (e.g., a lawyer working for an acquirer who plans to launch a tender offer for the shares of a target company who trades the target’s shares).
has no normative force and thus should not be used to resolve issues related to the awareness/use debate.

IV. INSIDER TRADING POLICIES IMPOSED BY EMPLOYERS INCLUDE THE AWARENESS RULE AND EVEN MUCH MORE RESTRICTIVE PROHIBITIONS ON TRADING BY EMPLOYEES

Consider an employee of a public company or firm often in possession of MNPI such as a law firm or investment bank. When the individual agreed to work for the company and the company agreed to employ the individual, the parties entered into a contractual relationship that included agreed-upon benefits and burdens for both parties. Most obviously, the employee agreed to provide certain services, and the company agreed to compensate the employee with some mix of cash salary, employment benefits, bonuses, and equity. But the agreement between the parties includes a great many other terms as well, many of which are significant restrictions on the employee’s behavior. Some of these are closely related to the company’s business, such as prohibitions on taking corporate opportunities, disclosing the company’s confidential information, soliciting the company’s customers or employees, competing against the company, or engaging in other business activities that would prevent the employee from devoting substantially all his working hours to the company. Furthermore, employees are commonly required to follow a certain dress code at work, to avoid romantic or sexual relationships with at least certain other employees, to eschew receiving gifts from persons with whom the company does business, to refrain from commenting on the company or its business publicly or on social media, to avoid actions that could bring the company into disrepute, and even to refrain from certain political activities (such as making political contributions from their personal funds) that could disqualify the company from certain government contracts. Employees agree to these restrictions because, in exchange, they receive benefits they value even more, not only the obvious ones like salary, benefits and equity, but also less obvious ones, like the prestige of working for the employer, training from more senior employees, opportunities to network and make business connections, and so on.

Now, the restrictions that public companies impose on their employees virtually always include restrictions related to trading securities. Although nothing in the federal securities laws requires public companies to adopt insider trading policies,30 most public companies (and certainly virtually all large and well-advised public companies), as well as most financial

30. The New York Stock Exchange encourages listed companies to adopt insider trading policies. N.Y. STOCK EXCH., LISTED COMPANY MANUAL § 309 (2022), https://nyseguide.nnrules.com/listed-company-manual/document?treeNodeId=csb-da-filter!WKUS-TAL-DOCS-PHC%7B0588BF4A-D3B5-4B91-94EA-BE9F17057DF0%7D—WKUS_TAL_5667%23teiid-87 [https://permalink.a.ccs/SpCBa5Y] (noting that "policies for the guidance of [a company’s] personnel relating to transactions in the company’s stock . . . can be very helpful to employees who have access to important confidential information").
institutions, law firms and accounting firms, have such policies.31 Critically, such policies virtually always prohibit employees from trading securities when they are in possession of MNPI, not merely from using MNPI to trade.32

31. See, e.g., O’RICK, HERRINGTON & SUTCLIFFE LLP, IPO INSIGHTS: INSIDER TRADING POLICIES 1 (2020), https://media.oorick.com/Media%20Library/public/files/insights/ipo/insider/trading-policies.pdf [https://perma.cc/WSA8-GJ84] (“While there are no SEC rules or regulations requiring that public companies have insider trading policies, most public companies adopt such policies and procedures to prevent and detect unlawful trading by directors, executive officers and employees, or insiders.”); LATHAM & WATKINS LLP, U.S. IPO GUIDE, 51 (2022), https://www.lw.com/thoughtLeadership/lw-us-ipo-guide [https://perma.cc/TLB5-H63Y] (“Public companies ordinarily have a written policy that governs the ability of employees, directors, contractors, and other related persons to trade in the company’s securities.”); ADAM E. FLEISHER & SOPHIE GRAIS, CLEARY GOTTLIEB LLP, GOING PUBLIC: A GUIDE TO U.S. IPOS FOR FOUNDERS, OFFICERS, DIRECTORS AND OTHER MARKET PARTICIPANTS 34 (2020), https://www.clearygottlieb.com/-/media/organize-archive/cgsh/files/news-pdfs/going-public-a-guide-to-us-icos-for-founders-officers-directors-and-other-market-participants.pdf [https://perma.cc/H6U2-57CM] (“You are prohibited from engaging in any transaction in ADP securities . . . .”). Professor Verstein mentions that Netflix’s Insider Trading Policy prohibits employees from trading while in possession of MNPI and concludes that “There is some evidence that firms actually prefer” an awareness rule, Verstein, supra note 1, at 1275. This vastly understates the matter. Insider trading policies are not generally publicly available, and I am aware of no empirical study of them, but many such policies are or become publicly disclosed, and every such policy I have ever seen involves an awareness rule. See, e.g., supra note 31, as does a standard form policy prepared by a leading practitioner. See generally FERRARA ET AL., supra note 10, at § 7.02 (discussing provisions in insider trading policies).

