

# FEATURED ARTICLE

## EXPLAINING DIRKS

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### ABSTRACT

*The personal benefit element of the tipping violation established in Dirks v. SEC has been misunderstood. Courts, the SEC, and criminal prosecutors have broadly construed it to create liability for insiders who received remote, speculative, immaterial, or intangible returns after disclosing confidential company information. Several situations, such as an insider's gift of confidential information to a relative or friend or an intention to benefit the recipient of the information, do not require the insider to receive anything at all.*

*The drafting history of the majority opinion in Dirks in the papers of its author Justice Lewis Powell reveals that the current wide interpretations of personal benefit in tipping cases are not consistent with the test the Court intended. The principal test of personal benefit was meant to be the insider's receipt of cash or something of value within a short time.*

*The special fact situations mentioned in Dirks, including a disclosure as a gift or with an intention to benefit, were not independent and sufficient grounds for finding that an insider received a personal benefit. Rather they were situations that often could create an inference of personal benefit. The drafting history and Justice Powell's previous opinions show that Powell carefully used the word inference in the final opinion. He wanted proof of a fact situation to allow but not require a fact finder to conclude a tipper received a personal benefit. He did not intend proof of a fact situation to create a presumption or ultimate liability.*

*Lessons from the drafting history show that the Supreme Court misapplied the gift situation in Salman. They also show that the Second Circuit's Martoma decision misinterpreted the intention to benefit language in the fact situations.*

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## INTRODUCTION

*Dirks v. Securities and Exchange Commission*<sup>1</sup> is a consequential Supreme Court decision. It gave the Supreme Court's stamp of approval to a fraud claim for tipping as part of the insider trading prohibition in the federal securities laws.<sup>2</sup> The decision also determined the elements for a tipping claim and catalyzed a new area for law enforcement and legal practice. The Securities and Exchange Commission ("SEC") and criminal prosecutors bring a large number of tipping cases every year.<sup>3</sup> Many of the most famous insider trading decisions involved tipping allegations, such as *Salman*,<sup>4</sup> *Martoma*,<sup>5</sup> *Newman*,<sup>6</sup> and *Chestman*.<sup>7</sup> The government charged Ivan Boesky,<sup>8</sup> Martha Stewart,<sup>9</sup> and Raj Rajaratnam<sup>10</sup> as tippees. As a legal or practical matter, hedge funds, broker-dealers, and financial analysts must have policies and procedures in writing to avoid the possibility that their receipt of information will be viewed as a tip.<sup>11</sup>

1. 463 U.S. 646 (1983).

2. The prohibition against fraud in the purchase or sale of a security in Rule 10b-5, 17 C.F.R. § 240.10b-5, issued under authority of section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), forbids insider trading.

3. See SEC, DIVISION OF ENFORCEMENT ANNUAL REPORT 7, 15, 20–21, 24–25, 27 (2019), <https://www.sec.gov/files/enforcement-annual-report-2019.pdf>.

4. *Salman v. United States*, 137 S. Ct. 420, 423 (2016).

5. *United States v. Martoma*, 894 F.3d 64, 67 (2d Cir. 2018).

6. *United States v. Newman*, 773 F.3d 438, 443 (2d Cir. 2014), *abrogated in part by Salman v. United States*, 137 S. Ct. 420 (2016).

7. *United States v. Chestman*, 947 F.2d 551, 564 (2d Cir. 1991) (en banc).

8. Government's Memorandum with Regard to the Sentencing of Ivan F. Boesky at 2–3, *United States v. Boesky*, 1989 WL 46628 (S.D.N.Y. 1989) (No. 86 Cr. 378 (MEL)), [http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r8l.cf1.rackcdn.com/collection/papers/1980/1987\\_1214\\_BoeskySentencingGovernmentT.pdf](http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r8l.cf1.rackcdn.com/collection/papers/1980/1987_1214_BoeskySentencingGovernmentT.pdf).

9. Press Release, SEC, SEC Charges Martha Stewart, Broker Peter Bacanovic with Illegal Insider Trading (June 4, 2003), <https://www.sec.gov/news/press/2003-69.htm>.

10. *SEC v. Rajaratnam*, 918 F.3d 36, 39 (2d Cir. 2019).

11. 15 U.S.C. §§ 78o(g), 80b-4a (requiring broker-dealers and investment advisers to have written policies and procedures to prevent insider trading); see also Andrew N. Vollmer, *How Hedge Fund Advisers Can Reduce*

For all that, *Dirks* has been misunderstood. It meant to authorize a tipping claim in a narrow, specific set of circumstances when the insider's wrongdoing was not in doubt, but law enforcement agencies, courts, and legal writers have construed it broadly. They have skipped over a critical feature of the opinion and constantly stretched liability for tipping.

The misunderstanding centers on the meaning of the personal benefit element of a tipping violation. In a majority opinion written by Justice Lewis Powell, the *Dirks* Court reasoned that, to be liable, an insider must have disclosed confidential information to an outsider in breach of the insider's fiduciary duty of trust and confidence. How do investigators and courts evaluate whether an insider tipped in breach of a duty? *Dirks* said: "[T]he test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders."<sup>12</sup> This is the personal benefit element or test.

A paragraph in *Dirks* explained the personal benefit test. An insider needs to receive "cash, reciprocal information, or other things of value."<sup>13</sup> The opinion then listed certain fact patterns that often create an inference that the insider expected to receive a personal benefit: the insider's gift of information to a trading relative or friend or a relationship between the tipper and the tippee suggesting a quid pro quo or the insider's intention to benefit the tippee (the "fact situations").<sup>14</sup> Since the opinion was issued, it and the personal benefit element have been the subject of considerable commentary.<sup>15</sup>

As the SEC, criminal prosecutors, and courts applied the personal benefit element in enforcement cases after *Dirks*, the test expanded and became easier to meet. *Dirks* referred to the insider's gain and receipt of cash or things of value, but, over time, less tangible and more remote, speculative, and immaterial returns to the insider satisfied the test.<sup>16</sup> Maintaining a good relationship with a friend and

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*Insider Trading Risk*, 3 J. SEC. L., REG. & COMPLIANCE 106 (2010) (describing internal policies and procedures to avoid tipping issues).

12. *Dirks v. SEC*, 463 U.S. 646, 662 (1983).

13. See *infra* note 149.

14. *Dirks*, 463 U.S. at 663–64.

15. JOHN P. ANDERSON, *INSIDER TRADING: LAW, ETHICS, AND REFORM* 71–75 (2018); STEPHEN M. BAINBRIDGE, *INSIDER TRADING LAW AND POLICY* 59–64 (2014); 4 THOMAS LEE HAZEN, *TREATISE ON THE LAW OF SECURITIES REGULATION* § 12:167 (7th ed. 2020); DONALD C. LANGEVOORT, *INSIDER TRADING: REGULATION, ENFORCEMENT & PREVENTION* § 4 (2015); LOUIS LOSS, JOEL SELIGMAN & TROY PAREDES, *FUNDAMENTALS OF SECURITIES REGULATION* (7th ed. 2018); Karen E. Woody, *The New Insider Trading*, 52 ARIZ. ST. L.J. 594 (2020); Michael D. Guttentag, *Selective Disclosure and Insider Trading*, 69 FLA. L. REV. 519 (2017); Jonathan R. Macey, *Beyond the Personal Benefit Test: The Economics of Tipping by Insiders*, 2 U. PA. J.L. & PUB. AFFS. 25 (2017); Ronald J. Colombo, *Tipping the Scales Against Insider Trading: Adopting a Presumption of Personal Benefit To Clarify Dirks*, 45 HOFSTRA L. REV. 117 (2016); Donna Nagy, *Beyond Dirks: Gratuitous Tipping and Insider Trading*, 42 J. CORP. L. 1 (2016); A.C. Pritchard, *Dirks and the Genesis of Personal Benefit*, 68 SMU L. REV. 857 (2015); Sarah S. Gold & Richard L. Spinogatti, *Consequences of Justice Powell's Slippery Slope in "Dirks,"* 254 N.Y. L.J. 3 (2015).

16. See discussion *infra* Part II; Pritchard, *supra* note 15, at 869–70 (SEC "persuaded lower courts to adopt broad interpretations of *Dirks*' personal benefit requirement").

frequent partner in real estate deals qualified as a personal benefit,<sup>17</sup> as did effecting a reconciliation and maintaining a networking contact with a friend.<sup>18</sup> A hope of currying favor with a boss and items such as an iPhone, live lobsters, a gift card, and a jar of honey were sufficient.<sup>19</sup> In short, the “evidentiary ‘bar is not a high one.’”<sup>20</sup>

The fact situations creating an inference took on lives of their own. Although none called for evidence that the insider received anything, courts and authorities read *Dirks* to mean that proof of a fact situation alone constituted proof of the insider’s receipt of a personal gain. A well-known example is the Supreme Court’s insistence in *Salman* that an insider’s disclosure to a brother as a gift fulfilled the personal benefit requirement.<sup>21</sup> Another is the decision of a Second Circuit panel that the government may satisfy the personal benefit element with proof that an insider intended to benefit a tippee—even a total stranger.<sup>22</sup> In these cases, the personal benefit requirement effectively disappeared.

Is this the state of the law *Dirks* contemplated? These lax standards for satisfying the personal benefit test seem at odds with *Dirks*, which required proof that an insider in effect sold the confidential business information for pecuniary gain, reciprocal information, or something of value. The fact situations have always been particularly discordant because they do not require proof that the insider actually received anything.

The *Dirks* file in the Powell Papers and drafts of the *Dirks* opinion shed light on questions about the personal benefit element.<sup>23</sup> The drafting history reveals the following: Justice Powell admitted in his internal documents that, to a large extent, he and his law clerk invented the elements for a tipping claim from sources other than traditional legal authorities. An earlier insider trading decision was a starting place, but otherwise most details did not come from a statute, regulation, or judicial precedent.

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17. See *SEC v. Yun*, 327 F.3d 1263, 1280 (11th Cir. 2003).

18. See *SEC v. Sargent*, 229 F.3d 68, 77 (1st Cir. 2000).

19. See *United States v. Martoma*, 894 F.3d 64, 74 (2d Cir. 2018) (citing *United States v. Jiau*, 734 F.3d 147, 153 (2d Cir. 2013)).

20. *Martoma*, 894 F.3d at 76 (quoting *SEC v. Obus*, 693 F.3d 276, 292 (2d Cir. 2012)).

21. *Salman v. United States*, 137 S. Ct. 420, 427–28 (2016).

22. *Martoma*, 894 F.3d at 75.

23. The source for the drafting history of the *Dirks* opinion was the Powell Papers, which are part of the Lewis F. Powell Jr. Archives at Washington & Lee University School of Law. See WASH. & LEE SCH. L., *Dirks v. Securities and Exchange Commission*, <https://scholarlycommons.law.wlu.edu/casefiles>. The file for *Dirks* has 453 PDF pages. My citations to documents from the “Dirks File” list the type of document, the date, and the number of the page in the File where the document begins. When relevant, pincites are given for a specific page within the File and for the page number of the particular document.

Professor Adam Pritchard did pioneering work on the Powell Papers for the *Dirks* case and more generally for Justice Powell’s opinions on the federal securities laws. See Pritchard, *supra* note 15; see generally A.C. Pritchard, *Justice Lewis F. Powell, Jr. and the Counterrevolution in the Federal Securities Laws*, 52 DUKE L.J. 841 (2003).

The drafting history tells us that comments from Justice Sandra Day O'Connor pushed the concept of personal gain to the forefront late in the drafting of the opinion. Personal gain became the main element for proof of tipping liability, and the gain was to be objective and concrete, such as receipt of cash or tangible value. This was consistent with Powell's goal of providing market participants and law enforcement authorities with a limiting principle of reasonable certainty and predictability.

The drafting record tells us the source of the gift theory and the other fact situations creating an inference of personal benefit. These concepts came from an article about the *Dirks* case that a practitioner published in a weekly legal newspaper a week before the oral argument. The article did not cite any authority for the fact situations.

The drafting history highlights that the fact situations were not proof or examples of personal benefit. The Court deliberately set the situations apart from the government's need to prove that an insider received cash or something of value to meet the personal benefit test by saying that they were types of circumstances that often could lead a fact finder to infer that the insider received or expected a personal benefit. The critical word for the fact situations was "infer" or "inference." The practitioner's article in the legal periodical said a court could infer the ultimate standard for liability from proof of a fact situation, and every draft of the *Dirks* opinion used the word "infer" or "inference" with the fact situations.

Powell was careful about using the word "inference." Before he wrote *Dirks*, Powell wrote several opinions discussing the differences between inferences and types of presumptions.<sup>24</sup> He was attuned to those differences and deliberately chose to use the word "inference" in *Dirks*. He wanted the fact situations to create an inference of personal benefit and not a presumption or ultimate liability. According to Powell's other opinions, an inference was a permissible but not mandatory logical deduction for a fact finder. A jury was not bound to accept the correctness of an inference. A presumption was different. It was mandatory and necessarily shifted the burden of producing contrary evidence. An inference did not have the legal effect of shifting the burden of production, although it had that practical effect. Neither an inference nor a presumption shifted the ultimate burden of persuasion. Therefore, in *Dirks*, evidence that the insider received cash or something of value was proof of personal benefit and breach of a fiduciary duty. Evidence of a fact situation created an inference of personal benefit but did not establish it.

