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## INSIDER TRAITOR: DOES ADVANTAGED TRADING BETRAY SOURCES OR SHAREHOLDERS?

Adapted from the writings of Dayan Yitzhak Grossman

In the previous article, we considered the applicability of the halachos of fraud to insider trading, from the perspective of the popular understanding that the problem with insider trading is that the counterparty to the trade is somehow harmed. In this article, we consider some halachic perspectives toward the two actual American legal rationales for the prohibition against insider trading: the “classical” theory and the more recent “misappropriation” theory.

### THE CLASSICAL THEORY

Under the classical theory of insider trading, corporate insiders, such as the directors, officers, and employees of a company, are prohibited from trading based on material nonpublic information (MNPI) that they have obtained in connection with their positions in the company. This theory targets a corporate insider’s breach of duty to the shareholders with whom the insider transacts.<sup>1</sup>

As the U.S. Supreme Court explains:

Under the “traditional” or “classical” theory

of insider trading liability, §10(b) and Rule 10b-5 are violated when a corporate insider trades in the securities of his corporation on the basis of material nonpublic information. Trading on such information qualifies as a “deceptive device” under §10(b), we have affirmed, because “a relationship of trust and confidence [exists] between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation.”...That relationship, we recognized, “gives rise to a duty to disclose (or to abstain from trading) because of the ‘necessity of preventing a corporate insider from...tak[ing] unfair advantage of...uninformed...stockholders.’”<sup>2</sup>

Under this theory, insider trading is a form of self-dealing:

Investor expropriation—also known as self-dealing or tunneling—takes such forms as excessive executive compensation and perquisites, transfer pricing, insider trading, self-serving transactions, and outright theft.<sup>3</sup>

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<sup>2</sup> United States v. O’Hagan, 521 U.S. 642 (1997), pp. 651-52.

<sup>3</sup> The Law and Economics of Self-Dealing. The Digest: No. 7, July 2006. NBER. Cf. Self-Dealing. Investopedia.

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 HaRav Yosef Grossman zt"l



### PARSHAS BO MOONRISE

Excerpted and adapted from a shiur by  
 Dayan Yehoshua Grunwald

This month shall be for you the beginning of the months, it is the first for you of the months of the year.

Shmos 12:1

The mitzvah of kiddush hachodesh (sanctifying the month) does not apply today, but we do have the mitzvah of kiddush *levanah* (sanctifying the moon). One interesting question that occasionally arises is whether one may recite kiddush *levanah* on Friday night.

The Maharil writes that if Shavuot falls on *motza'ei* Shabbos, one should not recite kiddush *levanah*, because just as the restriction of *techum* Shabbos prohibits a person from walking 2000 *amos* on the ground, so does it forbid him from elevating himself 2000 *amos* into the sky. (The same logic would forbid kiddush *levanah* on Shabbos.) The Bach explains that since saying kiddush *levanah* is like greeting the Shechinah (Sanhedrin 43a), it is considered as if one has ascended to the heavens and traversed the *techum*. Although some *Rishonim*, such as the Maharash and Rashba, question this ruling, the Rama (O.C. 426) accepts it as authoritative.

A number of *Acharonim* also question the Maharil and Rama on the grounds that a

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### Stop-Loss Order

**Q** I was unsure whether I had already *bentched*, so I *bentched* to be certain. Midway through, I recalled that I had in fact done it earlier. What should I have done at that point?

**A** A general principle in halacha is that *safek de'Oreisa lechumra* (where there is uncertainty in a *de'Oreisa* matter, we act strictly) and *safek deRabanan lekula* (where there is uncertainty in a *deRabanan* matter, we act leniently). One ramification of this rule is that a man who ate bread but is unsure whether he recited *birkas hamazon* should recite it, because his obligation of *birkas hamazon* is *mide'Oreisa*. But a similarly-

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As we have previously noted, however:

...Halacha seems to have no black-letter law on self-dealing, and *poskim* who discuss cases of such do not clearly articulate the precise nature of the wrong perpetrated by the self-dealer.<sup>4</sup>

The Divrei Chaim (Sanz) discusses a court-appointed guardian who leased his principal's property for less than its fair value, in exchange for a kickback from the tenant, which he pocketed. He maintains that the landlord has the option either to void the lease or to demand for himself the money that the agent took from the tenant, "for it is his, since the house was worth more than the rent for which it was leased due to the bribe, and so [the bribe] must certainly be returned to the owner of the house."<sup>5</sup>

The Divrei Chaim, however, is discussing a form of self-dealing where the agent is committing outright theft from his principal, and he is simply making the eminently logical point that in such a case, the product of his self-dealing is considered to have been stolen from the principal and so must be returned to him. This straightforward argument does not apply to less-egregious forms of self-dealing like our case of insider trading, where, as we have noted, there is no clear harm at all to those to whom the insider owes fiduciary duties.

The Divrei Malkiel discusses a sale in which part of the purchase price was to be the disbursement to the seller of charity funds that were controlled by the father of the buyer. He argues that this is "absolute theft," as the father has no right to make a personal purchase with charity funds. He adds that even though the money was contributed to charity with the intent that the father distribute it according to his discretion, and his opinion may be that the seller is indeed an appropriate recipient of the funds, he is nevertheless an interested party (*nogeia bedavar*) so he may not make such a decision on his own, "as it is known that officials in charge of charity (*gaba'ei tzedakah*) are like judges that the community has accepted upon itself."<sup>6</sup>

So while the Divrei Malkiel initially asserts that the form of self-dealing he is discussing constitutes "absolute theft," he subsequently seems to concede that this is not necessarily so if the buyer is an appropriate recipient of the funds, and he is therefore forced to fall back on condemning the seller's conduct merely on the basis of the doctrine that public officials like *gaba'ei tzedakah* have the status of judges. But while this is indeed an established halachic

doctrine with respect to public officials,<sup>7</sup> I am unaware of any significant precedent for its application to officers or agents of private businesses.<sup>8</sup>