32. E.g., THE HERSHEY CO., THE HERSHEY COMPANY INSIDER TRADING POLICY 1 (2021), https://investors.thehersheycompany.com/content/dam/hershey-corporate/documents/investors/insider-trading-policy.pdf [https://perma.cc/Y84U-V2DB] [hereinafter THE HERSHEY COMPANY INSIDER TRADING POLICY] (“No Insider may buy, sell or otherwise transact in . . . Company securities while aware of material nonprofit information concerning the Company.”); Insider Trading Policy, ADP (Apr. 6, 2022), https://www.adp.com/about-adp/corporate-social-responsibility/ethics/insider-trading-policy.aspx [https://perma.cc/H6U2-57CM] [hereinafter ADP Insider Trading Policy] (“You are prohibited from engaging in any transaction in ADP securities while aware of material nonpublic information about ADP. It makes no difference whether or not you relied upon or used material non-public information in deciding to trade . . . .”); Securities Trading Policy, DUKE ENERGY CORP., https://www.duke-energy.com/our-company/investors/corporate-governance/securities-trading-policy [https://perma.cc/2VRE-XJBM] [hereinafter Duke Energy Securities Trading Policy] (“If a director, officer, employee, agent or advisor of the Corporation has material, nonprofit information relating to the Corporation, it is the Corporation’s policy that neither that person nor [certain persons and entities related to the person] may buy or sell Corporation Securities . . . .”). Professor Verstein mentions that Netflix’s Insider Trading Policy prohibits employees from trading while in possession of MNPI and concludes that “There is some evidence that firms actually prefer” an awareness rule. Verstein, supra note 1, at 1275. This vastly understates the matter. Insider trading policies are not generally publicly available, and I am aware of no empirical study of them, but many such policies are or become publicly disclosed, and every such policy I have ever seen involves an awareness rule. As noted below, Ferrara takes it for granted that insider trading policies will impose an awareness rule, see supra note 31, as does a standard form policy prepared by a leading practitioner. See Berkeley, Corporate Policy on Insider Trading, supra note 31, at Part I § 2(a) (“No director, officer or employee . . . may purchase or sell, or offer to purchase or sell, any Company security . . . . while in possession of material nonpublic information about the Company.”). Professor Verstein says that the Amazon Code of Business Conduct and Ethics is “ambiguous” as between the awareness rule and the use rule because it bans trades “based on” MNPI. Verstein, supra note 1, at 1275
Indeed, in his treatise on insider trading, Ferrara begins his discussion of insider trading compliance programs by stating, “In drafting and implementing a compliance program, securities issuers should take special care to ensure that their officers, directors and employees do not trade in the corporation’s securities when such persons are in possession of material, nonpublic information.”

Indeed, insider trading policies virtually always go much further than even the possession rule would require. For example, public companies commonly impose so-called blackout periods during which certain senior employees (the ones most likely to have MNPI) are absolutely forbidden to trade the company’s securities, regardless of whether they are aware of any MNPI or not. Such blackout periods include both quarterly blackout periods, which usually begin about two weeks before the end of the fiscal quarter and end two business days after the company discloses its financial results for the quarter by filing a Form 10-Q or 10-K, and special blackout periods, which the company declares in the period leading up to a public disclosure about significant events like mergers or acquisitions, cybersecurity incidents, or new...
product developments. The rationale underlying blackout periods is twofold: They prophylactically prevent insider trading, and they help avoid even the appearance of impropriety. In addition, even when blackout periods are not in effect (i.e., during so-called trading windows), insider trading policies commonly require the most senior employees (again, the ones most likely to have MNPI) to pre-clear all their trades with a particular company officer, usually the chief compliance officer. To help enforce these rules, many companies require at least their most senior employees to disclose to the company all of their brokerage or securities accounts and provide information about all trades they undertake through such accounts. The overall effect is a system of restrictions and monitoring that prohibits a great deal of trading, including not only illegal insider trading (whether under a use standard or even an awareness standard) but also much other trading as well.

V. CONVENTIONAL INSIDER TRADING POLICIES VIOLATE THE EQUAL PROFITS PRINCIPLE BUT ARE ALSO EFFICIENT

There is no mystery about why companies adopt insider trading policies that go far beyond what the law and even the possession rule require. The company has strong interests, including legal and reputational interests, in ensuring that its employees neither violate the insider trading laws nor even appear to be doing so. This is true of public companies, and it is perhaps even more true of investment banks, law firms, and accounting firms. The effect of these policies, however, is that insiders, both when they possess MNPI and even when they do not, will often be prohibited from trading when other persons, otherwise similarly situated, would be free to do so. The company’s insider trading policies thus reduce the profits that employees might make from trading relative to what other persons otherwise similarly situated might make. In other words, typical insider trading policies tend to ensure that, for corporate insiders, the No Greater Profits Principle is fulfilled but the No Lesser Profits Principle is violated—indeed, routinely violated.

36. See generally, FERRARA ET AL., supra note 10, at § 7.02[d]–[e] (discussing blackout periods and trading windows).

37. FLEISHER & GRAIS, supra note 31, at 34 (stating that "most public companies have window or blackout [periods]" in order to "prevent insider trading violations and the appearance of any impropriety"); HERSHEY COMPANY INSIDER TRADING POLICY, supra note 32, at 1 ("The Hershey Company . . . has adopted this Insider Trading Policy . . . to help its directors, officers and employees comply with insider trading laws and to prevent even the appearance of improper insider trading.").

38. HERSHEY COMPANY INSIDER TRADING POLICY, supra note 32, at 7–8 (requiring pre-clearance of certain trades); ADP Insider Trading Policy, supra note 32 (same); Duke Energy Securities Trading Policy, supra note 32, at § VI(B) (same); Berkeley, Corporate Policy on Insider Trading, supra note 31, at Part II § 3 (same). See generally FERRARA ET AL., supra note 10, at § 7.02[f] (discussing pre-clearance rules).