These lessons from the drafting history and Powell's earlier opinions show that the *Salman* Court wrongly applied the gift theory as sufficient proof of personal benefit. A disclosure to a close relative as a gift or proof of another fact situation does not establish that the insider received a personal benefit. The proper understanding of the fact situations in *Dirks* is that, if the government introduces evidence of the predicate facts in one of the fact patterns, such as a quid pro quo

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24. See *infra* Section IV.B.

relationship or a disclosure as a gift to a trading relative or friend, and the defendant does not introduce evidence to rebut the predicate facts or to counter the inference that the tipper received a personal gain for disclosing confidential information to an outsider, the issue of personal gain may be submitted to the jury or fact finder. The fact finder is permitted, but not required, to conclude that the insider received a valuable personal gain. The fact finder is permitted to draw other reasonable inferences from the evidence. The inference does not change the burden of persuasion, which remains with the government. The government must present evidence that eliminates reasonable doubt in a criminal case and that is a preponderance in a civil case.

Following this approach likely would have changed outcomes because many courts treat proof of a fact situation, such as the gift facts, as independent proof that an insider received a personal benefit. For instance, the result in *Salman* might have been different. Evidence in the case had rebutted that the insider received a benefit from disclosing information to his brother.

The *Dirks* drafting history resolves a critical point disputed between the majority and dissent in *Martoma*. The *Martoma* majority was wrong in its construction of the fact situation referring to an intention to benefit. A relationship between the insider and the tippee is needed before an intention to benefit is relevant.

The drafting history and lessons of *Dirks* have vitality today. They improve our understanding of obscure parts of *Dirks* that the courts have misinterpreted and that continue to matter in government enforcement cases. Although the question about the use and relevance of internal judicial records is controversial, reasons exist to take those records into account. The Supreme Court used a draft opinion at least once, and the reliance of the U.S. legal system on the doctrines of precedent and stare decisis depends on the best, most accurate understanding of an applicable judicial decision.

This Article develops these points in five main Parts. Part I provides the necessary foundation with a summary of *Chiarella* and a more extended review of the final opinion in *Dirks*. Part II describes how courts and law enforcement authorities have applied the personal benefit element. Part III uses the Powell Papers to tell the story of the drafting of the paragraph on the personal benefit element in *Dirks*. Part IV explores three of the main lessons from the drafting history. The first is that the personal benefit element set a high standard and required an insider to receive cash or something of proximate value. The second lesson is that the Court wrote the fact situations to do no more than allow an inference of a personal benefit, but lower courts and law enforcement authorities failed to use them that way. The third lesson is that *Martoma* misinterpreted the intention-to-benefit language. Finally, Part V has a few remarks about the relevance of using drafting history. The Article concludes that courts and law enforcement agencies should heed these lessons from the drafting history of *Dirks* and rein in their expansive constructions of the personal benefit element in tipping cases.

## I. THE FOUNDATIONS OF THE PROHIBITIONS ON INSIDER TRADING AND TIPPING

A tipping violation is a species of insider trading. Insider trading is a type of fraud prohibited by section 10(b) of the Securities Exchange Act and Rule 10b-5.<sup>25</sup> Insider trading occurs when a person has material non-public information about a company or security, has a fiduciary duty to maintain the confidentiality of the information for a principal, and buys or sells an affected security to make personal profits. In general terms, tipping occurs when an insider with a duty to keep information confidential discloses the information to an outsider who does not have a duty to keep the information confidential and who then buys or sells an affected security. This Part explores the foundations of the prohibition on tipping in two Supreme Court decisions: *Chiarella* and *Dirks*.

### A. *Chiarella v. United States*

The Supreme Court found a prohibition against insider trading in Rule 10b-5 in *Chiarella v. United States*.<sup>26</sup> *Chiarella* was the foundation for *Dirks*. The defendant in *Chiarella* worked at a financial printing company, deduced the names of targets in corporate takeover bids, and bought stock in the target companies before the takeovers were announced publicly. He was convicted of criminal violations of Rule 10b-5, but the Supreme Court reversed.<sup>27</sup>

Justice Powell wrote the majority opinion. He quoted the general anti-fraud terms of section 10(b) and Rule 10b-5 and explained that the Court needed to determine whether silence was fraudulent or deceptive because the charge against *Chiarella* was that he had failed to inform sellers of the stock of the targets that a forthcoming bid would make their shares more valuable. The statute, legislative history, and rule did not provide specific guidance to resolve the case.<sup>28</sup>

Powell found that a person committed fraud by failing to disclose material information only when he or she had a duty to disclose.<sup>29</sup> In general, a person did not have a duty to disclose simply by possessing material non-public information,<sup>30</sup> but corporate insiders who obtained confidential information because of their position with the corporation were different. Corporate insiders had a relationship of trust and confidence with the corporation's shareholders, and that relationship entitled the shareholders to know the information before the insider transacted in the company's securities.<sup>31</sup> The Court cited the SEC case *In re Cady, Roberts & Co.* to say that "a corporate insider must abstain from trading in the shares of his

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25. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.

26. 445 U.S. 222 (1980).

27. *Id.* at 224–25.

28. *Id.* at 225–26.

29. *Id.* at 228, 230.

30. *Id.* at 235.

31. *Id.* at 227–29.

corporation unless he has first disclosed all material inside information known to him."<sup>32</sup> Disclosure before trading would prevent corporate insiders from benefiting personally when they had an obligation to put the shareholders' welfare before their own.<sup>33</sup> In a footnote, the majority opinion cited sources addressing the liability of tippees of corporate insiders as participants after the fact in the insider's breach of fiduciary duty, but the Court did not express an opinion on that question.<sup>34</sup> The Court held that Chiarella did not violate Rule 10b-5 because he had no duty to disclose. He was not a corporate insider and did not have a relationship with the sellers of securities that could give rise to a duty.<sup>35</sup> The law did not require parties in a securities transaction to have parity of information, and a duty to disclose did not arise from the mere possession of non-public market information.<sup>36</sup>

In 1997, the Supreme Court extended the direct insider trading prohibition developed in *Chiarella* to cover misappropriation cases.<sup>37</sup> A misappropriation case occurs when a person who is not a company insider receives confidential information material to the price of a company's securities from a source other than the company (such as an investor planning to make a large purchase of the company's stock), has a fiduciary duty to the source, and buys or sells the stock before the source's information becomes public.<sup>38</sup>

### B. *Dirks v. SEC*

The Supreme Court decided *Dirks v. SEC* three years after *Chiarella* and made tipping part of the insider trading prohibition.<sup>39</sup> Dirks worked for a broker-dealer analyzing insurance companies. A former officer of an insurance company, Equity Funding, told Dirks that the assets of the company were vastly overstated and urged him to verify and publicly disclose the problem. The former officer also informed insurance regulators but feared they would not believe his report. Dirks interviewed employees of Equity Funding, corroborated the wrongdoing, and approached a major newspaper in the hope of prompting a story that would expose the fraud. Dirks also disclosed the information to some of the clients of his broker-dealer employer, who sold securities of Equity Funding. Within a short time, law enforcement authorities intervened to stop the misconduct at Equity Funding. The SEC sued Dirks for informing his clients and found that he aided and abetted the fraudulent sale of Equity Funding securities by the clients. The D.C. Circuit agreed.<sup>40</sup>

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32. *Id.* at 227 (discussing *In re Cady, Roberts & Co.*, 40 SEC 907, 1961 WL 59902 (1961)). *Cady, Roberts* was a settled proceeding. 40 SEC at 907.

33. *Chiarella*, 445 U.S. at 230.

34. *Id.* at 230 n.12.

35. *Id.* at 231–33.

36. *Id.* at 233, 235.

37. *United States v. O'Hagan*, 521 U.S. 642, 649–53 (1997).

38. *See id.*

39. *Dirks v. SEC*, 463 U.S. 646, 659–61 (1983).

40. *Id.* at 648–52; Brief for SEC 3–10, *Dirks v. SEC*, 463 U.S. 646 (1983) (No. 82-276).



The Supreme Court, in a majority opinion again written by Justice Powell, first reaffirmed the insider trading analysis from *Chiarella*, which had cited *Cady, Roberts* for the fiduciary duty of certain corporate insiders to disclose material, non-public corporate information before trading in the company's securities or to refrain from trading to make secret, personal profits.<sup>41</sup> The difficulty was that *Dirks* was not an insider and did not have a fiduciary duty to Equity Funding or its shareholders. *Dirks* received information from Equity Funding insiders and was a tippee. He did not commit an insider trading violation if he did not breach a duty to refrain from trading or transmitting the information to others.<sup>42</sup>

The Court forcefully rejected the argument that a person has a duty to abstain from trading solely because the person knowingly received material non-public information from an insider. Such a rule could inhibit market analysts who regularly seek out corporate information from insiders and use the information to make judgments about the value of securities.<sup>43</sup>

At the same time, insiders with a fiduciary duty not to use confidential corporate information to their advantage "may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain."<sup>44</sup> A "tippee's duty to disclose or abstain is derivative from that of the insider's duty."<sup>45</sup> That reasoning led the Court to isolate the circumstances in which an outsider could be subject to a duty not to trade on information received from an insider: A "tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach."<sup>46</sup>

A tipping violation does not occur unless the insider's disclosure of confidential information to a tippee was a breach of the insider's fiduciary duty. "All disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders."<sup>47</sup> Whether a disclosure was a breach of duty depends on the purpose of the disclosure, and "the test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach."<sup>48</sup>

The Court then discussed the personal benefit test in one key paragraph. This paragraph is the object of our attention and therefore deserves a complete quotation:

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41. *Dirks*, 463 U.S. at 653–54.

42. *Id.* at 655, 665.

43. *Id.* at 657–59.

44. *Id.* at 659.

45. *Id.*

46. *Id.* at 660.

47. *Id.* at 661–62.

48. *Id.* at 662.

The SEC argues that, if inside-trading liability does not exist when the information is transmitted for a proper purpose but is used for trading, it would be a rare situation when the parties could not fabricate some ostensibly legitimate business justification for transmitting the information. We think the SEC is unduly concerned. In determining whether the insider's purpose in making a particular disclosure is fraudulent, the SEC and the courts are not required to read the parties' minds. *Scienter* in some cases is relevant in determining whether the tipper has violated his *Cady, Roberts* duty. But to determine whether the disclosure itself "deceive[s], manipulate[s], or defraud[s]" shareholders, *Aaron v. SEC*, 446 U.S. 680, 686 (1980), the initial inquiry is whether there has been a breach of duty by the insider. This requires courts to focus on objective criteria, *i.e.*, whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings. *Cf.* 40 S.E.C., at 912, n.15; Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 Harv. L. Rev. 322, 348 (1979) ("The theory . . . is that the insider, by giving the information out selectively, is in effect selling the information to its recipient for cash, reciprocal information, or other things of value for himself . . ."). There are objective facts and circumstances that often justify such an inference. For example, there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.<sup>49</sup>

The Court's goal in this paragraph was to provide market participants and law enforcement authorities with a "limiting principle" of reasonable certainty and predictability.<sup>50</sup> A guiding principle was "essential . . . for those whose daily activities must be limited and instructed" by the insider trading rules.<sup>51</sup> The opinion recognized the danger of imprecise rules. Imprecision "prevents parties from ordering their actions in accord with legal requirements. Unless the parties have some guidance as to where the line is between permissible and impermissible disclosures and uses, neither corporate insiders nor analysts can be sure when the line is crossed."<sup>52</sup> The absence of legal limitations also conferred too much discretion on enforcers.<sup>53</sup>

Limiting legal liability for insider trading was not the same as blessing trading on material non-public information. The Court recognized that "trading on material nonpublic information is behavior that may fall below ethical standards of conduct"

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49. *Id.* at 663–64 (footnote omitted and slight alterations made to the internal citations).

50. *Id.* at 664.

51. *Id.*

52. *Id.* at 658 n.17.

53. *Id.* at 664 n.24 ("Without legal limitations, market participants are forced to rely on the reasonableness of the SEC's litigation strategy, but that can be hazardous, as the facts of this case make plain.")

or a moral ideal,<sup>54</sup> but that did not mean that the behavior in all circumstances must be a civil or criminal violation of Rule 10b-5.

Under the Court's rule for tippee liability, Dirks did not commit a violation. The insiders who provided Dirks with information did not violate their duties to the Equity Funding shareholders. They received no monetary or personal benefit for revealing the corporate secrets and were motivated only by a desire to expose the fraud.<sup>55</sup>

## II. APPLICATIONS OF THE PERSONAL BENEFIT TEST

After *Dirks*, the SEC, criminal prosecutors, and courts applied the personal benefit element in tipping cases, but they expanded the concept of personal benefit, making it easier to satisfy and dissolving any crispness to the line between lawful and unlawful conduct. Law enforcers and courts often applied the gift theory or aspects of the fact situations as dispositive proof of the insider's receipt of a personal benefit. They enfeebled the attempt to set a limiting principle and the emphasis on the tipper's receipt of cash or something of value. The history of the application of the personal benefit requirement has been continual accretion.

