COMMENTARY

INFORMATION, PRIVILEGE, OPPORTUNITY AND INSIDER TRADING

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I. BACKGROUND OF INSIDER TRADING LEGISLATION

Insider trading legislation requires insiders to publicly report their trades through securities commissions and prohibits them from using confidential, undisclosed information that is material to the value of securities in connection with the trades.[1] In Canada, insider trading is both a civil and quasi-criminal offense.[2] In the United States, Rule 10b-5 of the Securities Exchange Act is often cited as authority for prosecuting insider trading cases.[3]

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1. F.H. BUCKLEY AND M.Q. CONNELLY, CORPORATIONS: PRINCIPLES AND POLICIES 657 (1988) [hereinafter PRINCIPLES AND POLICIES]. Chapter 8 of this book gives one of the best presentations of insider trading, from both an economic and legal perspective. Both Canadian and United States laws are discussed.

2. *Id.* For civil sanctions, see OSA 131(1)-(2), (4) and CBCA § 125(5)(a)-(b). For criminal treatment of insider trading, see OSA § 75.

3. 17 C.F.R. § 240.10b-5 (1989). Rule 10b-5 addresses the employment of manipulative and deceptive devices. It states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
> (a) To employ any device, scheme, or artifice to defraud,
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, . . . not misleading, or
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

One of the earliest and most important cases involving insider trading was *SEC v. Texas Gulf Sulphur Co.*[4] In this case, the company's geologist discovered valuable mineral deposits in Ontario, Canada in 1959. In late 1963, company drilling discovered evidence that there might be rich deposits of copper and zinc at the spot in question. After the geologist notified management of the find, the company's officers, directors and employees began buying shares of the company's stock on the open market, before the find was known to the general public. Other individuals who were not connected with the company also bought shares before the information became public. Those individuals who were connected with the company were named in a Securities and Exchange Commission (SEC) complaint. The others involved were not prosecuted by the SEC, but some of them later became parties to private civil actions.

By early 1964, word began to spread and the stock's price began to climb. On April 12 of that year, the company announced that it was working in the area in question, but more drilling would be required before a proper evaluation could be made. Four days after that announcement, Texas Gulf announced a major strike. In its suit, the SEC alleged that between the time of the "misleading" press release of April 12 and the accurate announcement four days later, many shareholders sold their stock for prices that were lower than what they would have sold them for if they had known the information that was announced on April 16. Insiders acquired shares during this period, but the number of shares they acquired during the twenty-two week period in question represented less than 10% of the total shares traded during that timespan. The share price doubled within three weeks after the announcement of April 16. The appellate court held that:

> not only are directors or management officers of corporation 'insiders' within meaning of rule of Securities and Exchange Commission, so as to be precluded from dealing in stock of corporation, but [the] rule is also applicable to one possessing information, though he may not be strictly termed an 'insider' within meaning of Securities Exchange Act, and thus anyone in possession of material inside information is an 'insider' and must either disclose it to investing public, or, if he is disabled from disclosing it in order to protect corporate confidence, or he chooses not to do so, must abstain from trading in or

4. 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

> recommending securities concerned while such inside information remains undisclosed.[5]

A. THE CONCEPT OF JUSTICE

Before proceeding further, a definition of justice would be appropriate. Once justice is defined, the definition can be applied to the practice of insider trading to determine whether the practice is just. A just act can be between individuals or between the state and one or more individuals although, in the final analysis, an act involving the state is carried out by an individual. According to one popular theory, justice is the absence of coercion; acts between consenting adults are just. Individuals or governments who prevent such acts are acting unjustly, and individuals who commit acts that aggress against others, except in self-defense, are acting unjustly.[6] A corollary to this view is that the proper scope of government is to protect life, liberty, and property, and any act by government that goes beyond this scope results in injustice because it must necessarily use coercion to take from some to give to others.[7] Space does not permit a detailed defense of this position, but others have already discussed the point thoroughly.[8]

If injustice results when one individual takes the property of another without that person's consent, and the proper scope of government includes prevention of such acts, then government should attempt to prevent coercive (or fraudulent) takings and should refrain from interfering in nonfraudulent transactions that are between consenting adults. In the case of insider trading, the SEC might be the proper agency of government to prevent such transactions, if insider

5. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 833 (2d Cir. 1968).

6. Robert Nozick's and Murray N. Rothbard's definitions are along the same lines, but John Rawls' is not. For an elaboration of various theories of justice, see R. NOZICK, ANARCHY, STATE, AND UTOPIA (1974); M. ROTHBARD, THE ETHICS OF LIBERTY (1982); J. RAWLS, A THEORY OF JUSTICE; B. BARRY, THE LIBERAL THEORY OF JUSTICE (1973); O. BIRD, THE IDEA OF JUSTICE (1967). Perhaps the most detailed bibliography on the theory of justice, at least for books first published before 1900, is in 1 THE GREAT IDEAS: A SYNTOPICON 850-79 (R. Hutchins ed. 1952).