A RESPONSE TO PROFESSOR VERSTEIN

Why do corporate insiders put up with this? The answer is obvious, and it is the same reason that employees agree to all kinds of other restrictions on their behavior that employers demand: the insiders are being compensated for doing so. That is, individuals subject to insider trading policies are in a contractual relationship with the source of the MNPI, and they are compensated under the relevant contract for abiding by the policy, including for refraining from trading when they are in possession of MNPI. Scholars have long recognized that insider trading can be viewed as a form of employee compensation, and in a competitive market, employees who receive less of one form of compensation will receive more of another form. Employees and other insiders subject to strict insider trading policies make less trading securities than other people otherwise similarly situated, but they also get higher salaries or other benefits in exchange for abiding by the strict insider trading policies and thus forgoing additional trading profits.

This point bears some elaboration. Start with the market in which insider trading policies typically apply: the employment market for business and financial executives. This market is highly competitive. There are many employers and many employees, and the parties on both sides tend to be well-informed about business matters and financially sophisticated; moreover, for parties on both sides, the transaction costs of switching (the costs to employees of changing jobs, the costs to employers of hiring replacements) are relatively low, the biggest costs usually being losses of firm-specific human capital. Individuals thus change firms relatively frequently. The competitive nature of the market means that the terms of employment agreements, including insider trading policies (which are, of course, incorporated into such agreements), will be efficient. That is, they will maximize the joint surplus created by the transaction. In particular, contractual provisions that create substantial value for one party at a small cost to the other party will very likely be included in the agreement, perhaps with a minor adjustment to the price term to compensate the party who is bearing the small cost.

40. E.g., HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET 138–41 (1966). For an explanation of why insider trading would be an extremely inefficient form of employee compensation, see Miller, supra note 39 at 308–09. In particular, if insider trading were legal and a company permitted it, the company would be providing the employee a form of equity compensation in amounts that (a) were uncontrollable and even unknowable by the company, (b) could not be reliably reported on the company’s financial statements, and (c) were largely unrelated to the employee’s contribution to the success of the company. It is hard to imagine that any rational company would agree to such an arrangement. See id.

41. If we consider the employment market generally (and not just the market for individuals with business or financial sophistication), the same analysis applies and is probably even stronger because (a) the company’s interest in such individuals not insider trading is the same, but (b) the value of trading securities to such persons, being unsophisticated, is generally less than the value of such trading to sophisticated individuals. In other words, insider trading policies generate larger costs for sophisticated employees than for unsophisticated ones, and so if the benefits of such policies (for employers and employees jointly) exceed the costs of such policies (for employers and employees jointly) for sophisticated employees, then a fortiori the same is true for unsophisticated employees.
Now, typical insider trading policies, with their awareness standard, blackout periods, and pre-clearance rules, create substantial value for the company at little cost to the employee. They create substantial value for the company because, as mentioned above, the company has strong interests not only in its employees not using its MNPI but also in its employees not even appearing to profit in this way. Of course, it is possible for an employee in possession of MNPI to trade without using that MNPI, or to trade while using the MNPI just a little bit, having some other reason as the primary reason for the trade. But it is also blindingly obvious that, when an employee in possession of MNPI trades, the employee will always appear to the market to be using the MNPI. Perhaps a careful, expensive, and time-consuming investigation of the facts might show that the employee did not really use the MNPI, but investors have little incentive to inquire so closely into such matters; they will generally assume that an employee in possession of MNPI who traded the company’s securities was using the MNPI to trade, and this assumption will, of course, usually be correct. Hence, allowing employees to trade when they are in possession of MNPI, regardless of whether or how much an employee actually uses the MNPI, is bad for the company’s business. Companies thus have a strong interest in prohibiting employees from trading while in possession of MNPI—a strong incentive, that is, to impose an awareness rule.

An important exception arises, however, because, as mentioned above, employees of public companies often want, for diversification or cashflow purposes, to sell shares of the company’s stock that they have received as compensation. This common problem can be, and nearly universally is, handled through Rule 10b5-1 trading plans, which, subject to certain conditions, allow employees to agree in a binding way, at a time when they possess no MNPI, that they will sell securities at pre-determined times and in pre-determined amounts at certain future dates. Insider trading policies virtually always allow for Rule 10b5-1 trading plans, though they also frequently impose conditions on them beyond those required by law. To the

42. See supra note 40.

43. If the employee is purchasing company shares, the assumption will be virtually always correct. Employees are naturally over-invested in the companies they work for and thus under-diversified; an economically rational employee would purchase additional shares of the employer only if the employee had reason to believe that the investment would produce an abnormal return—i.e., the employee was almost certainly using MNPI. For just the same reasons, employees will often want to sell company shares even when they think the shares are (at least to a certain extent) undervalued, but the problem of employees cashing out their shares can be, and is, handled by Rule 10b5-1 plans discussed immediately infra in the text.


45. See supra notes 34–35 and accompanying text.
extent that Rule 10b5-1 plans do not fully address the problem of employees wanting to sell shares for reasons unrelated to MNPI (e.g., a sudden need for funds), most insider trading policies allow an employee, in appropriate cases and subject to certain conditions, to request that the chief compliance officer exempt a particular trade from the insider trading policy. 46 Naturally, one of the conditions of obtaining such an exemption is that, at the time the exemption is granted and at the time of the trade, the employee does not possess any MNPI. 47

For both the company and the employee, a strict insider trading policy likely creates benefits significantly in excess of costs. For the company, there are modest costs involved in implementing and administering the policy, but there are substantial benefits in the form of protection for the company’s legal and reputational interests. For employees, there are costs from restrictions on their trading activities, especially selling shares, but these costs are largely mitigated by Rule 10b5-1 trading plans and case-by-case exemptions in extraordinary circumstances. In addition, there are significant benefits for employees, for employees can be sure that, if they comply with the policy, they are safe against even unjustified accusations of insider trading. Even if the benefits of such policies for employees do not exceed the costs, those residual costs are surely less than the benefits captured by the company, and so the company can easily afford to compensate the employees (e.g., with increased salary) for the costs they bear and still be better off. Strict insider trading policies of the kind commonly used in the market thus solve a problem in which the company’s interests and the employee’s interest to some degree conflict, and, as economic theory would suggest, the solution embodied in those policies is efficient.