A prominent example is the Supreme Court decision in *Salman*, which used the gift theory as independent and sufficient proof of a personal benefit to the tipper.<sup>56</sup> The insider, an investment banker, gave his brother confidential information about mergers and acquisitions. The brother passed the confidential information to Salman.<sup>57</sup> The insider was close to his brother and disclosed the information because he loved his brother and wanted to help him and fulfill his needs. The insider did not testify that he made the disclosures to receive cash or something of value, and evidence showed that, in one instance, the insider implored his brother not to trade securities based on a disclosure.<sup>58</sup> In the Supreme Court, Salman challenged the conviction because of the lack of evidence that the insider received anything of a pecuniary or similarly valuable nature.<sup>59</sup> The Court rejected the argument, relying exclusively on the gift sentences in *Dirks*: "Our discussion of gift giving resolves this case. . . . *Dirks* makes clear that a tipper breaches a fiduciary duty by making a gift of confidential information to 'a trading relative,' and that rule is sufficient to resolve the case at hand."<sup>60</sup> "In such situations, the tipper benefits personally because giving a gift of trading information is the same thing as trading by the tipper followed by a gift of the proceeds."<sup>61</sup> The Court said the

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54. *Id.* at 661 n.21.

55. *Id.* at 665–67.

56. *Salman v. United States*, 137 S. Ct. 420 (2016).

57. *Id.* at 424.

58. *Id.*

59. *Id.* at 426.

60. *Id.* at 427.

61. *Id.* at 428.

“tipper benefits either way.”<sup>62</sup> *Dirks*, in the *Salman* Court’s view, did not require a tipper to receive something of a pecuniary or similarly valuable nature in exchange for a gift to family or friends.<sup>63</sup>

Several circuit court decisions also illustrate the breadth of the personal benefit element. The Eleventh Circuit ruled that “all the SEC needs to show is that the tipper received a ‘benefit,’ directly or indirectly, from his disclosure.”<sup>64</sup> Benefit “does not always have to be pecuniary. A reputational benefit that translates into future earnings, a quid pro quo, or a gift to a trading friend or relative all could suffice to show that the tipper personally benefitted.”<sup>65</sup> The showing needed to prove a benefit to the tipper “is not extensive” and was defined in *Dirks* “in very expansive terms.”<sup>66</sup> The evidence that the *Yun* tipper expected to benefit by maintaining a good relationship with a friend and frequent partner in real estate deals was sufficient.<sup>67</sup>

Similarly, the First Circuit requires only a “thin” benefit to the tipper. Personal benefit to a tipper “is satisfied by benefits as thin as ‘reconciliation with [a] friend’ and the maintenance of ‘a useful networking contact,’ . . . or ‘the mere giving of a gift to a relative or friend.’”<sup>68</sup>

In *Martoma*, a panel of the Second Circuit stressed the breadth of the personal benefit concept:

The Supreme Court defined personal benefit broadly. . . . [T]he test for a personal benefit is whether objective evidence shows that “the insider personally will benefit, directly or indirectly, from his disclosure” of confidential information to the tippee. *Dirks* set forth numerous examples of personal benefits that prove the tipper’s breach . . . .<sup>69</sup>

The court then gave equal weight to pecuniary gain and all the fact situations as proof of a personal benefit. The court continued:

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62. *Id.*

63. *Id.* Other courts applied more extreme versions of the gift theory. *See* SEC v. Blackwell, 291 F. Supp. 2d 673, 692 (S.D. Ohio 2003) (denying a motion to dismiss in part because an allegation that the insider disclosed material non-public information “alone is enough to allow the Court to find an adequate allegation as to the personal benefit element”; a “mere allegation that the insider has disclosed material non-public information is sufficient to create a legal inference that the insider intended to provide a gift to the recipient of the information, thereby establishing the personal benefit requirement”); SEC v. Blackman, No. 3:99-1072, 2000 WL 868770, at \*9 (M.D. Tenn. May 26, 2000) (mere fact of disclosure sufficiently alleges “gift” to satisfy personal benefit requirement of *Dirks*).

64. SEC v. Yun, 327 F.3d 1263, 1270 (11th Cir. 2003).

65. *Id.* at 1275.

66. *Id.* at 1280.

67. *Id.*

68. United States v. McPhail, 831 F.3d 1, 10–11 (1st Cir. 2016) (citations omitted); *see also* SEC v. Sargent, 229 F.3d 68, 77 (1st Cir. 2000) (effecting a reconciliation and maintaining a networking contact with a friend was a personal benefit).

69. United States v. Martoma, 894 F.3d 64, 73–74 (2d Cir. 2018) (citations omitted), *amending and replacing* 869 F.3d 58 (2d Cir. 2017).

We have applied *Dirks* to uphold a wide variety of personal benefits. We held that a jury could infer a personal benefit from the fact that a tipper hoped to curry favor with his boss, and from the fact that another tipper and the tippee were friends from college. We found evidence of a personal benefit sufficient where the tippee gave one tipper an iPhone, live lobsters, a gift card, and a jar of honey, and where the tippee had another tipper admitted into an investment club where the tipper had the opportunity to access information that could yield future pecuniary gain (even though he never realized that opportunity). In another case, we held that the government need not show that the tipper expected or received a specific or tangible benefit in exchange for the tip . . . .<sup>70</sup>

The panel said a personal benefit “may be indirect and intangible and need not be pecuniary at all”<sup>71</sup> and summarized that “the evidentiary bar is not a high one.”<sup>72</sup> In fact, for those courts and law enforcement authorities following *Martoma*, the personal benefit element is gone altogether, as discussed below.<sup>73</sup>

The *Martoma* interpretation contrasted sharply with the views of an earlier Second Circuit panel in *Newman*. In *Newman*, the government argued that one insider received a personal benefit because a person who had been an acquaintance for years provided career advice and assistance and a second insider received a personal benefit because he and the tippee were family friends that had met at church and occasionally socialized together.<sup>74</sup> The court observed that, if “this was a ‘benefit,’ practically anything would qualify.”<sup>75</sup> The government could not “prove the receipt of a personal benefit by the mere fact of a friendship, particularly of a casual or social nature.”<sup>76</sup> The *Newman* panel said that, in a case based on the gift theory, prosecutors needed to prove both a close personal relationship between the tipper and the tippee and the tipper’s receipt of a valuable gain: An “inference [of a personal benefit] is impermissible in the absence of proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.”<sup>77</sup>

*Newman* was an exception. The strong trend since *Dirks* has been to broaden the personal benefit test and to view the fact situations as independent grounds of

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70. *Id.* at 74 (citations and quotation marks omitted).

71. *Id.* at 75.

72. *Id.* at 76 (quotation marks omitted).

73. See *infra* notes 216–219 and accompanying text.

74. *United States v. Newman*, 773 F.3d 438, 452 (2d Cir. 2014).

75. *Id.*

76. *Id.*

77. *Id.*; see *Gupta v. United States*, 913 F.3d 81, 86–87 (2d Cir. 2019) (discussing the personal benefit element, *Dirks*, *Salman*, *Newman*, and *Martoma*); see also *United States v. Blaszczyk*, 947 F.3d 19, 35–37 (2d Cir. 2019) (holding that the government does not need to prove the personal benefit element or other tipping requirements from *Dirks* when charging a tipper and tippee with the crimes of wire fraud and securities fraud in Title 18).

establishing personal benefit even though none of those situations involves the tipper's receipt of anything of tangible value.

The reason for a broad personal benefit test, according to some courts, was that it was the appropriate way to identify the tipper's purpose in making a disclosure. The courts sought to determine why an insider made the disclosure, whether the insider had a legitimate reason, and whether the insider had a corporate purpose in making a disclosure. *Martoma* justified a low threshold for personal benefit by saying that it "proves a breach of fiduciary duty because it demonstrates that the tipper improperly used inside information for personal ends and thus lacked a legitimate corporate purpose. That is precisely what, under *Dirks*, the personal benefit element is designed to test."<sup>78</sup> The government had argued for such an approach in *Salman*; its proposed standard, which the Court rejected, was that "a tipper personally benefits whenever the tipper discloses confidential trading information for a noncorporate purpose."<sup>79</sup>

Criminal and SEC charging decisions exploit the willingness of the courts to apply the personal benefit element generously. The criminal charges in *Newman* and *Salman* are examples. SEC examples in the past few years include complaints citing only the insider's benefit from providing gifts of confidential information to close personal friends or relatives.<sup>80</sup>

The natural question is whether the interpretation of the personal benefit element held by most courts and law enforcement personnel is faithful to *Dirks*. That question prompts others. Where did the personal benefit test come from? Was it drafted as a broad or narrow test? Where did the fact situations come from; why did the Supreme Court single out those three fact patterns; and how do they fit with the personal benefit standard? Why do the fact situations not involve the insider's receipt of a personal benefit, and how are they examples or proof of personal benefit when the insider receives nothing? These were the mysteries of *Dirks* and its progeny that led me to the file on *Dirks* in the Powell Papers. As the next Parts of the Article discuss, the drafting history provides partial answers to these questions.<sup>81</sup>

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78. *United States v. Martoma*, 894 F.3d 64, 75 (2d Cir. 2018); *see also* *SEC v. Maio*, 51 F.3d 623, 632–33 (7th Cir. 1995) (discussing whether the insider had a "legitimate purpose" for a disclosure and wondering why the insider needed to tell the tippee anything).

79. *Salman v. United States*, 137 S. Ct. 420, 426 (2016).

80. *See* Complaint at 19, *SEC v. Collins*, No. 18-cv-07128 (S.D.N.Y. Aug. 8, 2018), <https://www.sec.gov/litigation/complaints/2018/comp-pr2018-151.pdf>; Complaint at 10, *SEC v. Pinto-Thomaz*, No. 18-cv-05757 (S.D.N.Y. June 26, 2018), [www.sec.gov/litigation/complaints/2018/comp-pr2018-113.pdf](http://www.sec.gov/litigation/complaints/2018/comp-pr2018-113.pdf).

81. Professor Pritchard's article about the Powell Papers and Justice Powell's securities law opinions broadly outlined the Justice's approaches to *Chiarella* and *Dirks*. Pritchard, *supra* note 23, at 930–42. His article about *Dirks* concentrated on issues of scienter, motive, purpose, and breach of duty more than personal benefit. Pritchard, *supra* note 15. Professor Anderson also discussed the scienter element in tipping cases. JOHN P. ANDERSON, *INSIDER TRADING* 71–75 (2018). Other writers used some of the drafting history of *Dirks* but not to examine the specific questions discussed in this Article. *See* Donald C. Langevoort, *Watching Insider Trading Law Wobble: Obus, Newman, Salman, Two Martomas, and a Blaszczak* 13–21 (unpublished manuscript) (Nov.

### III. THE DRAFTING HISTORY OF *DIRKS*

The *Dirks* majority held that a tippee violates the anti-fraud provisions of the federal securities laws only when the tipper breaches a fiduciary duty by disclosing confidential corporate information in exchange for a personal benefit and when the tippee knew or should have known of the insider's breach. The paragraph defining personal benefit referred to pecuniary gain and things of value but also contained the fact situations in which the insider did not receive any personal benefit.<sup>82</sup>

The tipping violation was a new claim, and the drafting history of the *Dirks* opinion is informative about the meaning of the new element requiring that a tipper receive a personal benefit.<sup>83</sup> *Chiarella* was an important starting point; it recognized the need to prevent an insider's personal benefit from corporate information.<sup>84</sup> Otherwise, little of the personal benefit approach came from precedent or the briefs of the parties or the Department of Justice. The drafting history reveals that significant parts of Justice Powell's legal analysis, the gift theory, and the other fact situations came from a practitioner's commentary in a D.C. legal periodical published a week before oral argument in the then-pending *Dirks* case. It also shows that Powell accepted a suggestion from Justice O'Connor that transformed the test for a tipping violation that Powell had proposed.

#### A. *The Chazen Article*

The commentary in the legal periodical that helped shape Justice Powell's analysis was an article by Leonard Chazen, who was then a partner at Fried, Frank, Harris, Shriver & Jacobson.<sup>85</sup> The Chazen article heavily influenced both Powell and his law clerk, James O. Browning, who is now a district judge in New Mexico. The law clerk cited and drew from the article for a memorandum to the Justice, which was written just over a week after the date of the *Legal Times* piece.<sup>86</sup> In a memorandum to the other Justices in which he laid out his thinking, Powell relied on the Chazen article, although he did not cite or quote it.<sup>87</sup> Early drafts of the *Dirks* opinion cited and contained long quotations from the article.<sup>88</sup> Powell sent Browning a memorandum on the first draft of the opinion with this comment: "I suppose you have used the best points made by Chazen. I thought his article was

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19, 2019), available at <https://ssrn.com/abstract=3490636>; Michael D. Guttentag, *Selective Disclosure and Insider Trading*, 69 FLA. L. REV. 520, 527–28 (2017).

82. *Dirks v. SEC*, 463 U.S. 646, 660, 663–64 (1983).

83. See *supra* note 23.

84. *Chiarella v. United States*, 445 U.S. 222, 230 (1980).

85. Leonard Chazen, 'Dirks' Presents Unique Corporate, Social Issues, LEGAL TIMES 14 (Mar. 14, 1983).

86. Memorandum from Jim Browning to Powell, J. 5–8 (Mar. 22, 1983) (Dirks File 31, 35–38). A minor example was that the memorandum called *Dirks* "a freak case." *Id.* at 7 (Dirks File 37). Chazen had also written that "*Dirks* is in some respects a freak case." Chazen, *supra* note 85, at 18, col. 4.