### THE MISAPPROPRIATION THEORY

Under the misappropriation theory, corporate *outsiders* are prohibited from trading based on material non-public information (MNPI) in breach of a duty owed to the source of the information, not to the counterparty. The misappropriation theory premises liability on a trader's deception of those who entrusted him with access to confidential information, thereby defrauding the principal of the exclusive use of that information. The relevant question is whether the source disclosed the information with an expectation of confidentiality, that is, with the expectation that such information would not be shared with other parties. It is sufficient to prove that the [trader] knew or had reason to know that the information was disclosed in a confidential manner.<sup>9</sup>

As the Supreme Court explains:

The "misappropriation theory" holds that a person commits fraud "in connection with" a securities transaction, and thereby violates §10(b) and Rule 10b-5, when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information... Under this theory, a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information. In lieu of premising liability on a fiduciary relationship between company insider and purchaser or seller of the company's stock, the misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information.

Translating this theory into halachic terms is complex and somewhat beyond the scope of this article; we will merely note here that the basic question of whether halacha recognizes

<sup>7</sup> See the responsum of the Maharam of Rothenberg in Hagahos Maimoniyos *Hilchos Tefilah perek 11 os 2* and Teshuvos Maimoniyos *Hilchos Kinyan siman 27* (cited in Darchei Moshe C.M. beginning of *siman 163* and codified by Rama *ibid. se'if 1*); Trumas Hadeshen *psakim uchsavim siman 214* (cited in Darchei Moshe *ibid.*, and codified by Rama *ibid. 37:22*); Shu"t Chasam Sofer C.M. *siman 160* (cited in Pis'chei Teshuvah *ibid. siman 8 s.k. 2*).

<sup>8</sup> As we noted in *The Fiduciary Standard*, R' Yaakov Schwartzburt (Siach Mishpat (5763) *siman 2*) asserts that self-dealing by an employee, even when the employer's interests are not directly harmed thereby, constitutes *geneivas da'as*, since an employer would not retain an employee who engages in such conduct. I do not currently have access to Rav Schwartzburt's analysis, but as I recall, my impression upon reading it was that this argument was somewhat speculative and not solidly sourced.

<sup>9</sup> Insider Trading US: Misappropriation Theory: Breach By A Corporate Outsider. Wilkie Compliance. Cf. Misappropriation Theory. Investopedia; Troy Cichos. The Misappropriation Theory of Insider Trading: Its Past, Present, and Future.

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situated woman does not, because her obligation is only *mideRabanan*. The same is true of a man who ate less bread than *kedei sviah* (enough to be satiated), whose obligation is also only *mideRabanan*.



DAYAN YOSEF GREENWALD

If you began to recite *birkas hamazon* in a case of *safek de'Oreisa* but then remembered that you had already recited it, you must stop immediately, because it is a *bracha levatalah*.

With respect to *hilchos tefilah*, one who is unsure whether or not he davened davens again, but for a different reason: A person may daven all day long (Shulchan Aruch, O.C. 107:1 and Mishnah Brurah 2) as a *tefilas nedavah* (voluntary *tefilah*). Even one who began the *shmonah esrei* due to uncertainty and remembered in the middle that he had davened previously may finish, because the second *tefilah* can just be a *tefilas nedavah* (Mishnah Brurah 7). In *birkas hamazon*, however, there is no such thing as *nedavah*.

the concept of defrauding someone of the exclusive use of his intangible property is discussed by the *poskim* in various contexts.

The Noda Bihudah was asked about a customer who hired a printer to print the customer's commentary on part of Shas. The printer retained the printing plates after the project was completed, and he later sought to use them to print his own edition of Shas, sans the customer's commentary. The customer objected that since he had paid for the typesetting, the printer had no right to benefit from this work without compensating him for it, and he demanded a partial refund of the price he had paid for the work.

The Noda Bihudah's ruling is complex, but at least in certain circumstances, he does accept the basic argument of the customer that the printer is obligated to compensate him for the benefit he derives from what is rightfully his (*neheneh*).<sup>10</sup> Other *poskim*, however, reject the customer's argument entirely, because the customer has no ownership interest in the printer's plates, so he has no possible claim of *neheneh* against him.<sup>11</sup>

<sup>10</sup> Shu"t Noda Bihudah *tinyana* C.M. *siman 24*.

<sup>11</sup> Hagahos Baruch Ta'am to the Noda Bihudah *ibid.*; Shu"t Yeshuos

<sup>4</sup> Partnerships: A Comprehensive Halachic Guide To Contemporary Partnerships, p. 47. Cf. this author's *The Fiduciary Standard, Self-Dealing and Conflicts of Interest*. Bais HaVaad Halacha Journal.

<sup>5</sup> Shu"t Divrei Chaim (Sanz) *cheilek 2 C.M. siman 46*.

<sup>6</sup> Shu"t Divrei Malkiel *cheilek 5 siman 212*.

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*reshus hayachid* (private domain) halachically extends up to the sky, so one who recites *kiddush levanah*

in his yard should not violate the *techum*. Perhaps for this and other reasons, the Mishnah Brurah mentions only that there

are kabbalah-based reasons for the ruling. In the Sha'ar Hatziyun, though, he offers an additional halachic reason: Since one should rejoice during *kiddush levanah*, there is a concern that he will dance on Shabbos, which is generally forbidden, even for a mitzvah (see O.C. 339 and Mishnah Brurah).

If Friday night is the deadline for *kiddush levanah*, the Mishnah Brurah says one may rely upon the lenient view.

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