VI. THE EQUAL PROFITS PRINCIPLE, AS APPLIED TO CORPORATE INSIDERS, IS IMPLAUSIBLE

The argument above shows that typical insider trading policies violate the Equal Profits Principle (or at least the No Lesser Profits Principle half of it) and that such policies are efficient. What does this tell us about the Equal Profits Principle? Professor Verstein intends the Equal Profits Principle to be a normative principle, not a factual description of what actually occurs in the market. Hence, the fact that a common market practice results in the principle being routinely violated does not, by itself, show that the principle is wrong or implausible. Of course, because typical insider trading policies flagrantly violate the Equal Profits Principle, anyone defending that principle would have to say that, in whatever sense the Equal Profits Principle is right, such policies are wrong. Given the obvious efficiency of typical insider trading policies, this suggests to me a reductio ad absurdum of the principle. In any

46. E.g., supra note 38.
47. E.g., Hershey Company Insider Trading Policy, supra note 32, at 7–8; ADP Insider Trading Policy, supra note 32; Duke Energy Securities Trading Policy, supra note 32, at § VI(B); Berkeley, Corporate Policy on Insider Trading, supra note 31, at Part II § 5; see Ferrara et al., supra note 10, at § 7.02[f].
event, I can see no cause for concern if grown adults, especially the kinds of sophisticated individuals bound by insider trading policies, freely agree to forgo certain potential trading profits in exchange for the kinds of compensation packages that executives at public companies or elite investment bankers and attorneys typically receive.

Put another way, Professor Verstein insightfully pointed out that resolving the awareness/use debate requires that we first determine, in a principled way, in what circumstances mixed-motives insider traders should be convicted,48 and he then suggested the Equal Profits Principle to determine that issue. 49 He never attempted to justify the Equal Profits Principle but took it as given, assuming it was “ecumenical, intuitively plausible, and broadly compatible with all normative positions.”50 I have been arguing that the principle is not, after all, intuitively plausible. In my view, when we unpack the principle into the No Greater Profits Principle and the No Lesser Profits Principle, the former may be intuitively plausible in most cases, but the latter generally is not. In particular, the No Lesser Profits Principle (and thus the Equal Profits Principle generally) is incompatible with the manifestly efficient practices that sophisticated parties adopt to govern their affairs. At the very least, the principle is inefficient, and in whatever sense typical insider trading policies adopted by public companies and other firms holding large amounts of MNPI are right and good, the Equal Profits Principle must be wrong and bad.

VII. AN ALTERNATIVE SOLUTION TO THE PROBLEM OF MIXED-MOTIVES INSIDER TRADING

But if the argument so far shows that the Equal Profits Principle is implausible in the most important kinds of insider trading cases and so cannot serve as a basis for resolving the awareness/use debate in such cases, the argument also suggests an alternative principle that may be able to do so. That is, the argument so far has shown that, at least between sources of MNPI and their insiders (I shall consider the problem of tippees below), the efficient rule is generally the awareness rule, for that is the rule nearly universally negotiated in the market. Now I would suggest that any rule agreed upon, as a matter of contract, between the source of the MNPI and the insider entrusted with the MNPI should also be the rule enforced by the federal securities laws, at least as to traders bound by such contracts.

To be sure, this is a non-trivial step. We are taking the rule agreed to by the parties as a matter of contract, a rule that would normally be enforced privately with the kinds of remedies available in contract law (monetary damages, injunctions), and we are then enforcing that rule publicly, with enforcement actions by government agencies and even criminal prosecutions backed up by criminal penalties (fines, imprisonment). I would suggest,

---

48. Verstein, supra note 1, at 1272–78.
49. Id. at 1278.
50. Id.
however, that this is essentially true of all prohibitions on insider trading. That is, as I have argued elsewhere,51 even if insider trading were legal, companies would contract to prohibit their employees from trading on the basis of their MNPI. The fact that companies insist on contractual prohibitions that go so far beyond existing insider trading law52 strongly supports this view. Why then do we have public enforcement of insider trader laws? Why not leave the matter as one of contract between the parties? The answer, I have argued,53 is that, although companies and their insiders have strong reasons for entering agreements under which the insiders promise not to trade on the company’s MNPI, companies have only very ineffective means of enforcing this promise since they have only very ineffective means of detecting insider trading by their employees and punishing the employees whom they catch.54 Effective enforcement of agreements by insiders not to trade on the company’s MNPI requires government enforcement of the prohibition, both for the detecting of violations (the Commission’s system of market surveillance, backed by the subpoena power) and for imposing sufficiently severe penalties when violators are caught (criminal sanctions) to generate adequate levels of deterrence. Essentially, we make insider trading illegal for the same reasons that we make stealing the company’s trade secrets55 or embezzling its funds illegal: Contractual sanctions would be grossly inadequate to enforce agreed-upon rules, and so, absent public enforcement of those rules, the efficient business relationships that require such rules would be substantially inhibited.