87. Memorandum for Conference from Powell, J. 4–5 (Mar. 23, 1983) (Dirks File 45, 48–49).

88. See, e.g., First Draft of Opinion by Powell, J. 24–27 (Apr. 30, 1983) (Dirks File 172, 195–98); Second Draft of Opinion by Powell, J. 21–23 (May 10, 1983) (Dirks File 204, 224–26).

on target.”<sup>89</sup> The similarities between Chazen passages and the personal benefit paragraph in the final *Dirks* opinion illustrate the extent to which Chazen shaped the approach.<sup>90</sup>

Chazen saw the question in *Dirks* as a clash between a corporation’s desire to conduct some business in private and the interests of securities analysts and markets in learning as much material information about a public company as possible. He was cognizant of the important role securities analysts played in the securities markets and the threat to their role from an overly broad tipping rule.<sup>91</sup> He recognized that the insider trading prohibition in *Chiarella* involved more than just a breach of fiduciary duty—it also involved “the element of unjust enrichment, the insider’s exploitation for personal gain of information he receives in a corporate capacity.”<sup>92</sup>

Chazen argued that the elements of a tipping case and a direct insider trading case should start from the same place. A tipping violation should require proof that the insider exploited confidential information in violation of his fiduciary duty to the corporation plus proof that the tippee knowingly assisted the insider in exploiting the confidential information.<sup>93</sup> Chazen proposed that liability for tipping “should depend on the purpose of the disclosure.”<sup>94</sup> The insider would be liable if:

(i) in breach of a fiduciary duty, he disclosed confidential information to someone who traded on the information, and (ii) the purpose of the disclosure was to get a benefit in return from the recipient or to make a gift of information to the recipient by giving him an advantage over other traders. A recipient of such a tip would be liable if he used the information in connection with securities trading, knowing the purpose of the disclosure.<sup>95</sup>

Chazen conceded that the test was subjective, but the “courts would not be required to read the parties’ minds.” Courts could “infer purpose from the surrounding circumstances,” including by looking at two factors in particular that “would tend to show that the informant acted with an improper purpose:”

- There is a relationship between the informant and the recipient which suggests that the informant expected a quid pro quo from the recipient (e.g., the recipient is a customer of the informant) or that the informant wished to benefit the recipient (e.g., they are relatives or friends).

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89. Memorandum from Powell, J. to Jim Browning 5 (May 2, 1983) (*Dirks* File 50, 54).

90. Justice Powell’s analysis was not identical to Chazen’s, and Chazen would have extended liability further than the final *Dirks* opinion. For example, Chazen would have presumed the liability of an insider for a voluntary disclosure to a favored securities analyst and for a “tip to strangers or casual acquaintances . . . at a cocktail party or some other social setting.” Chazen, *supra* note 85, at 20, cols. 3–4.

91. *Id.* at 14, cols. 1–2.

92. *Id.* at 18, col. 3.

93. *Id.*

94. *Id.* at 20, col. 2.

95. *Id.*



- The disclosure was made at the initiative of the informant rather than in response to questioning by the recipient.<sup>96</sup>

“[A] strong nonfinancial motive for providing information,” such as the Equity Funding insider’s desire to expose the fraud, “would be evidence that the disclosure was not made with a forbidden purpose.”<sup>97</sup>

Earlier in the article, Chazen set up the factors that depended on evidence that the insider expected a quid pro quo from a customer or intended to benefit a relative or friend. He explained that tipping was an indirect method of insider trading because the insider could exploit confidential corporate information “indirectly by passing it on to a securities trader who would reward him for the information.”<sup>98</sup> To Chazen, exploitation was the use for personal gain of information an insider received in a corporate capacity.<sup>99</sup> Chazen said those elements existed in “classic tipping situations,” such as when a broker-dealer firm disclosed investment banking information to a customer in exchange for more brokerage commissions.<sup>100</sup> Chazen then gave another classic tipping situation:

The twin elements—breach of fiduciary duty and exploitation of information—are also present, though not quite so obviously, when an insider makes a gift of confidential information to a relative or friend, with the expectation that the recipient will trade on the information. The tip and trade are the functional equivalent of trading on the information by the insider followed by a gift of the profits to the recipient.<sup>101</sup>

Large parts of Chazen’s approach and analysis were his own, although he drew from *Chiarella*, its footnote on the treatment of a tippee as a participant after the fact in an insider’s breach of fiduciary duty, and a few other major insider trading and securities cases.<sup>102</sup> In describing the proposed elements of a tipping violation and the factors that would tend to show improper purpose, Chazen did not refer to supporting legal authority or precedent. Chazen cited nothing to substantiate the broker-dealer leak to a customer or the gift to a relative or friend as “classic tipping situations.”

### B. *Early Chambers Drafts*

Justice Powell’s initial inclination was to follow Chazen’s lead and resolve *Dirks* by making a tipping violation turn on the purpose or intent of the insider’s

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96. *Id.*

97. *Id.*

98. *Id.* at 18, col. 3.

99. *Id.*

100. *Id.*

101. *Id.* at 18, col. 4.

102. See generally Chazen, *supra* note 85.

disclosure of confidential information.<sup>103</sup> The first draft of the opinion within Powell's chambers incorporated substantial portions from Chazen. As edited in Powell's handwriting, these two paragraphs set out the elements of a tipping violation:

It is first necessary, in order to make out a tipping case against an insider, to prove that the insider exploited confidential information in violation of his fiduciary duties to shareholders. Whether disclosure of material nonpublic information is a breach of duty thus depends on the purpose of the disclosure. The tipper will be liable if (i) he discloses material, nonpublic information to one who trades on the information and (ii) the purpose of the disclosure was to receive some benefit in return or to make a gift of the information to the recipient to enable him to gain a market advantage over other traders. Similarly, a 10b-5 claim against an alleged tippee must be based on the theory that he knowingly participated with the insider in exploiting the confidential information: in essence that he was an aider and abetter. A recipient of such a tip would be liable if he used the information in connection with securities trading, knowing the purpose of the disclosure.<sup>104</sup>

The draft then had a citation to Chazen in the text and a long footnote quoting Chazen. The footnote quoted the two "classic tipping situations" of the broker-dealer's disclosure to a customer and the gift to a relative or friend.<sup>105</sup>

The draft, as edited, then started a new paragraph dismissing the SEC's concern about fabricated business justifications for a disclosure. This second paragraph finished with the following:

As in other areas of the law, courts are permitted to infer purpose from the surrounding circumstances. Two factors in particular would tend to show that the informant acted with an improper purpose. First, it is reasonable to infer improper purpose when there is a relationship between the informant and the recipient that suggests that the informant expected a quid pro quo from the recipient, such as when the recipient is a customer, or that the informant wished to benefit the recipient, such as when they are relatives or friends. Second, [that] a disclosure was made at the initiative of the informant rather than in response to questioning by the recipient may create an inference that the insider seeks to exploit information available to him. On the other hand, a strong nonfinancial motive for providing the information would be evidence that the disclosure was not made with a forbidden purpose.<sup>106</sup>

This text came nearly verbatim from Chazen and concluded with an "*id.*" citation back to the earlier Chazen reference in the text.

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103. Memorandum for Conference from Powell, J. 4 (Mar. 23, 1983) (Dirks File 45, 48); First Draft of Opinion by Powell, J. 24 (Apr. 30, 1983) (Dirks File 172, 195); Memorandum from Powell, J. 1-2 (May 14, 1983) (Dirks File 59, 59-60).

104. First Draft of Opinion by Powell, J. 24-25 (Apr. 30, 1983) (Dirks File 172, 195-96).

105. *Id.* at 25-26 (Dirks File 196-97).

106. *Id.* at 26-27 (Dirks File 197-98).

One of Justice Powell's handwritten edits in this segment is noteworthy. The law clerk's draft said that a disclosure initiated by the insider rather than the tippee could "raise a presumption" of improper purpose, but Powell changed it to read that a disclosure at the insider's initiative could "create an inference."<sup>107</sup> As discussed later, the difference between an inference and a presumption was important to Powell, and he wanted the factors and circumstances to create an inference.<sup>108</sup>

Powell's edits and comments on the first draft confessed concern about the lack of traditional legal authority for the claim being constructed. In the left margin next to the two-part test for liability, Powell wrote: "Jim – Is there any source we can cite for this rule other than JOB [Browning] & LFP [Powell]?"<sup>109</sup> In a memorandum accompanying his edits, Powell told Browning: "We have little or no authority for the rule we create. . . ."<sup>110</sup> That candor validates the criticism of *Dirks* that the tipping prohibition and its elements went beyond existing law.<sup>111</sup>

Browning produced a second chambers draft of the opinion on May 10, 1983, and Powell revised and commented on it on May 14–15.<sup>112</sup> Powell made a significant change by deciding to delete citations to and quotations from the Chazen article. Browning's second draft had retained citations to Chazen in the text and a long footnote quoting Chazen's classic tipping situations, but Powell wrote a note next to the footnote: "I am now doubtful about relying on a current news commentary."<sup>113</sup> Powell struck through the citation to Chazen in the text. A few pages later, Powell deleted a footnote reference to Chazen and wrote: "Jim – As Chazen's article was not in a scholarly journal, I am now doubtful about citing it."<sup>114</sup> The remaining drafts through the final opinion did not mention the Chazen article, although they retained large sections of text adapted or borrowed from it.

Powell also raised a question about a change that added personal gain language. The second draft had text saying a tipper must breach a duty to shareholders by using his access to confidential information for personal gain. Powell put a handwritten note in pencil next to this sentence: "Jim – Since we have not defined personal gain at this point shouldn't this come out here." He bracketed and drew an arrow to "by using his access to confidential information for personal gain."<sup>115</sup>

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107. *Id.* at 27 (Dirks File 198).

108. See *infra* notes 174–98 and accompanying text.

109. First Draft of Opinion by Powell, J. 24 (Apr. 30, 1983) (Dirks File 172, 195).

110. Memorandum from Powell, J. to Jim Browning 5 (May 2, 1983) (Dirks File 50, 54).

111. See Andrew N. Vollmer, *A Rule of Construction for the Personal Benefit Requirement in Tipping Cases*, 11 N.Y.U. J.L. & LIBERTY 331, 340–41 (2017) (commenting that the tipping violation was "a new theory of liability with new elements of proof" and "a complete invention of the Supreme Court with only a distant tie to Section 10(b) and Rule 10b-5"); Karen E. Woody, *The New Insider Trading*, 52 ARIZ. ST. L.J. 594, 608 (2020) (stating that the elements of the tipping violation "were created nearly out of whole cloth").

112. Second Draft of Opinion by Powell, J. (May 10, 1983) (Dirks File 204).

113. *Id.* at 21 (Dirks File 224).

114. *Id.* at 24 (Dirks File 227).

115. *Id.* at 14 (Dirks File 217).

In addition to editing the draft, Powell wrote an insert to revise and replace the material on the elements of a tipping violation. The second half of the paragraph addressing a tipper's breach of duty and purpose reads:

The critical question, therefore, is whether there was an intent or purpose to disclose material nonpublic information to one who could trade on the information to the detriment of shareholders. Ascertaining intention may be difficult, but this is a familiar question often confronted by courts. There are facts and circumstances that often justify inferences of wrongful purpose. For example, there may be a relationship exists [sic] the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the recipient. Also, such an inference may arise where the disclosure was made at the initiative of the insider rather than by the recipient titee [sic].<sup>116</sup>

The revision did not mention personal benefit or gain and removed references to the idea of a gift, but Powell expected his law clerk to work on the language. In an aside to Browning, Powell said "you will have to write it out more carefully."<sup>117</sup>

A fourth draft of the opinion for use within Powell's chambers came six days later, on May 20, 1983.<sup>118</sup> Language on both personal gain and gifts reappeared, and the structure and analysis crept closer to the final version. The predicate for a prohibition on tipping was that insiders whose fiduciary duty prevented use of undisclosed corporate information for personal advantage "may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain."<sup>119</sup> A "tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider breaches his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows of that breach."<sup>120</sup> The "elements of a Rule 10b-5 violation in a tipping case should be the same as in an inside-trading case."<sup>121</sup> The insider must exploit "confidential information received as a result of [a specific relationship to the shareholders] for his personal benefit."<sup>122</sup> "Whether disclosure of material nonpublic information is a breach of duty therefore depends in large part on the purpose of the disclosure."<sup>123</sup>

Unlike the revision Powell drafted on May 14, the fourth draft reverted to a new paragraph to describe situations indicating a breach of fiduciary duty. The new paragraph, which included one handwritten edit from Powell, began with language

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116. Memorandum from Powell, J. 1-2 (May 14, 1983) (Dirks File 59, 59-60) (underline in original).

117. *Id.* at 3 (Dirks File 61).

118. Fourth Draft of Opinion by Powell, J. (May 20, 1983) (Dirks File 231). The *Dirks* file of the Powell Papers does not have a third draft of the opinion.

119. *Id.* at 18 (Dirks File 248).

120. *Id.* at 19-20 (Dirks File 249-50).

121. *Id.* at 21 (Dirks File 251).

122. *Id.*

123. *Id.* at 22 (Dirks File 252).

from Powell's insert and then resurrected the gift example from Chazen, although without attribution:

There are facts and circumstances that often may justify an inference that the insider has breached his fiduciary duty. For example, there may be a relationship that exists between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information certainly exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.<sup>124</sup>

Powell then advanced from typed drafts to printed drafts within chambers and continued to make wording changes, but the approach to the tipping elements was stable.<sup>125</sup> An insider needed to breach a fiduciary duty when making a disclosure to an outsider, and the breach of duty depended in large part on an improper purpose. Two changes were: (i) a deletion of one of the references to the insider's personal benefit and (ii) the dilution of the tippee's culpability from a knowledge standard to the need to prove that a tippee knew or should have known of the insider's breach. A violation did not occur "unless the insider or provider of the information has breached his duty to the corporation's shareholders, and the tippee knows or should know that there has been a breach."<sup>126</sup> The paragraph on the fact situations did not change.

