

Tippee Liability If the Tipper Is Not Guilty? The Fluid Boundaries of Insider Trading

September 28, 2023

Though “insider trading” has long been recognized as an illegal and abusive way to cheat in the securities trading game, new potential forms of this activity have recently emerged. For example, we recently reported on an SEC action against an executive who used nonpublic information about his company’s impending merger to trade options on a competitor company’s shares. See [“SEC Cultivates Shadow Trading Theory: Emerging Species of 10b-5 Violation?”](#) *Expect Focus – Life, Annuity, and Retirement Solutions* (April 2022). Despite the competitor company not being directly involved in the transaction, the impending merger was likely to impact its value. Recent studies have also shown that traders armed with nonpublic information about mergers or acquisitions involving specific companies are potentially profiting by trading in shares of exchange-traded funds based on indexes that include those companies’ shares. Again, this type of gaming might be a violation, particularly in certain contexts. See [“ETF Share Transactions Based on Nonpublic Information: An Illegal Secret Ingredient?”](#) *Expect Focus – Life, Annuity, and Retirement Solutions* (May 2023). More recently, the government is asserting that a jury may find a “tippee” guilty of insider trading under federal securities laws, even if the jury finds the “tipper” not guilty. A jury has done just that in *United States v. Klundt*, a case in the U.S. District Court for the Northern District of Illinois. This appears paradoxical considering the 1983 U.S. Supreme Court case, *Dirks v. SEC*, which is generally understood to establish a tippee’s liability for trading on material nonpublic information as derivative of the tipper’s liability. Specifically, under *Dirks*, tippee liability arises when a tipper (a) “has breached his fiduciary duty ... by disclosing the information to the tippee” and (b) “receives a personal benefit from the disclosure.” The *Klundt* jury seems to have been instructed accordingly; hence, it’s not immediately clear how they found the tippee guilty while exonerating the tipper. Understandably, the tippee has filed a motion that he also be acquitted or, in the alternative, afforded a new trial. In contrast, the government maintains that the verdict should stand, pushing the boundaries of past interpretations of insider trading. At the time of this publication, the motion remains pending. Given these recent developments, those responsible for compliance and other aspects of developing and

implementing firms' insider trading compliance procedures would be wise to remain vigilant about the expanding range of potential violations.

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