Now, if this is right—if the function of insider trading law is not so much to set substantive rules for insider trading but to enforce the rules negotiated by private parties in the market because private enforcement mechanisms would be largely inadequate—then of course the insider-trading laws should track the terms of the relevant agreements. Hence, in those cases in which the insider has agreed not to trade while in possession of the company’s MNPI—that is, the great majority of cases—the insider trading laws should without a doubt enforce the awareness rule. In those rare cases in which the parties have agreed to the use rule, however, the inside r trading laws should probably enforce the use rule. There are non-trivial arguments based on administrative convenience (it is easier to have one rule for all cases) and honoring the common expectations of the marketplace (investors expect an awareness rule) for enforcing the awareness rule even in cases when parties have agreed to a use rule, but those arguments strike me as relatively weak. Still, since parties would so rarely agree to a use rule, not much is at stake in such disputes. Whether the law applies the awareness rule in all cases or only in


52. See supra notes 32–37 and accompanying text.

53. Miller, supra note 39, at 308–09.

54. Id.

those cases where the parties have agreed to that rule comes to much the same thing in practice.\(^{56}\)

VIII. OUTSIDERS IN POSSESSION OF MNPI RARELY HAVE MIXED MOTIVES, AND WHEN THEY DO, THE ONES WE WANT TO TRADE MAY TRADE, EVEN UNDER THE AWARENESS RULE

The argument so far has concerned insiders, persons who are in a contractual relationship with the source of the MNPI on the basis of which they might trade. We also have to consider persons not in such relationships who nevertheless become aware of proscribed MNPI because insiders ("tippers") disclose it to them ("tippees").\(^{57}\) The Equal Profits Principle turned out to be implausible with respect to insiders, but perhaps it fares better in relation to tippees. That is, we should consider whether the Equal Profits Principle suggests a plausible way for the law to handle tippee liability for insider trading.

Let us begin with the law of tippees as it currently exists. Broadly speaking, there are two main kinds of cases in which an insider intentionally discloses MNPI to a tippee.\(^{58}\) In the first, the tipper discloses the MNPI to the tippee, usually a family member or close friend, reasonably believing that the tippee has agreed to keep the MNPI confidential,\(^ {59}\) but the tippee betrays this

---

\(^{56}\) There is a strong doctrinal analogue to the argument in the text, at least with respect to the misappropriation theory of insider trading. Under O’Hagan, someone who agrees not to use another’s MNPI but then trades using the MNPI without disclosing this fact to the source deceives the source in a manner sufficient to bring the conduct within the scope of Rule 10b-5 and Section 10(b) of the Securities Exchange Act of 1934. United States v. O’Hagan, 521 U.S. 642, 656 (1997). By parity of reasoning, someone who agrees not to trade while aware of another’s MNPI but then trades while aware of the MNPI without disclosing this fact to the source would presumably deceive the source in a manner sufficient to bring the conduct within the scope of Rule 10b-5 and Section 10(b). Under the classical theory, the allegedly deceived parties are the company’s stockholders, not the source of the information, id. at 652 (citing Chiarella v. United States, 445 U.S. 222, 228–29 (1980)), but this idea has always been implausible and problematic. E.g., Richard A. Epstein, Returning to Common-Law Principles of Insider Trading After United States v. Newman, 125 YALE L.J. 1482, 1496 (2016). If, as many scholars have suggested, we assimilate the classical theory to the misappropriation theory, such problems are mitigated (the “deception” claim made for the misappropriation theory is stronger than for the classical theory, even if still somewhat strained), and the doctrinal solution limned above for the misappropriation theory would apply in the classical theory as well.

\(^{57}\) A person who, through his or her own initiative and perspicacity, develops information not generally known to others but valuable for trading purposes may unquestionably trade using that information. Chiarella, 445 U.S. at 234–35.

\(^{58}\) If the disclosure is made inadvertently, then the information received, while material non-public information, is not proscribed MNPI, and so the recipient is free even to use the information to trade, e.g., SEC v. Switzer, 590 F. Supp. 756, 756–67 (W.D. Okla. 1984) (defendant who at a track meet overheard a conversation including material non-public information was under no duty to disclose or abstain from trading), and so no question of mixed-motive trading can arise.

\(^{59}\) Rule 10b5-2 provides a non-exclusive list of circumstances in which a person has a duty of trust or confidence for purposes of the misappropriation theory under Rule 10b-5, 17 C.F.R. § 240.10b5-2 (2022).
trust and trades on the MNPI. In these cases, the tippee is substantially like an insider, the only difference being that the tippee’s duty to keep the information confidential and not trade on it arises not from a direct relationship with the source of the information but from an indirect one running through the tipper. Such tippees are clearly liable under Rule 10b-5-2. In the second kind of case, the insider discloses the MNPI to the tippee improperly, expecting that the tippee will use it to trade. Sometimes the tipper does this because he expects some personal benefit in return, such as cash or other things of value. Other times the tipper is making a gift of the information, commonly to a family member or close friend. Under the Supreme Court’s decisions in Dirks and Salman, both paying tippees and donee-tippees violate Rule 10b-5 if they trade on the MNPI they receive from the tipper.