### C. Justice O'Connor's Suggestion

Justice Powell circulated a draft to the other Justices on May 26, 1983.<sup>127</sup> The Justices then sorted into a group joining with Powell and a group joining a dissent by Justice Blackmun.<sup>128</sup>

One important exception was Justice Sandra Day O'Connor, who expressed an inclination to join Powell's opinion if he made "some changes that I do not think will affect your basic approach."<sup>129</sup> O'Connor objected to the subjective purpose requirement because it was an inherently difficult determination to make even with the "rules of thumb, e.g., the one [Powell suggested] concerning relationship

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124. *Id.* at 23 (Dirks File 253).

125. See Chambers Draft 12–14 (May 22, 1983) (Dirks File 278, 289–93); Chambers Draft II 11–15 (May 25, 1983) (Dirks File 297, 308–13).

126. Chambers Draft II 13, 15 (May 25, 1983) (Dirks File 297, 309, 311).

127. First Court Draft (circulated May 26, 1983, stamped May 28, 1983) (Dirks File 334).

128. Letter from Brennan, J., to Blackmun, J. (June 27, 1983) (Dirks File 109); Letter from Burger, C.J., to Powell, J. (June 14, 1983) (Dirks File 76); Letter from White, J., to Powell, J. (June 2, 1983) (Dirks File 69); Letter from Stevens, J., to Powell, J. (June 1, 1983) (Dirks File 66); Letter from Marshall, J., to Powell, J. (June 1, 1983) (Dirks File 67); Letter from Rehnquist, J., to Powell, J. (June 1, 1983) (Dirks File 68); Letter from Blackmun, J., to Powell, J. (May 31, 1983) (Dirks File 65).

129. Letter from O'Connor, J., to Powell, J. 1 (June 7, 1983) (Dirks File 70).

between the parties, that are used to help determine subjective intent.”<sup>130</sup> She wrote “it might be better to focus on benefit, rather than purpose.”<sup>131</sup> She cited several legal authorities where the focus was:

more on whether the insider derives a direct or indirect benefit from his disclosure, and that benefit is primarily of a pecuniary nature. An emphasis on benefit differs from your approach only insofar as it establishes a more objective indicia of liability. If, as a factual matter, the insider did not benefit from his disclosure, then I am not inclined to be concerned with a further inquiry into his motivation.<sup>132</sup>

Powell replied to O’Connor: “I am grateful to you for suggestions that I think are quite constructive.”<sup>133</sup> His law clerk, Jim Browning, and a person from O’Connor’s chambers worked out changes to the opinion,<sup>134</sup> and O’Connor approved some changes before a new draft was circulated to the Justices.<sup>135</sup>

When Powell circulated the new draft on June 9, he sent a letter to Justices White, Rehnquist, and Stevens, who had already agreed to join the first draft, informing them that the substantive differences from the first draft “resulted from my conversations with” Justice O’Connor.<sup>136</sup> Powell told them that the changes were “constructive” and that “the reasoning of the opinion is not changed. [O’Connor] thought my reference to the ‘purpose’ of the insider was unnecessarily subjective. She prefers using the more objective term: ‘benefit’ to the insider, direct or indirect.”<sup>137</sup>

#### D. Final Drafts

The June 9 printed second draft in Justice Powell’s file included changes to respond to Justice O’Connor’s suggestion plus handwritten edits that Powell had added to the printed version. As edited, the approach continued to require a breach of the insider’s fiduciary duty and continued to depend on the purpose of the disclosure.<sup>138</sup> Powell then added a quotation from *Cady, Roberts* that referred to use of inside information for personal advantage and a sentence that read: “Thus, the test is . . . whether the insider personally expects to benefit, directly or indirectly, from his disclosure.”<sup>139</sup>

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130. *Id.* at 2 (Dirks File 71) (underline in original).

131. *Id.* at 3 (Dirks File 72) (underline in original).

132. *Id.*

133. Letter from Powell, J., to O’Connor, J. (June 9, 1983) (Dirks File 73).

134. *Id.*

135. See Second Court Draft (circulated June 9, 1983) (Dirks File 371). In Justice Powell’s handwriting, the draft had “6/9” next to “circulated” and “Sandra approved before I circulated” with an arrow pointing to some page numbers with changes. *Id.*

136. Letter from Powell, J., to White, J., Rehnquist, J., and Stevens, J. (June 9, 1983) (Dirks File 74).

137. *Id.* (citations omitted).

138. Second Court Draft 14–15 (circulated June 9, 1983) (Dirks File 371, 384–85).

139. *Id.* at 15 (Dirks File 385).

The next paragraph became the explanation of personal benefit that was in the final opinion. It had changes to implement O'Connor's suggestion in print plus many handwritten edits by Powell. As in the final opinion, the first part of the paragraph said the SEC should not be concerned with the possibility that defendants would fabricate a legitimate business justification for transmitting information because "the SEC and the courts are not required to read the parties' minds"<sup>140</sup>—a phrase originally in the Chazen article.<sup>141</sup> The second half of the paragraph, with Powell's edits, said:

But the initial inquiry is whether there has been a breach of duty by the insider. This requires courts to focus on whether the insider expects to receive a direct or indirect personal benefit from the disclosure, such as—for example—a pecuniary gain or a reputational benefit that [illegible] translate into future earnings. *Cady, Roberts*, id at 912, n 15. Cf. Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 Harv. L. Rev. 324, 348 (1979) ("The theory . . . is that the insider, by giving the information out selectively, is in effect selling the information to its recipient for cash, reciprocal information, or other things of value for himself. . ."). There are objective facts and circumstances that often justify such an inference. For example, there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.<sup>142</sup>

O'Connor sent a letter to Powell joining the opinion on June 10, 1983.<sup>143</sup> A further draft was circulated on June 27, 1983.<sup>144</sup> One change from the June 9 version was the addition of an instruction that courts should "focus on objective criteria" when considering the question of personal benefit.<sup>145</sup> O'Connor's June 7 letter had recommended personal benefit because "it establishes a more objective indicia of liability."<sup>146</sup> After circulation of another draft, the Court announced the opinion on July 1, 1983.<sup>147</sup>

#### IV. LESSONS FROM THE DRAFTING HISTORY

The drafting history solves several of the mysteries of *Dirks*. *Chiarella* was the springboard for the tipping violation and the need for a breach of duty, but

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140. *Id.* at 16 (Dirks File 386).

141. See Chazen, *supra* note 85, at 20, col. 2.

142. Second Court Draft 16 (circulated June 9, 1983) (Dirks File 371, 386).

143. Letter from O'Connor, J., to Powell, J. (June 10, 1983) (Dirks File 75).

144. Third Court Draft (circulated June 27, 1983) (Dirks File 389).

145. *Id.* at 16–17 (Dirks File 404–05).

146. Letter from O'Connor, J., to Powell, J. 3 (June 7, 1983) (Dirks File 70, 72).

147. Fourth Court Draft (circulated June 28, 1983) (Dirks File 431).

otherwise major aspects of the claim did not come from traditional legal authorities. The source of the prominence and details of the personal benefit element was the June 7, 1983 letter from Justice O'Connor, and the source of the fact situations and the structure of much of the analysis for the tipping violation was the Chazen article.

Three other lessons merit further discussion. One is that the personal benefit standard was to be rigorous and require cash or things of value. Second, the fact situations were intended to create a permissible inference of a personal benefit and were not meant to stand on equal footing with receipt of tangible value as independent methods of proving personal benefit. Finally, the drafting history demonstrates that the majority in *Martoma* erred in concluding that a relationship between the tipper and the tippee was not necessary for an intention to benefit to be considered as a personal benefit.

#### A. *Cash and Things of Value as Personal Benefit*

The drafting history shows that, with prodding from Justice O'Connor, Justice Powell settled on an exacting standard for the main element for proof of liability. The insider needed to receive a personal benefit or gain. For O'Connor, personal benefit was "primarily of a pecuniary nature," but possibly some other "objective indicia of liability."<sup>148</sup> Without benefit, O'Connor was not inclined to look further into motivation. The final opinion listed pecuniary gain, a reputational benefit that would translate into future earnings, "cash, reciprocal information, and things of value."<sup>149</sup> It quoted a law review article saying that an insider must in effect sell the information to the tippee<sup>150</sup> and instructed courts to "focus on objective criteria" because the Court did not want the SEC or the lower courts to be "required to read the parties' minds."<sup>151</sup>

Most items on the list had instant, functional worth to the insider. That was true of pecuniary gain, cash, and things of value.<sup>152</sup> The sale of confidential information for reciprocal information implied that the reciprocal information was a similar tip that would produce cash or something of usable value for the insider within the short period of time associated with a sales transaction.

One item in the list—"reputational benefit that will translate into future earnings"—does not fit well with its neighbors. It is less objective than other

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148. Letter from O'Connor, J., to Powell, J. 3 (June 7, 1983) (Dirks File 70, 72).

149. *Dirks v. SEC*, 463 U.S. 646, 663–64 (1983).

150. *Id.* (quoting Victor Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322, 348 (1979)).

151. *Id.* at 663.

152. Justice Powell stopped the quotation in the parenthetical from the Brudney article before the reference to "possibly prestige or status or the like" as other things of value. See Victor Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322, 348 (1979). Prestige and status would not have been objective criteria.



items.<sup>153</sup> Its functional value is less immediate, and it requires further events to occur to generate cash in the future.<sup>154</sup> Nothing in the drafting history or the citation to *Cady, Roberts* helps to explain the phrase. It appeared in the printed portion of the June 9 draft, which is the first draft to respond to Justice O'Connor's suggestion to use personal benefit and the first draft to reflect the collaboration of the two Justices' clerks. It should be read within its context and as consistently as possible with the characteristics of the main items of personal benefit in *Dirks*:<sup>155</sup> susceptible to proof with objective criteria and usable worth within a reasonable time. Justice Powell explicitly tied the reputational benefit to financial gain with the reference to future earnings. To qualify as a personal benefit, a reputational effect should be provable with evidence of objective facts and should produce functional value to the insider relatively quickly. The insider's reasonably prompt receipt of concrete value was "the test" for a breach of fiduciary duty. The idea was simple and easy to understand and apply.

Justices Powell and O'Connor's prescription for objective indicia of a valuable return to the insider fits with other goals Powell had for *Dirks*. Powell did not want the SEC to have a broad theory of liability to enforce. He was on a "campaign to rein in the SEC" and was uneasy "with the SEC's efforts to expand Rule 10b-5 through aggressive interpretation."<sup>156</sup>

The standard for personal gain fit with Powell's effort to set a "limiting principle" and to draw a bright line between fraudulent action by an insider and conduct that might be inappropriate but not fraudulent.<sup>157</sup> A tough standard of pecuniary gain or something close to it would draw the bright line. The Court was looking for a way to replicate the prohibition on the obvious badness of an insider who trades securities for his or her own personal account and makes secret profits from

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153. Guttentag, *supra* note 15, at 529 ("[T]he ways in which a reputational benefit might translate into future earnings are certainly not as easy to objectively ascertain as the pecuniary gain test originally proposed by Justice O'Connor.").

154. The phrase on reputational benefit does not fit well for another reason. An insider who betrayed his or her fiduciary duty and made an unauthorized disclosure of internal corporate information would create a reputation for bad acts rather than a desirable reputation, yet a payoff in the future from a bad reputation does not seem to be what the majority really had in mind when referring to a "reputational benefit." The entire concept of reputational benefit as a personal gain from misconduct is peculiar. It is also different from the fact situations that follow (gifts and quid pro quo relationships) and from a disclosure with the expectation or hope of receiving a reciprocal favor, introductions to well-connected people, or something of usable value from the tippee. Professor Donald Langevoort discusses reputational benefit in his treatise, but many of the examples are about a person who disclosed information with the expectation of receiving something valuable in return rather than a person who disclosed information to affect the perception of his or her skills or capabilities and then received remuneration for a new project because of that altered perception. LANGEVOORT, *supra* note 15, at § 4.7, 16–19.

155. The Supreme Court applies similar approaches under the *noscitur a sociis* and *eiusdem generis* canons of construction when interpreting a list of items in a statute. *See, e.g.,* *Yates v. United States*, 135 S. Ct. 1074, 1085–86 (2015); *United States v. Williams*, 553 U.S. 285, 294 (2008); *Washington State Dep't of Soc. & Health Servs. v. Guardianship Estate of Keffeler*, 537 U.S. 371, 384–85 (2003); *Gustafson v. Alloyd Co.*, 513 U.S. 561, 575 (1995).

156. Pritchard, *supra* note 23, at 923, 930.

157. *See Dirks v. SEC*, 463 U.S. 646, 661 n.21, 664 (1983).

confidential company information. That situation did not present many opportunities for mistaken law enforcement activity. The insider's stark misconduct is not often ambiguous or in a gray area of possible permissibility. The insider's trade for personal and secret profits, when done with knowledge of material non-public information and with scienter, easily and with little room for doubt falls into a category of unlawful activity condemned several years earlier in *Chiarella*. The Court in *Dirks* aimed for similar confidence that a tipper was engaged in fraud. For that reason, the standard for tipping liability was to resemble the blameworthy conduct of the insider who traded: secret profits, cash, something of real value, or something of tangible value in the near term.<sup>158</sup> The majority deliberately set the line there to preserve the beneficial flow of information in the securities markets and to give participants in the markets adequate notice of communications that were not permitted.

