

# When your patients disclose ‘insider information’



Douglas Mossman, MD

Dear Dr. Mossman:  
My patient is an officer in a large corporation. During therapy, he sometimes talks about how the company is doing. Would I risk malpractice liability if I used this information in managing my retirement investments?

Submitted by “Dr. B”

As most physicians find out within a short time of finishing medical school, doctors learn all kinds of useful things from their patients, including information that can help them manage personal matters outside their practices. But are you allowed to use nonpublic business information to make investment decisions?

As this article explains, legal rules and case law suggest that if psychiatrists or therapists act on potentially profitable business information incidentally mentioned by a patient during treatment, they may be subject to serious legal problems. To explain why, we’ll begin with a brief overview of business terms, including “securities” and “insider trading.” Then, to answer Dr. B’s question, we’ll look at what kind of legal consequences may result if mental health professionals are found guilty of “misappropriating” confidential business information.

## Securities and security rules

Approximately one-half to two-thirds of Americans have money invested in the stock market—either through their retirement plans, by owning mutual funds, or

by holding stocks of individual companies.<sup>1</sup> Stocks are a type of financial instrument, or security, that companies issue to raise capital. Companies also raise money by issuing debt, typically in the form of bonds that pay interest to the holder, who in buying the bond has in effect loaned money to the company. Derivatives refer to securities that have prices that move up or down depending on the value of some underlying asset, such as stock prices.<sup>2</sup>

Stock prices fluctuate in reaction to general economic developments—changes in the unemployment rate, in the cost of basic materials (eg, oil or metals used in manufacturing), or in government policies that influence consumers’ purchasing decisions. But the key factor in determining the price of a company’s stock is investors’ beliefs about the company’s future earnings.<sup>3</sup> Because investors usually have to make educated guesses about a company’s future, actually *knowing* something about a company before the general public finds out would give an investor a huge—but possibly unfair—advantage over other investors.

Making markets fair for all investors is the key purpose of U.S. laws on trading securities. In the 1930s, Congress created the Securities and Exchange Commission (SEC), a federal agency charged with ensuring that companies report the truth about their financial situation and that potential investors receive full, fair disclosure of available public information.<sup>4</sup> Among the many ways that the SEC does this is by enforcing regulations concerning “insider trading.”

DO YOU HAVE A QUESTION ABOUT POSSIBLE LIABILITY ?

► Submit your malpractice-related questions to Dr. Mossman at [douglas.mossman@qhc.com](mailto:douglas.mossman@qhc.com).

► Include your name, address, and practice location.

If your question is chosen for publication, your name can be withheld by request.

## 'Insider trading'

Corporate "insiders" (eg, directors or employees) often know a lot about how their businesses are doing, and they buy or sell stock in their own companies. Such trading is legal if the insiders follow federal regulations about the timing of their investments and report them publicly.

Insider trading is illegal, however, if an individual acquires material, nonpublic information about a corporation through a relationship that involves trust and confidence and then uses that information when buying or selling a security. The SEC has prosecuted corporate employees who traded securities after learning of confidential developments in their companies, friends and family members of corporate officers who bought or sold securities after getting such information, and employees of law firms who misused information they received while providing services to corporations whose securities they traded.<sup>5</sup>

To be guilty of insider trading, a person must:

- buy or sell a security based on information that the person realizes is material and nonpublic,<sup>6</sup> and
- have received the confidential information under circumstances that create a duty of trust or confidence.<sup>7</sup>

If both of these conditions are met, the person has wrongfully used confidential information with which he was entrusted, or "misappropriated" that information for personal gain.<sup>8</sup>

Physicians sometimes gain information that, if used for investment decisions, might lead to accusations of insider trading. Stock prices of pharmaceutical companies rise before public announcements of clinical drug trials, which suggests that information about those results leaks out in advance.<sup>9</sup> Recently, physicians have gotten into well-publicized legal trouble by making investment decisions based on information they obtained while participating on an institution's board<sup>10</sup> and from learning early results of clinical drug trials.<sup>11</sup>

### Box

#### Excerpt from the Hippocratic Oath

And about whatever I may see or hear in treatment, or even without treatment, in the life of human beings—things that should not ever be blurted out outside—I will remain silent, holding such things to be unutterable.

Source: Reference 13

But would it be wrong for a psychiatrist to make a potentially profitable investment based on information obtained *incidentally* during a treatment encounter? After all, it's not as though the psychiatrist would be a corporate insider or would have acquired the information improperly. Yet courts have ruled that a psychiatrist's trading on such information might constitute malpractice and could be grounds for even more serious legal consequences.

#### Potential malpractice issues

The federal court ruling in *United States v Willis*<sup>12</sup> describes how a psychiatrist learned during treatment that a patient's husband was seeking to become CEO of a large bank. Realizing that this development might make the bank more valuable, the psychiatrist told his broker what he had learned and purchased 13,000 shares of the bank's stock for himself and his children. When the husband's efforts were announced publicly a few weeks later, the psychiatrist sold the shares at a big profit.

Quoting the vow of confidentiality contained in the Hippocratic Oath (**Box**),<sup>13</sup> the court held that the psychiatrist had an obligation to the patient not to disclose information learned during her treatment without her permission. The court said the patient "had an economic interest in preserving the confidentiality of the information disclosed," and the psychiatrist's actions "might have jeopardized her husband's advancement" and financial benefits the wife would have gained. Also, the psychiatrist's "disclosures

### Clinical Point

Physicians sometimes gain information that if used for investment decisions might be considered insider trading



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## Clinical Point

A psychiatrist who uses information a patient discloses during treatment for financial gain could face legal consequences

## Related Resources

- Insider trading versus medical professionalism. *Lancet*. 2005;366(9488):781.
- Nijm LM. The online message board controversy. Physicians hit with claims of libel and insider trading by their employers. *J Leg Med*. 2000;21(2):223-239.

### Disclosure

Dr. Mossman reports no financial relationship with any company whose products are mentioned in this article or with manufacturers of competing products.

jeopardized the psychiatrist-patient relationship," which might negate the wife's financial investment in her care, require her to find a new psychiatrist, or require additional treatment to deal with how the psychiatrist's behavior had affected her.<sup>12</sup>

## More legal consequences

Dr. Willis had legal problems more serious than just a malpractice lawsuit. He faced criminal prosecution for insider trading and mail fraud, and the court refused to dismiss these charges. The court reasoned that the psychiatrist received the information while in a position of trust and confidence, and breached that trust when he used that confidential information for his personal benefit—behavior that meets the legal definition of "misappropriation." Because the psychiatrist received stock trade confirmations through the U.S. mail, he also could face federal charges of mail fraud. Ultimately, Dr. Willis pled guilty and paid \$137,000 in fines and penalties. Although Dr. Willis retained his New Jersey medical license and avoided a prison sentence, the district court sentenced him to 5 years of probation and

required that he perform 3,000 hours of community service.<sup>14,15</sup>

In a second case,<sup>16</sup> a licensed clinical social worker made investments through a broker based on information learned during a therapy session about upcoming business developments (the 1994 Lockheed-Martin Marietta merger). The social worker pled guilty to insider trading, forfeited the illegal gains, and paid a large fine.

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## Bottom Line

Making investment decisions based on confidential information obtained from a patient may lead to charges of illegal insider trading. Psychiatrists who are thinking about trading securities based on patients' statements made in confidential treatment settings should "forget about it," or at least seek legal advice about whether such trading would be permissible or put them at considerable legal risk.