Now, the Equal Profits Principle is supposed to help us deal with cases in which a trader has mixed motives for trading, and so it is important to see that tippees almost never have mixed-motives to trade, whether of the multiple-ends or multiple-reasons varieties. The reason is that tippees are aware of MNPI only on the rare occasions when they receive tips, and then for only brief periods of time because the useful life of any piece of MNPI is generally quite short, often a matter of days or hours (MNPI is usually quickly disclosed to the market). Hence, the times during which tippees are aware of MNPI—the only times during which a tippee could even possibly have mixed-motives to trade—are few and brief. In particular, a tippee can be a multiple-ends trader only if, closely coinciding with the time of a tip, the tippee has some purpose, unrelated to making a profit, to trade the securities of the very same company about which he had been tipped. We are asked to believe, for example, that, fearing an imminent visit from his bookie’s debt collector, the trader is about

61. See 17 C.F.R. § 240.10b-5.
63. Salman v. United States, 137 S. Ct. 426, 427 (2016) (tipper provided the information as a gift to his brother).
66. As Professor Epstein has pointed out, it is simpler and clearer to analyze tippee liability under the traditional principles concerning bona fide purchasers of property: Just as the law imposes a constructive trust on anyone who receives stolen property other than a bona fide purchaser, so too anyone who receives material non-public information from a tipper and who either knows the information has been disclosed improperly (i.e., is not bona fide—which is always the case if the tippee is paying for the information) or has received the information gratis (i.e., as a gift) should be prohibited from trading on it. See Epstein, supra note 56, at 1507.
to sell shares of the company to pay the bookie, and at just that moment the trader gets a hot tip from an insider to sell the shares of the very same company. Similarly, a tippee can be a multiple-reasons trader only if, closely coinciding with the time of a tip, the tippee has developed new and significant information concerning the very same company about which he had been tipped. We are asked to believe, for instance, that just as he is contemplating various reasons to buy a certain stock, the tippee receives a hot tip to buy the very same stock. For tippees who are not market professionals following the company in question (to whom I shall return below), such scenarios are entirely implausible. Aside from market professionals, a tippee becoming a genuine mixed-motive trader is about as likely as your stumbling on a buried treasure in the wilderness only to discover that, the day before, you had inherited the very land on which the treasure was buried from a relative you never knew you had. Such things happen in novels and in the hypotheticals of law professors but not in real life. Thus, since tippees other than market professionals are virtually never either multiple-ends traders or multiple-reasons traders, there is no meaningful distinction, as applied to such tippees, between the awareness standard and the use standard. Most tippees, when they get MNPI, use it.

As to tippees who are market professionals, there is a genre of insider trading cases such as *Newman* 67 and *Rajaratnam* 68 in which tippees can, with greater or lesser plausibility, argue that they were trading on information other than, or in addition to, the MNPI they received in a tip because they were engaged in legitimate research on the company. Such cases can present genuine examples of multiple-reasons, mixed-motive trading. As with respect to insiders, the No Greater Profits Principle is entirely plausible with respect to such tippees, for just as most people think that insiders ought not be permitted to benefit from their access to MNPI, so too do most people think that tippees ought not be permitted to benefit from illicit tips. As to the No Lesser Profits Principle, the argument in favor of the principle—that is, the standard argument for allowing such tippees to trade, provided that they are not using the MNPI about which they are tipped (or provided that this MNPI is not the primary reason for their trading)—is the following: Without such trading, the other information that the trader has will not be reflected in the price of the security, with the result that securities will be mispriced, capital misallocated and inefficiencies produced. In theory, this is perfectly correct, but the argument is nevertheless wholly unconvincing in practice. Whatever information the trader has, it is likely to be discovered by others soon enough, and so it will quickly be reflected in the price of the security, with or without the tippee’s trading. Moreover, unless the trader has very large amounts of capital to invest and is willing to wager such amounts on the validity of the new information, his trades are unlikely to affect the price of the security in a material way. Hence, even if the trader does trade on his own information,

68. United States v. Rajaratnam, 719 F.3d 139 (2d Cir. 2013).
there will likely be no appreciable effect on the market’s allocation of capital, and even if the trader does not trade on that information, the price of the company’s shares will reflect the information soon enough.

Professor Verstein tries to build a more convincing and sympathetic example when he discusses the possibility that a legitimate investor investigating a company might, contrary to its intention, become aware of MNPI (say because an insider blurts out such information)69 and then be prevented from trading under the awareness rule.70 In particular, Professor Verstein mentions Muddy Waters Research, a hedge fund that specializes in