Courts have gone much too far in diluting the personal benefit standard. Under prevailing views, a benefit does not need to be "specific or tangible"<sup>159</sup> or "extensive."<sup>160</sup> These views are not consistent with the *Dirks* final opinion or its drafting history.

The objective personal benefit test that Powell added to secure O'Connor's vote was a significant amendment to the opinion because of the specificity of the element of the violation and its effect on the fact situations. Before O'Connor's intervention, the reasoning was that the insider's disclosure needed to breach a duty to shareholders, which depended on an improper purpose. The facts and circumstances needed to be examined for an improper purpose. The fact situations were facts and circumstances that could often justify an inference that the insider had an improper purpose and breached his fiduciary duty.<sup>161</sup> After O'Connor's letter, the reasoning started in the same way with the need for a breach of duty, which depended on the purpose of a disclosure, but an unlawful purpose no longer was to be determined from all the facts and circumstances. Now "the test" was whether the insider expected a personal benefit from a disclosure. The passages on facts and circumstances creating inferences and on the fact situations remained almost unchanged, but they had an entirely new function. Because of the insertion of the personal benefit test, the function of the fact situations was to create an inference that the insider expected to receive a personal benefit rather than an inference that the insider had an improper purpose.

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158. See *United States v. Martoma*, 894 F.3d 64, 84 (2d Cir. 2018) (Pooler, J., dissenting) (citing the "protections of the personal benefit rule" as "a clear guide for conduct, preventing liability for slip ups and other innocent disclosures").

159. *SEC v. Warde*, 151 F.3d 42, 48 (2d Cir. 1998).

160. *SEC v. Yun*, 327 F.3d 1263, 1280 (11th Cir. 2003).

161. First Court Draft 13–16 (circulated May 26, 1983, stamped May 28, 1983) (*Dirks* File 334, 346–49).

*B. Personal Benefit as an Inference from the Fact Situations*

The drafting history also conveys a greater appreciation of the sharp distinction between the fact situations and the standard for identifying misconduct by an insider. Proof of a fact situation, such as a gift to a relative or friend or a relationship indicating an intention to benefit, did not qualify as proof of the insider's misconduct. In early drafts of the opinion, the misconduct was tipping with an improper purpose. In later drafts, the misconduct was tipping in exchange for a personal benefit. Proof of a fact situation created a permissible but not obligatory inference that an insider engaged in the misconduct. Both Chazen and the drafts of the opinions described the fact situations as evidence creating an inference. Justice Powell was familiar with the meaning of an inference as part of the law of evidence, and he used the word carefully, as one of his early edits demonstrated. The final opinion was explicit that the fact situations only created an inference rather than ultimate proof of the insider's personal benefit, but most courts and commentators have not heeded the distinction.

As explained above, Chazen was the origin of the fact situations.<sup>162</sup> For Chazen, the standard for an insider's liability for a tip was improper purpose. He described the two classic tipping situations to show that an improper purpose existed when a disclosure was made to get a benefit in return from the recipient or to make a gift of information to the recipient. He admitted his standard was subjective, but courts could "infer purpose from the surrounding circumstances." Factors that would "tend to show" that the informant acted with an improper purpose included a relationship between the tipper and tippee suggesting that the tipper expected a quid pro quo from the recipient or that the tipper wished to benefit a relative or friend.<sup>163</sup> Chazen drew distinctions among evidence, presumptions, and liability. The phrase "tend to show" nearly certainly meant evidence. He also referred to other "evidence" that a disclosure was not made with a forbidden purpose and to the possibility of adopting presumptions of an improper purpose in certain situations.<sup>164</sup> In egregious cases, the evidence would establish liability.<sup>165</sup>

The draft opinions adopted the inference language Chazen had used to describe the ways to prove improper purpose from surrounding circumstances. The first chambers draft of the opinion used nearly the same words that Chazen had used to describe factors that would tend to show that the insider acted with an improper purpose, but the draft used "infer" or "inference" three times.<sup>166</sup>

All the drafts stuck with "inference." Justice Powell's revision of the fact situations in the second chambers draft had this introductory language: "The critical

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162. See *supra* Section III.A.

163. Chazen, *supra* note 85, at 20, col. 2.

164. *Id.* at 20, cols. 2–4.

165. *Id.* at 20, cols. 2–3.

166. First Draft of Opinion by Powell, J. 26–27 (Apr. 30, 1983) (Dirks File 172, 197–98).

question, therefore, is whether there was an intent or purpose to disclose material nonpublic information to one who could trade on the information to the detriment of shareholders. Ascertaining intention may be difficult, but this is a familiar question often confronted by courts. There are facts and circumstances that often justify inferences of wrongful purpose.”<sup>167</sup> Later, when implementing Justice O’Connor’s recommendation for the more objective personal benefit test, Powell added the word “objective” to the “facts and circumstances” sentence so it read: “There are objective facts and circumstances that often justify such an inference.”<sup>168</sup> That sentence remained in the final opinion.

Two sentences at the end of the personal benefit paragraph and after the inference language addressed the gift situation. A reader of the paragraph might ask whether the gift scenario was one of the fact situations subject to the inference possibility or was something different. *Salman*, other decisions, and SEC and criminal cases treated the gift sentences as an independent ground for proving benefit to an insider. This was possibly because the language of the gift sentences was stronger and more dispositive than the wording of the preceding sentence on fact situations creating an inference, such as a relationship that “suggests.”<sup>169</sup> The first gift sentence used language that could be read to imply that a gift of confidential information satisfied the personal benefit element: “The elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend.”<sup>170</sup>

The structure of the paragraph on personal benefit and the drafting history overcome this interpretation and show that the gift scenario was one of the fact situations that could create an inference of personal benefit. As a matter of structure, the two gift sentences followed the transition sentence referring to objective circumstances that often justify an inference of a personal benefit and completed that thought by concluding the personal benefit paragraph. The placement in the paragraph after the inference sentence makes the gift sentences difficult to construe as a return to the elaboration of independent proof of personal benefit, especially because the insider receives nothing when making a gift to another.

The drafting history confirms this reading. Nearly all of the language in the gift sentences came directly from Chazen. He described the gift idea as one of his two classic tipping situations: “The twin elements—breach of fiduciary duty and exploitation of information—are also present, though not quite so obviously, when an insider makes a gift of confidential information to a relative or friend. . . .”<sup>171</sup> Later in the article, Chazen used the two tipping situations as the basis for a test for tipping liability and treated a disclosure to benefit a recipient—that is, a gift to a

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167. Memorandum from Powell, J. 1–2 (May 14, 1983) (Dirks File 59, 59–60).

168. Second Court Draft 15 (circulated June 9, 1983) (Dirks File 371, 385).

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

170. *Id.*

171. Chazen, *supra* note 85, at 18, col. 4.

relative or friend—as a factor that could support an inference that the insider acted with an improper purpose.<sup>172</sup> Justice Powell and his clerk initially followed Chazen’s analysis, language, and test and quoted the classic tipping situations, including the gift sentences, in a footnote. They then eliminated the footnote and gift language in the second chambers draft. In the fourth chambers draft, the two gift sentences from Chazen reappeared, but they now were in the text of a separate paragraph with a topic sentence referring to facts and circumstances allowing an inference of a breach of fiduciary duty, which is how Chazen used the gift concept in his test.<sup>173</sup> The gift situation continued to follow the inference sentence through the final opinion. For these reasons, the gift concept should be viewed as a fact situation that could create an inference of a personal benefit.

The word “inference” was loaded with technical legal meaning for Powell. He was careful about the difference between a presumption and an inference and the effect on the burden of production or persuasion. He was attuned to the different meanings and uses of the words “inference” and “presumption” and of variations on the word “presumption” such as true presumption, permissive presumption, and mandatory presumption. Between the time he joined the Court in 1972 and the time of the *Dirks* opinion in 1983, Powell wrote at least six opinions discussing inferences, presumptions, the burden of production, and the burden of persuasion.<sup>174</sup> Most were criminal cases, but one was civil.

Several of the decisions give an idea of the depth of Powell’s understanding of this area. Early in his time on the Court, Powell wrote a majority opinion in a criminal case examining whether a jury instruction about an inference on an important element of the crime violated due process. The jury had been instructed it would ordinarily be justified in inferring from unexplained possession of recently stolen mail that the defendant knew the mail was stolen.<sup>175</sup> Powell found no due process violation and, during the course of the opinion, reviewed four recent Supreme Court decisions that had considered “criminal law presumptions and inferences.”<sup>176</sup> He also discussed the effect of the inference on the burdens of production and persuasion:

[T]he practical effect of instructing the jury on the inference arising from unexplained possession of recently stolen property is to shift the burden of

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172. *Id.* at 20, col. 2.

173. See *supra* notes 103–24 and accompanying text.

174. See *Connecticut v. Johnson*, 460 U.S. 73, 90, 96–97 (1983) (Powell, J., dissenting) (concerning whether a presumption of intent in a criminal case was harmless error and discussing the way a presumption functions); *Tex. Dep’t of Cmty. Affs. v. Burdine*, 450 U.S. 248, 252–56 (1981) (discussing inferences, rebuttable presumptions, prima facie cases, burdens of production, and burdens of persuasion in employment discrimination cases); *Cty. Court of Ulster Cty. v. Allen*, 442 U.S. 140, 168–77 (1979) (Powell, J., dissenting) (discussing allocation of burdens of proof and use of presumptions and inferences in criminal cases); *Patterson v. New York*, 432 U.S. 197, 226–32 (1977) (Powell, J., dissenting) (same); *Mullaney v. Wilbur*, 421 U.S. 684, 699–702 & n.31 (1975) (same); *Barnes v. United States*, 412 U.S. 837, 841–46 (1973) (same).

175. *Barnes*, 412 U.S. at 838.

176. *Id.* at 841.

going forward with evidence to the defendant. If the Government proves possession and nothing more, this evidence remains unexplained unless the defendant introduces evidence, since ordinarily the Government's evidence will not provide an explanation of his possession consistent with innocence.<sup>177</sup>

Even if the defendant introduced some evidence to support innocent possession, the court could still instruct the jury on the inference. The jury would need to weigh the evidence and the inference. "The jury is not bound to accept or believe any particular explanation any more than it is bound to accept the correctness of the inference."<sup>178</sup>

Powell wrote the landmark *Mullaney v. Wilbur*<sup>179</sup> two years later. It held that the Due Process Clause did not permit a state to require a defendant in a criminal case to establish facts by a preponderance of the evidence that would reduce a conviction from murder to manslaughter.<sup>180</sup> The prosecution needed to prove the absence of those facts beyond a reasonable doubt. Again, Powell demonstrated an appreciation of the legal effects of presumptions and inferences:

Generally in a criminal case the prosecution bears both the production burden and the persuasion burden. In some instances, however, it is aided by a presumption or a permissible inference. These procedural devices require (in the case of a presumption) or permit (in the case of an inference) the trier of fact to conclude that the prosecution has met its burden of proof with respect to the presumed or inferred fact by having satisfactorily established other facts. Thus, in effect they require the defendant to present some evidence contesting the otherwise presumed or inferred fact. . . .

In each of these cases, however, the ultimate burden of persuasion by proof beyond a reasonable doubt remained on the prosecution. Shifting the burden of persuasion to the defendant obviously places an even greater strain upon him since he no longer need only present some evidence with respect to the fact at issue; he must affirmatively establish that fact. Accordingly, the Due Process Clause demands more exacting standards before the State may require a defendant to bear this ultimate burden of persuasion.<sup>181</sup>

A final opinion worth mentioning is Justice Powell's dissent in *County Court of Ulster County v. Allen*.<sup>182</sup> The question was whether a New York statute providing that the presence of a firearm in an automobile was presumptive evidence of its illegal possession by all the persons occupying the vehicle violated the Due

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177. *Id.* at 846 n.11.

178. *Id.* at 845 n.9.

179. *Mullaney v. Wilbur*, 421 U.S. at 684.

180. *Id.* at 703-04.

181. *Id.* at 702-03 n.31 (citations omitted).

182. *See* *Cty. Court of Ulster Cty. v. Allen*, 442 U.S. 140, 168-77 (1979) (Powell, J., dissenting).

Process Clause.<sup>183</sup> Powell concluded that the presumption did not meet the constitutional requirements of due process, one of which was that both an inference and a presumption needed to reflect some valid general observation about the natural connection between events as they occur in society.<sup>184</sup> He again included an extended discussion of presumptions and inferences in a criminal case,<sup>185</sup> noted the difference between true presumptions and permissible inferences, and said the distinction between mandatory and permissive presumptions had not been important in the Supreme Court's criminal cases.<sup>186</sup>

For the last two points, Powell cited a section from a leading civil procedure treatise of the time written by Fleming James.<sup>187</sup> That section gave more details about inferences, presumptions, and evidentiary burdens. The use of a civil procedure treatise indicated that, except for the special due process rules the Court found necessary to fashion for criminal cases, inferences and presumptions operated similarly in civil and criminal cases. According to James, an inference and a presumption both involved a relationship between a proven or admitted fact A and another fact or conclusion B, which needed to be proven.<sup>188</sup> According to James, an inference and a presumption had different legal consequences. The process of proof in trials constantly involved inferences, which were logical deductions as a matter of general lay reasoning and experience without the aid of any special procedural rules of litigation. Proof of proper mailing of a letter allowed a fact finder to infer that the addressee received it. Proof of long skid marks on pavement allowed a fact finder to infer that the vehicle was travelling at high speed.<sup>189</sup> If a proponent introduced evidence of A and the opponent did not introduce any evidence to negate A or its inference B, the proponent was allowed to have the existence of B go to the fact finder. The fact finder was permitted to conclude B from A but was not required to conclude B.<sup>190</sup> The fact finder was allowed to reach other conclusions.

