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## USE AND KNOWING POSSESSION: AN OLD DEBATE GAINS NEW RELEVANCE AMIDST THE GOVERNMENT'S LATEST INSIDER TRADING ENFORCEMENT PUSH

*An open question in insider trading law is whether the government must prove that an insider actually used material nonpublic information to trade, or whether the government merely must prove that the insider knowingly possessed material nonpublic information at the time of the trade. The SEC's Rule 10b5-1, which was recently amended in late 2022, still sets out a "knowing possession" standard, but this rule is in tension with previous decisions by federal courts of appeals and has received only inconsistent deference from the courts. In this article, the authors describe the "use" versus "knowing possession" debate, go over the recently amended version of Rule 10b5-1, and discuss how new enforcement initiatives may lead to renewed scrutiny of the "knowing possession" standard by the courts amidst the broader trend towards reduced deference to agency interpretations of the law.*

By Brian A. Jacobs and A. Dennis Dillon \*

A mid-level executive puts in an offer on her first home. She long has expected to sell stock she holds with her employer to fund the purchase. Her offer is accepted. Excited to find a place of her own in a hot market, she enters into a contract. A few weeks before closing and a week before she plans to liquidate her stock holdings, however, she learns of a major accounting error that will force the company to restate its earnings. She decides to sell her stock anyway. Has she violated Section 10(b) and Rule 10b-5 by insider trading?

The answer depends in part on whether a person can be liable for insider trading when they merely possess inside information, whether or not they actually use that

information to trade. If the executive in this scenario were to trade willfully, the government's position could be that she had committed a crime. The Supreme Court has said that trading "on the basis of" inside information violates Section 10(b) of the Securities Exchange Act of 1934.<sup>1</sup> The SEC's Rule 10b5-1, in turn, defines trading "on the basis of" material nonpublic information as trading while "aware of" of such information. But when courts have confronted this "knowing possession" standard, they sometimes have held that the government must instead prove actual "use" of the information to

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<sup>1</sup> *United States v. O'Hagan*, 521 U.S. 642, 652–53 (1997).

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\* **BRIANA JACOBS** is a member of *Morvillo Abramowitz Grand Iason & Anello P.C.* Brian previously served as an Assistant U.S. Attorney in the Criminal Division of the U.S. Attorney's Office for the Southern District of New York, where he was Deputy Chief of Appeals. **A. DENNIS DILLON** is an associate at *Morvillo Abramowitz*. Their e-mail addresses are [bjacobs@maglaw.com](mailto:bjacobs@maglaw.com) and [ddillon@maglaw.com](mailto:ddillon@maglaw.com).

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