69. Professor Verstein has argued that management could intentionally convey material non-public information to an investor (such as a potential acquirer or an activist) precisely in order to disable the investor from trading. Andrew Verstein, Insider Tainting: Strategic Tipping of Material Nonpublic Information, 112 NW. U. L. REV. 725, 726–29 (2018). I find this idea implausible. In fact, investors of all kinds meet with managers constantly, and the universal practice in the market is that, even if asked to enter into confidentiality agreements, the investors pointedly refuse to do so, and the meeting occurs anyway. By clearly refusing to keep any information disclosed confidential, the investor assumes no duty of confidentiality under Rule 10b5-2 and is free to trade on any material non-public information disclosed to it. Chiarella v. United States, 445 U.S. 222, 227–28, 235 (1980); SEC v. Cuban, 620 F.3d 551, 554–55 (5th Cir. 2010). In other words, if the investor makes it clear that it is not agreeing to keep confidential (much less not trade on) any information that management discloses to it, then any information the investor receives, even if material and non-public, would not be proscribed MNPI in the hands of the investor. Any investor who remained worried about potential liability could always disclose publicly any information received from management and then trade, for having disclosed, it would have no further duty to abstain. See SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 838 (2d Cir. 1968). Although this is quite enough to dispose of the idea that management could disclose material non-public information to an investor in order to prevent the investor from trading, there is another consideration as well, which is that if management intentionally disclosed material non-public information to a bidder or activist, then the company would have an obligation under Regulation FD to simultaneously disclose the information publicly, Rule 100(a)(1), 17 C.F.R. § 243.100(a)(1) (2022), which would immediately end the possibility that anyone, whether the investor or anyone else, could insider trade on the information. Professor Verstein’s answer to this point is that Regulation FD prohibits disclosures only “to certain market professionals and to shareholders who the tipper reasonably foresees will trade,” with the result that “tips to would-be bidders of stock are not disallowed. Thus, tipping is not barred under Regulation FD to head off bidders and acquirers.” Verstein, supra note 69, at 755. This strikes me as thoroughly mistaken. For one thing, activist investors (if not strategic bidders) are virtually always “market professionals” (Professor Verstein’s term) covered by the rule, e.g., brokers, dealers, investment advisors, institutional investment managers filing a Form 13F, investment companies, or hedge funds (i.e., a person “who would be an investment company but for Section 3(c)(1) or Section 3(c)(7)” of the Investment Company Act of 1940). See 17 C.F.R. § 243.100(b)(1)(i)-(iii) (internal citations omitted). For another, by the time they have a meeting with management, both activist investors and strategic bidders virtually always already hold some shares of the target, making them “a holder of the issuer’s securities, under circumstances in which it is reasonably foreseeable that the person will purchase or sell the issuer’s securities on the basis of the information.” Id. at § 243.100(b)(1)(iv). In other words, so far from falling into the exceptions in Regulation FD, activist investors and strategic bidder are paradigm cases of the persons at whom the regulation is aimed. The exceptions in Regulation FD are meant to cover not investors but non-investors engaged in ordinary-course business communications with the issuer, including rating agencies and regulators. Selective Disclosure and Insider Trading, Securities Act Release No. 7881, Exchange Act Release No. 43154. Investment Company Act Release No. 24599. 73 SEC Docket 3 (Aug. 15, 2000) at *8. I am indebted to Saeed Muzumdar for the key points made in this footnote.

70. Verstein, supra note 1, at 1280–81.
detecting fraud and other serious problems at public companies, selling-short the affected companies’ shares, and then publicly revealing the negative information it has uncovered. Professor Verstein argues that, under an awareness rule, if Muddy Waters becomes aware of MNPI contrary to its wishes, it would be prohibited from trading on the information that it itself legitimately uncovered. The problem with this example is that, even if we assume an awareness rule, the argument conflates proscribed MNPI with mere material non-public information. That is, under an awareness rule, it is illegal to trade while aware of proscribed MNPI, not to trade while aware of material non-public information, and investors can and routinely do take steps to make sure that, if they come into possession of material non-public information, they do not do so in a way that makes that information proscribed MNPI.

Thus, investors of all kinds make it perfectly clear to the insiders with whom they speak (e.g., by notifying them in writing) that they do not wish to receive any material non-public information and, moreover, they are absolutely not agreeing to keep confidential any information (whether material non-public information or otherwise) the insiders may disclose to them. This protects investors under Rule 10b5-2. Second, investors make it perfectly clear that they absolutely will not provide any personal benefit of any kind to insiders for disclosing such information. This protects the investors from participating in a fiduciary breach by the insider. That is, as the Supreme Court explained in *Salman*, “[A] tippee is exposed to liability for trading on inside information only if the tippee participates in a breach of the tipper’s fiduciary duty,” and the tipper breaches that duty only if “the insider personally will benefit, directly or indirectly, from his disclosure,” such as by receiving “a pecuniary gain or a reputational benefit that will translate into future earnings.” An investor who, in speaking with insiders, makes it clear that the investor is not agreeing to keep any information confidential and will not provide anything in exchange for such information (and carefully documents all this, as sophisticated investors do) will thus not be subject to liability even if the insider discloses material non-public information and the investor trades on it. In such cases, the investor will be aware of material non-public information, but it will not be proscribed MNPI. Indeed, Professor Verstein’s example of Muddy Waters Research counts more against the point he is making than in favor of it. An insider who disclosed to Muddy Waters information about fraud or other wrongdoing at the company would be analogous to the insiders who disclosed the massive fraud at Equity Funding Corporation to investment analyst Raymond Dirks in the famous case of *Dirks*.

71. Id.
73. Id. (quoting *Dirks* v. SEC, 463 U.S. 646, 662 (1983)).
74. Id. (quoting *Dirks*, 463 U.S. at 663). The tippee can also be liable if the tipper is “mak[ing] a gift of confidential information to a trading relative or friend,” id. (quoting *Dirks*, 463 U.S. at 664), but presumably this is not the case when the insider is speaking to an institutional investor such as Muddy Waters.
As is well known, the Commission claimed that Dirks had violated the insider trading laws when he used the information to advise his clients to sell shares of Equity Funding, but the Supreme Court held otherwise because the insiders who tipped Dirks “received no monetary or personal benefit for revealing Equity Funding’s secrets, nor was their purpose to make a gift of valuable information to Dirks,” and thus “[i]n the absence of a breach of duty to shareholders by the insiders, there was no derivative breach by Dirks.”

True, the methods investors have to protect themselves in this context are not perfect. Just as in Dirks, the Commission might still wrongly accuse an investor who trades while in possession of material non-public information but not of proscribed MNPI of insider trading, and the risk of judicial error means that the investor might (wrongly) face liability if it trades. But given the Dirks precedent, the risk to investors who follow standard market practices to protect themselves would very likely be small.