A presumption was stronger than an inference and was more than the logical outgrowth of evidence of A. It was a device to allocate the burden of production of evidence. When B was presumed from A, the proponent introduced evidence of A, and the opponent did not introduce any evidence to counter A or B, the proponent was entitled to a directed verdict on B. B was established. If the proponent introduced evidence of A and the opponent wanted to counter B, the opponent had the burden to produce evidence to rebut either A or B.<sup>191</sup>

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183. *See id.* at 142–43 (main opinion).

184. *Id.* at 168, 170 (Powell, J., dissenting).

185. *Id.* at 168–71.

186. *Id.* at 168 n.1, 170 n.3.

187. *Id.* at 170 n.3 (citing FLEMING JAMES, JR., CIVIL PROCEDURE § 7.9 (1965)).

188. FLEMING JAMES, JR., CIVIL PROCEDURE § 7.9, at 259–60 (1965).

189. *Id.*

190. *Id.* at 260–61.

191. *Id.* The edition of Charles Alan Wright's treatise in use in 1983 set forth similar rules. An inference lacked legal compulsion. "The judge or jury may infer fact B from the proof of fact A, but they are perfectly free not to draw the inference." 21 CHARLES ALAN WRIGHT & KENNETH W. GRAHAM, JR., FEDERAL PRACTICE AND

Powell's opinions and the James treatise were consistent. Powell observed that a jury was not bound to accept the correctness of an inference.<sup>192</sup> An inference was only permissive, but a presumption was mandatory.<sup>193</sup> As a result, a presumption necessarily shifted the burden of producing contrary evidence. An inference did not have the legal effect of shifting the burden of production, but it had that practical effect.<sup>194</sup> Neither an inference nor a presumption shifted the ultimate burden of persuasion.<sup>195</sup>

The difference between an inference and a presumption, therefore, was significant to Powell, and he kept the two distinct in *Dirks*. When his law clerk used the word "presumption" in the paragraph describing a tipper's inappropriate conduct in the first draft of the *Dirks* opinion, Powell deliberately changed it to "inference" and made it consistent with nearby statements that already had the word "infer." In the first draft, the paragraph with the fact situations had a sentence with one of the factors that would help show that an insider acted with an improper purpose. On the draft, Powell made the following handwritten edit to the sentence: A disclosure "made at the initiative of the informant rather than in response to questioning by the recipient may ~~raise a presumption~~ create an inference that the insider seeks to exploit information available to him."<sup>196</sup>

Powell wanted proof of the fact situations to create an *inference* and not a *presumption* or ultimate liability. That was true in the early drafts of *Dirks*, when the standard of liability was a disclosure with an improper purpose, and in the final opinion, when a tipper was liable for a disclosure exchanged for a personal benefit. In the final opinion, evidence that the insider received cash or something of value was proof of personal benefit, the critical element of liability.<sup>197</sup> Evidence of the fact situations was an aid in establishing liability but not sufficient proof by itself. If the SEC or a prosecutor introduced evidence of a quid pro quo relationship, a relationship suggesting a disclosure was intended to benefit the tippee, or a disclosure to a friend or relative as a gift, the government qualified for an inference of the insider's gain. The defendant could rebut that inference with evidence that no relationship existed, the tippee was not a friend or relative, no quid pro quo arrangement existed, or the insider obtained no concrete gain from making a disclosure. A fact finder could draw its own conclusion on personal benefit within normal evidentiary boundaries, but it was not compelled to conclude that the insider breached his or her fiduciary duty. The burden of persuasion (preponderance of the evidence

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PROCEDURE § 5124, at 587 (1977). Presumptions were more complicated and had effects on the burden of production and a motion for a directed verdict. *Id.* § 5126.

192. *Barnes v. United States*, 412 U.S. 837, 845 n.9 (1973).

193. *Mullaney v. Wilbur*, 421 U.S. 684, 702-03 n.31 (1975).

194. *Id.*; *Barnes*, 412 U.S. at 846 n.11.

195. *Mullaney*, 421 U.S. at 702-03 n.31.

196. First Draft of Opinion by Powell, J. 27 (Apr. 30, 1983) (*Dirks* File 172, 198).

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



for the SEC and evidence of guilt beyond a reasonable doubt for criminal prosecutors) remained on the government.

Justice Powell not only used the weak concept of an inference; he also did not say the inference always existed. It existed “often” but not always.<sup>198</sup> Often is frequent and on many or numerous occasions, but it is not 100 percent of the time. The inference did not invariably apply, although Powell did not give any further guidance. The use of the word “often” was part of the message that a fact situation did not stand as proof that an insider received a personal benefit.

The shift in the key paragraph of *Dirks* from evidence that proved receipt of a personal benefit to situations that often created an inference of a personal benefit has not received proper attention. The Supreme Court, appellate courts, and leading commentators have viewed the fact situations as independent and sufficient grounds for proving that an insider breached a fiduciary duty by receiving a personal benefit. The differences between proof of the ultimate standard of liability as opposed to proof of predicate facts that “often” allow an “inference” have not been part of the analysis for most authorities. They quote the inference sentence from *Dirks* or use the word “inference,” but few follow its full evidentiary meaning.

The Supreme Court decision in *Salman*, discussed above, is Exhibit A.<sup>199</sup> The Court characterized the disclosure of confidential information from the insider to his brother as a gift and did not treat the gift facts as the basis of an inference of personal gain. It found that the insider benefited by giving a gift to his brother but cited no evidence that the insider received anything.<sup>200</sup> The unanimous Court parroted *Dirks* (and Chazen) by saying that a gift of inside information to a relative “is little different from trading on the information, obtaining the profits, and doling them out to the trading relative.”<sup>201</sup> *Dirks* had possibly offered that reasoning from Chazen to explain the basis for an inference, but *Salman* followed the statement with the baffling assertion that the “tipper benefits either way.”<sup>202</sup>

The assertion is baffling for two reasons. First, the Court recited evidence that the insider did not want to tip his brother and did not want the brother to trade on the confidential information. On one occasion, the insider offered his brother money, but the brother asked for information instead.<sup>203</sup> This evidence is contrary to the fiction that the insider’s disclosure was a substitute for cash from the insider’s own trade. If the Court had followed the inference procedure, the evidence might have defeated the personal benefit element altogether.

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198. *Id.*

199. *Salman v. United States*, 137 S. Ct. 420 (2016); see *supra* notes 56–63 and accompanying text. Similarly, in a footnote in *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299 (1985), that was not essential to the holding, the Court summarized the personal benefit element by saying it can derive from pecuniary gain, reputational benefit, or a gift to a relative or friend. *Id.* at 311 n.21.

200. *Salman*, 137 S. Ct. at 427–28.

201. *Id.* at 428.

202. *Id.*

203. *Id.* at 424.

Second, the assertion is baffling because a tipper does not obtain any profits when the tipper does not in fact trade and instead gratuitously discloses information. An insider receives nothing of tangible value when he or she discloses confidential information as a gift to a relative or friend. Giving a gift usually involves no expectation that the donor will get something back. The Court's assertion that the tipper benefits either way is difficult to understand. At best, the gift example must assume a relationship in which the insider feels a moral obligation to make a financial contribution to support the relative or friend and, to reduce or avoid that moral obligation, transmits material, non-public information that the relative or friend uses to trade securities to make money. That closeness and sense of obligation probably exists between an individual and certain of his or her family or friends, but it certainly does not exist with all family and friends. The chance that a financial obligation exists with family and friends might be sufficient to justify an inference of the insider's personal gain, but a fact finder would be more likely to reach that conclusion with proof that the disclosure likely reduced a financial obligation the insider otherwise would have had. Conversely, a defendant could rebut the inference with evidence that the insider had no moral or other obligation to make a financial contribution to the support of the relative or friend.

*Martoma* is Exhibit B.<sup>204</sup> A panel of the Second Circuit adopted a rule that a "tipper's intention to benefit the tippee proves a breach of fiduciary duty because it demonstrates that the tipper improperly used inside information for personal ends and thus lacked a legitimate corporate purpose."<sup>205</sup> A personal benefit "may be indirect and intangible and need not be pecuniary at all."<sup>206</sup> A tipper's intention to benefit the tippee was "a standalone personal benefit under *Dirks*."<sup>207</sup> The *Martoma* majority frequently used the word "infer," but nothing turned on it.<sup>208</sup> *Martoma* is discussed again below to show how the *Dirks* drafting history resolves a dispute between the majority and dissent in *Martoma*.<sup>209</sup>

The First Circuit and an often-cited securities law treatise also treat the pecuniary gain standard and the fact situations as independent methods of proving personal benefit. The First Circuit said "the mere giving of a gift to a relative or friend is a sufficient personal benefit,"<sup>210</sup> and the Loss treatise listed gift-giving as one of

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204. United States v. *Martoma*, 894 F.3d 64 (2d Cir. 2018), *amending and replacing* 869 F.3d 58 (2d Cir. 2017).

205. *Id.* at 75.

206. *Id.*

207. *Id.* at 74.

208. The *Martoma* dissent wrestled with evidentiary issues from the *Dirks* personal benefit test, the fact situations, and the majority's conclusion that proof of a tipper's intention to benefit a tippee satisfied the personal benefit test. The dissent was concerned about inferences from inferences but did not fully absorb that, according to *Dirks*, proof of a fact situation would allow an inference that the tipper received a personal benefit. *Id.* at 85 (Pooler, J., dissenting).

209. See *infra* Section IV.C.

210. SEC v. *Rocklage*, 470 F.3d 1, 7 n.4 (1st Cir. 2006).

three types of personal benefit.<sup>211</sup> Commentators generally have not ascribed significance to the inference sentence in *Dirks* and have typically favored a broad personal benefit test that outlaws many insider disclosures.<sup>212</sup>

A few readers of *Dirks* have been more discerning. Justice O'Connor was one. She read the fact situations in the *Dirks* draft as only "rules of thumb."<sup>213</sup> In addition, a district judge understood the relevant *Dirks* passages along the lines that Powell intended them. The judge quoted the *Dirks* inference sentence and the first of the gift sentences and then said:

[W]hen [the insider] disclosed insider information to his father-in-law, . . . it may be inferred that [the insider] received some personal benefit from the gift of information. Likewise, the burden of proof shifts from the SEC to [the tippee], and [the tippee] must prove that [the insider] derived no benefit from the disclosure in order to negate the inference that [the insider] benefitted from the transaction.<sup>214</sup>

The personal benefit paragraph in *Dirks* sought to convey that proof of the fact situations would not prove an insider's receipt of a personal benefit, and the drafting history reinforced the language in the opinion. Powell's familiarity with the legal consequences of inferences and presumptions meant that characterizing the fact situations as a basis for an inference was deliberate, not casual. At most, the government's evidence of a gift to a relative or friend or a relationship suggesting a quid pro quo or intention to benefit left the fact finder free to conclude or not to conclude that the insider made a confidential disclosure in return for usable value. As a practical matter, evidence from the government of a fact situation transferred the burden of producing rebuttal evidence to the defendant.

### C. *The Martoma Dispute About an Intention To Benefit*

The drafting history also shed light on a disputed issue in the Second Circuit's 2018 *Martoma* decision. The issue concerned the proper way to read some of the fact situations in *Dirks*, specifically the sentence that "there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter,

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211. LOSS ET AL., *supra* note 15, at 1514.

212. See, e.g., LANGEVOORT, *supra* note 81, at 13–21; Nagy, *supra* note 15, at 47 (arguing that the gift theory in *Dirks* did not require the tipper to receive a tangible benefit and that the *Dirks* Court was explicit that if a disclosure's purpose was to "enable the recipient to benefit," then it was improper and a breach of duty); Jonathan R. Macey, *The Genius of the Personal Benefit Test*, 69 STAN. L. REV. ONLINE 64, 67, 71 (2016) (treating a gift to a family member as a personal benefit but arguing that the requirement for a personal benefit to the insider is a reasonable position); Jill E. Fisch, *Family Ties: Salman and the Scope of Insider Trading Liability*, 69 STAN. L. REV. ONLINE 46, 53–54 (2016).