So, what becomes of the Equal Profits Principle in relation to tippees? The point of invoking that principle was to determine how mixed-motive insider trading cases should be resolved, but the argument has shown that mixed-motive cases either do not arise in connection with tippees or else are easily resolved by common market practices. That is, tippees other than market professionals do not develop their own information about companies (and so are very unlikely to be multiple-reason traders), and only in the case of the most fantastical coincidences could such tippees have an end-in-view other than profit for trading the very security about which they were tipped (and thus are very unlikely to be multiple-ends traders). Hence, such tippees present no mixed-motive problems of any practical significance. As to tippees who are market professionals, there is clearly no need to worry about the profits of dishonest ones who solicit proscribed MNPI by effectively bribing insiders to disclose it, and honest market professionals know how to protect themselves against liability under the insider trading laws. Following common market practices, they can be reasonably certain that, even if they come into possession of material non-public information, it will not be proscribed MNPI, and so even if they trade while in possession of such information (indeed, even if they use it to trade), they will not be guilty of insider trading. In short, there is no serious problem about mixed-motive trading for tippees.

CONCLUDING REMARKS

The problem of mixed motives in the law is Professor Verstein’s forte, and he has done impressive work on mixed motives in relation to equal protection and employment discrimination. I cannot help but think, however, that the insider trading laws are a less fertile ground for exploring

76. Id. at 667. Furthermore, when the information the insider is disclosing is evidence of fraud or criminality, there is presumably no duty on the part of the insider to keep such information confidential. Hence, disclosing it is not a breach of a fiduciary duty.
this problem. The insider trading laws are part and parcel of the corporate and securities laws, and in my view, with limited exceptions, such laws should be, and in fact mostly are, aimed at sophisticated commercial parties who prize efficiency, predictability, ease of administration, and low transaction costs. It is hard for me to see any rule that requires a court to determine which motives or reasons caused a person to act (let alone which of these was primary in a given case) fulfilling the reasonable needs of such parties. As the example of corporate insider trading policies shows, such parties do not adopt such rules to order their own affairs.

In response to such concerns, Professor Verstein argues that primary-reason tests are used in many areas of law.\textsuperscript{78} He is certainly right that they are common in tax law, but this is probably because tax law touches so many aspects of life that avoiding such tests becomes well-nigh impossible. In any case, I resist the idea that the tax laws are a model of clarity and economic rationality that ought to be imitated elsewhere.\textsuperscript{79} As demonstrated from all manner of commercial agreements, sophisticated parties go to great lengths to avoid inquiries into a party’s state of mind. If there is any reasonable alternative, sophisticated transactional attorneys virtually never draft agreements in a way that makes anything turn on the motive a party had for taking some action or other, much less whether, among those motives, one reason was stronger than another. The universal reliance of insider trading policies on the awareness standard and the even more objective standards involved in blackout periods and pre-clearance rules are examples of this, but there are innumerable others.\textsuperscript{80} For sophisticated commercial parties,

\begin{itemize}
  \item \textsuperscript{78} Verstein, \textit{supra} note 1, at 1298–99.
  \item \textsuperscript{79} I find Professor Verstein’s other examples drawn from what might be regarded as business law unconvincing. In corporate law, \textit{Cheff v. Mathes}, 199 A.2d 548, 554 (Del. 1964), is a very old Delaware case that did indeed rely on an inquiry about motives, but the doctrine of that case evolved in the 1980s into the \textit{Unocal} standard, \textit{Unocal v. Mesa Petroleum Co.}, 493 A.2d 949, 959 (Del. 1985), which inquires into the directors’ beliefs (i.e., whether they honestly believed that an antitakeover device was in the best interests of the company) and how reasonable those beliefs were, not the directors’ motives. \textit{See, e.g.}, \textit{Unitrin, Inc. v. Am. Gen. Corp.}, 651 A.2d 1361, 1384–85 (Del. 1995). In this regard, compare the Delaware Supreme Court’s abolition of the business purpose test in freezeout mergers in \textit{Weinberger v. UOP, Inc.}, 457 A.2d 701, 704 (Del. 1983). Similarly, in antitrust law, \textit{NAACP v. Claiborne Hardware Co.}, relied on an inquiry about motives, but the case is an extreme outlier in antitrust, involving an attempt to use the antitrust laws to suppress a political protest. 458 U.S. 886, 920–32 (1982). In mainstream antitrust cases, all the participants are commercial parties motivated by profits, and questions of motives (much less mixed motives) simply do not arise.
  \item \textsuperscript{80} To name just a few, (a) acquisition agreements typically include indemnification provisions that replace (under exclusive remedy clauses) remedies at common law (such as actions for contractual misrepresentation) that would require inquiries into whether a party actually relied on a representation; (b) non-reliance clauses in acquisition agreements or securities purchase agreements limit the actionable representations of a seller to those expressly made in writing in some agreement and so defeat actions based on what one party may have understood another to have said outside the agreement during negotiations; and (c) provisions in confidentiality or other preliminary agreements typically provide that neither party shall be bound except by a definitive written agreement between the parties, thus preventing actions based on what a party reasonably believed the other party said or did during negotiations (i.e.,
uncertainty of application is about the worst characteristic a rule can have. In the realm of sophisticated commercial parties, a primary-reason test would be a stranger in a strange land.

whether such conduct would reasonably be understood to be an offer or acceptance). This list could be expanded almost indefinitely.