213. Letter from O'Connor, J., to Powell, J. 2 (Jun. 7, 1983) (*Dirks* File 70, 71).

214. SEC v. Sekhri, No. 98 Civ. 2320 (RPP), 2002 WL 31654969, at \*2 (S.D.N.Y. Nov. 22, 2002); see also STEPHEN M. BAINBRIDGE, INSIDER TRADING LAW AND POLICY 63–64 (2014) (quoting an October 2011 Thomson Reuters blog on SEC v. Sekhri).

or an intention to benefit the particular recipient.”<sup>215</sup> The *Martoma* majority said that a tipper and tippee did not need to have a relationship for the government to rely on the intention-to-benefit prong.<sup>216</sup> An intention to benefit any person, even a stranger, would violate an insider’s fiduciary duty and satisfy the personal benefit element. The majority opinion described the textual disagreement with the dissent:

As we understand the dissent, our core disagreement is over whether intent to benefit is a standalone personal benefit under *Dirks*. The dissent argues that it is not, claiming instead that the correct formulation is a “relationship . . . that suggests . . . an intention to benefit” the tippee. The key sentence of *Dirks* is admittedly ambiguous. . . . But that is not the only reading. The comma separating the “intention to benefit” and “relationship . . . suggesting a *quid pro quo*” phrases can be read to sever any connection between them. The sentence, so understood, effectively reads, “there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or there may be an intention to benefit the particular recipient.”<sup>217</sup>

The *Martoma* majority read the need to prove the tipper’s receipt of a personal benefit out of the law. The intention-to-benefit factor was an independent and “standalone” way to prove that a tipper violated a fiduciary duty with a disclosure. A tipper did not need to receive any actual personal benefit, and the nature of the relationship between the tipper and tippee was not relevant. The government could “prove a personal benefit with objective evidence of the tipper’s intent, without requiring in every case some additional evidence of the tipper-tippee relationship.”<sup>218</sup> A tip “to a perfect stranger” could meet the intention-to-benefit factor in *Dirks*.<sup>219</sup> The *Martoma* majority did not treat proof of an intention to benefit as the basis for an inference of personal benefit. *Martoma*’s analysis of the intention-to-benefit language was essential to its review of the jury instructions. The instructions were not accurate but did not affect *Martoma*’s substantial rights because the insider had received consulting fees in exchange for confidential information.<sup>220</sup>

The *Dirks* drafting history lays the dispute between the *Martoma* majority and dissent to rest and confirms the dissent’s understanding. The origin of the relevant sentence was Chazen. He referred to factors that would be evidence that the insider had an improper purpose. One was “a relationship between the informant and the recipient which suggests that the informant expected a *quid pro quo* from the recipient (e.g., the recipient is a customer of the informant) or that the informant wished to benefit the recipient (e.g., they are relatives or friends).”<sup>221</sup>

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

216. *United States v. Martoma*, 894 F.3d 64, 74–76 (2d Cir. 2018).

217. *Id.* at 74 (citations omitted).

218. *Id.* at 75.

219. *Id.*

220. *Id.* at 78–79.

221. Chazen, *supra* note 85, at 20, col. 2.

The first chambers draft of the *Dirks* opinion took the Chazen passage with little change. The first draft said: “[I]t is reasonable to infer improper purpose when there is a relationship between the informant and the recipient that suggests that the informant expected a quid pro quo from the recipient, such as when the recipient is a customer, or that the informant wished to benefit the recipient, such as when they are relatives or friends.”<sup>222</sup>

Both Chazen and the first draft of the opinion used the phrase “relationship between the informant and the recipient that suggests” and then modified it with two restrictive clauses beginning with “that.” In one clause, the tipper expected something back from the tippee; in the other, the tipper wanted to confer a benefit. The relationship suggested each.

That language continued in the second chambers draft, but Justice Powell edited and shortened the sentence in handwriting on May 14–15, 1983. The edited version continued to have the relationship suggesting two scenarios: “First, it may be reasonable to infer improper purpose when there is a relationship between the informant and the recipient that suggests an expectation of a quid pro quo from the recipient or an intention to benefit a relative or friend.”<sup>223</sup>

Also on May 14, Powell wrote a revision to supersede his handwritten edits on this part of the second draft. The revision further shortened the language of the fact situations. Powell wrote: “There are facts and circumstances that often justify inferences of wrongful purpose. For example, there may be a relationship exists [sic] the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the recipient.”<sup>224</sup> Both of those sentences, with only a few changes, survived to the final opinion. The revision appeared to be an effort to trim words and did not signal a change in meaning from the Chazen sentence as adopted in the first and second draft of the opinion or from Powell’s handwritten edit to the same sentence at effectively the same time. If that is correct, the *Martoma* majority’s interpretation was not consistent with *Dirks*. A tipper and a tippee need to have a relationship suggesting that the tipper intended a disclosure to benefit the tippee. A tip to a stranger would not qualify.

## V. THE RELEVANCE OF DRAFTING HISTORY

Recourse to the drafts of the *Dirks* opinion and the other papers in Justice Powell’s *Dirks* file prompts questions about their relevance and usefulness today. Are the papers only of academic and historical interest, or should a judge, justice, or law enforcement authority take the papers into account when construing and applying the tipping violation from *Dirks* in current litigation? This final Part of the Article makes a few observations on that topic and concludes with several

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222. First Draft of Opinion by Powell, J. 26–27 (Apr. 30, 1983) (Dirks File 172, 197–98).

223. Second Draft of Opinion by Powell, J. 22 (May 10, 1983) (Dirks File 204, 225).

224. Memorandum from Powell, J. 2 (May 14, 1983) (Dirks File 59, 60).

reasons why any concerns about using drafting history do not fully apply to the personal benefit element of *Dirks*.

As an initial matter, some might argue that an inquiry into the relevance of the drafting history of *Dirks* is not necessary because the weight of current authority, with its expanded and stretched construction of the personal benefit element, should prevail over the original meaning of the element in *Dirks*. If the trend in modern courts is a departure from the text of *Dirks*, it is too late to go back. The interpretations by the majority of recent courts should be treated as settled law.

That does not seem to be the best answer. Adherence to more recent precedent should not supersede the obligation of the Supreme Court and the lower federal courts to adhere to the originating and superior precedent of *Dirks*. A central pillar of the U.S. legal system is respect for precedent and stare decisis. “Adherence to precedent is a foundation stone of the rule of law. It promotes the evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process. . . . [A]ny departure from the doctrine demands special justification. . . .”<sup>225</sup> Indeed, the *Salman* Court purported to follow precedent: “We adhere to *Dirks* . . . .”<sup>226</sup>

Precedent and stare decisis cannot do their jobs without confidence about the meaning of the text of a past opinion.<sup>227</sup> Obtaining the best, most accurate understanding of an applicable judicial decision is an indispensable first step toward giving the decision its appropriate precedential value.<sup>228</sup>

The connection between a full and accurate interpretation of a judicial opinion and the significant role of precedent in the U.S. legal tradition are powerful arguments in favor of using drafting history and internal judicial records of the Supreme Court as interpretive aids for the meaning of published opinions. Internal judicial records might illuminate what the opinion meant and might help establish the scope of the precedential effect of the opinion.

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225. *Kisor v. Wilkie*, 139 S. Ct. 2400, 2422 (2019) (majority opinion by Kagan, J.) (internal quotation marks, brackets, and citations omitted); see also Larry Alexander, *Constrained by Precedent*, 63 S. CAL. L. REV. 1, 3 (1989) (“The notion that courts ordinarily should follow precedent in deciding cases is one of the core structural features of adjudication in common-law legal systems.”).

226. *Salman v. United States*, 137 S. Ct. 420, 427 (2016).

227. *Seminole Tribe v. Florida*, 517 U.S. 44, 67 (1996) (“When an opinion issues for the Court, it is not only the result but also those portions of the opinion necessary to that result by which we are bound.”).

228. See Adrian Vermeule, *Judicial History*, 108 YALE L.J. 1311, 1319 (1999); Alexander, *supra* note 225, at 20–25; Frederick Schauer, *Precedent*, 39 STAN. L. REV. 571, 580–81, 594–95 (1987) (arguing that understanding the words of a principle of law and the factors, rationale, and reasons in an earlier decision is essential to ascertaining the circumstances in which and the degree to which the decision determines the outcome of a future case). Several opinions in *Ramos v. Louisiana*, 140 S. Ct. 1390 (2020), discussed stare decisis. A part of Justice Gorsuch’s opinion joined by two other Justices referred to “an old truth”: “It is usually a judicial decision’s reasoning . . . that allows it to have life and effect in the disposition of future cases.” *Id.* at 1404. In a different decision, the dissent of Justice Thomas said that understanding the reasoning underlying a judicial holding “provides pivotal insight into how the law will likely be applied in future judicial opinions.” *Georgia v. Public Resource.Org, Inc.*, 140 S. Ct. 1498, 1520 (2020) (Thomas, J., dissenting).

Context, circumstances, and weight are important. An internal record about a passage in a final opinion that is reasonably clear and precise is less important than a record discussing part of a judicial opinion that is vague, ambiguous, or imprecise. A draft of a section of an opinion that over time has taken on a settled construction notwithstanding some earlier confusion or that no longer is implicated in current litigation is less important than a draft of a particular part of an opinion that helps resolve a question presented in a pending case. Because a Justice's papers do not ordinarily become available to the public until years or even decades after an opinion comes out,<sup>229</sup> their contents can diminish in currency. Another circumstance to consider is the extent to which an internal judicial record influenced other members of the Court. A Justice's notes to him- or herself likely deserve less weight than a message to other members of a majority with an explanation of language that remains in a final opinion.

Many other factors could affect the weight or pertinence of an internal judicial record about a published opinion, and indeed the whole question of the use of drafting history is a controversial topic. Reasonable arguments exist both for and against using judicial records to interpret the meaning of published opinions,<sup>230</sup> although any discussion needs to take into account that the Supreme Court relied on a draft opinion at least once.<sup>231</sup>

This Article is not the place to address that debate any further. This Article is about the personal benefit element in *Dirks*. Nonetheless, even for a person not inclined to approve of the use of internal judicial materials, two things are different about the drafting history described here. First, the key lessons from the *Dirks* drafting history may be derived from words in the final opinion, even though that admittedly takes some work and has been overlooked by most courts. The drafting history and other material illuminate and clarify the points, but they lurk in the language of the final opinion and other published opinions and are not completely extrinsic.

Second, the *Dirks* drafting history sheds light on the meaning of authoritative legal text. Usually, a judicial opinion is an interpretation of an authoritative legal text such as the Constitution, a statute, or a regulation. Drafting history, therefore,

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229. See Kathryn A. Watts, *Judges and Their Papers*, 88 N.Y.U. L. REV. 1665, 1709–10 (2013); Stephen Wermiel, *SCOTUS for Law Students: Supreme Court Mysteries and the Justices' Papers (Corrected)*, SCOTUSBLOG (Jul. 2, 2018, 1:19 PM), <https://www.scotusblog.com/2018/07/scotus-for-law-students-supreme-court-mysteries-and-the-justices-papers/>.

230. See Vermeule, *supra* note 228, at 1319.

231. See *id.* at 1314 n.11. In *Muskrat v. United States*, 219 U.S. 346, 354–55 (1911), the majority approved the reasoning of and quoted from a draft opinion for an 1864 case. The final action of the Court in the 1864 case was a short statement dismissing for want of jurisdiction, *Gordon v. United States*, 69 U.S. (2 Wall.) 561 (1864), but the reporter of the Court published the draft opinion many years later, in 1885 or 1886, with a note saying that the members of the Court for the 1864 case had carefully considered the draft opinion and that the surviving members of that Court assented to its printing. The reporter printed it because, “[i]rrespective of its intrinsic value, it has an interest for the court and the bar, as being the last judicial paper from the pen of” Chief Justice Roger Taney. See *Gordon v. United States*, 117 U.S. 697, 697 (1885).

relates to the interpretation rather than the ultimate legal source when an understanding of the ultimate legal source is the true job at hand. *Dirks* is different because the opinion, rather than section 10(b) or Rule 10b-5, was the original source for the tipping claim, its elements, and the terms of the personal benefit element. The words of *Dirks* on those issues are the dispositive legal standard and stand in a position similar to the provisions of a statute or regulation.

Understanding *Dirks* is a prerequisite to understanding the law on tipping. The drafting history provides insight and guidance about the final opinion and adds value as courts continue to interpret and apply the personal benefit element.

#### CONCLUSION

Courts, the SEC, and criminal prosecutors have misunderstood the personal benefit element of the tipping violation recognized in *Dirks*. They have consistently broadened the test to create liability when insiders received something slight, speculative, or intangible after a disclosure of confidential information. They have also used three fact situations outlined in *Dirks* as independent grounds for a finding of personal benefit even though the situations did not involve a return of anything to the insider.

The drafting history of the majority opinion in *Dirks* does not support these interpretations. As envisioned by Justice Powell, the author of *Dirks*, and bolstered by an internal letter to Powell from Justice O'Connor, the personal benefit element was to be a method of narrowing liability. The principal test of personal benefit was to be the insider's receipt of cash or something of value.

The special fact situations mentioned in *Dirks*, including a disclosure as a gift or with an intention to benefit, were not independent and sufficient grounds for finding that an insider received a personal benefit. Instead, they were situations that often could create an inference of personal benefit. Powell carefully used the word "inference." He had written several opinions discussing the differences between inferences and types of presumptions, and he specifically wanted the fact situations to create an inference and not a presumption or ultimate liability. The government's proof of a fact situation, if not rebutted by evidence from the defendant, would permit a fact finder to infer a personal benefit but would not require the fact finder to reach that conclusion.

The drafting history and Powell's earlier opinions on inferences and presumptions explain explicit language in *Dirks* and, therefore, have continuing relevance. Courts and law enforcement agencies should take the lessons of the drafting history into account when construing the personal benefit element in tipping cases. It is not too late.