7. A similar view is taken by John Locke in his THE SECOND TREATISE ON CIVIL GOVERNMENT (1986) and at least some of America's founding fathers. The view is also developed in R. NOZICK, ANARCHY, STATE, AND UTOPIA (1974); R. EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN (1985); F. BASTIAT, THE LAW (1950); and D. RUSSELL, GOVERNMENT AND LEGAL PLUNDER: BASTIAT BROUGHT UP TO DATE (1985).

8. *See* NOZICK, EPSTEIN, BASTIAT and RUSSELL, *supra* note 7.

trading is deemed to be an unjust act. However, at least one former SEC Commissioner has pointed out the potential abuses that can occur when the SEC is given such regulatory authority,[9] as have others.[10] Some commentators have even questioned the constitutionality of SEC enforcement actions.[11] Perhaps regular common law

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9. *See* R. KARMEL, REGULATION BY PROSECUTION: THE SECURITIES & EXCHANGE COMMISSION VERSUS CORPORATE AMERICA (1982).

10. For more on SEC regulatory abuses, see Lowe v. SEC, 472 U.S. 181 (1985); G. LITTLER, ABOLISH THE SEC, in L.H. ROCKWELL, JR., THE FREE MARKET READER 273 (1988); Bubb, *SEC Regulations Endanger Free Press*, 4 FREE PRESS NETWORK 1 (Spring 1985); Freedman, *A Civil Libertarian Looks at Securities Regulation*, 35 OHIO ST. L.J. 280 (1974); McMenamin & Gorenc, Jr., *Subverting the First Amendment*, REASON 23 (Jan. 1983); *The First Amendment and Federal Securities Regulations: A Symposium*, 20 CONN. L. REV. 261-477 (1988); Comment, *The Right to a Free Press and the Regulation of Securities Newsletters: The Controversy Continues*, 56 U. CIN. L. REV. 1445 (1988). A whole body of literature is developing around the *Lowe* decision. For some recent articles on this case, see Aman, *SEC v. Lowe: Professional Regulation and the First Amendment*, 1985 SUP. CT. REV. 93 (1985); Coffhan, *Lowe v. Securities and Exchange Commission: The Deterioration of Financial Newsletter Regulation*, 10 NOVA L.J. 1267 (1986); Desch, *Lowe v. SEC: Guaranteeing the Right to Publish Investment Newsletters Through Statutory Construction*, 64 WASH. U.L.Q. 577 (1986); Draughon, *SEC v. Lowe: Redefining the Bona Fide Newspaper Exclusion*, 14 SEC. REG. L.J. 291 (1987); Garver, *Lowe v. SEC: The First Amendment Status of Investment Advice Newsletters*, 35 AM. U.L. REV. 1253 (1986); Gora, *Supreme Court Report: Five Wins and Nine Losses for Free Speech Fans*, 71 A.B.A. J. 116 (1985); Law, *Regulation of Investment Newsletter Publishers: The SEC's Power Reaches a New "Lowe,"* 11 VT. L. REV. 175 (1986); Lee, *The Effects of Lowe on the Application of the Investments Advisers Act of 1940 to Impersonal Investment Advisory Publications*, 42 BUS. LAW. 507 (1987); Levant, *Financial Columnists as Investment Advisers: After Lowe and Carpenter*, 74 CALIF. L. REV. 2061 (1986); Mohr, *Lowe v. SEC: Avoidance of the Commercial Speech Definition—The Right Result for the Wrong Reasons*, 17 U. TOL. L. REV. 1007 (1986); Nites, *The SEC's Regulation of the Financial Press: The Legal Implications of the Misappropriation Theory*, 52 BROOKLYN L. REV. 43 (1986); Norquist, *SEC v. Lowe: The Constitutionality of Prohibiting Publication of Investment Newsletters Under the Investment Advisers Act*, 69 MINN. L. REV. 937 (1985); Thompson, *Lowe v. SEC: Investment Advisers Act of 1940 Clashes with First Amendment Guarantees of Free Speech and Press*, 21 U. RICH. L. REV. 205 (1986).

11. *See* Morrison v. Olson, 108 S. Ct. 2597 (1988); SEC v. Jerry T. O'Brien, Inc., 467 U.S. 735 (1984); Blinder, Robinson & Co., Inc. v. SEC, 837 F.2d 1099 (D.C. Cir.), *cert. denied*, 109 S. Ct. 177 (1988); SEC v. Blinder, Robinson & Co., Inc. 511 F. Supp. 799 (1981); Balboni, *Section 3(a)(10) of the Securities Act of 1933—SEC v. Blinder Robinson & Co.—Proposed Standards for Fairness Hearings*, 17 NEW ENG. L. REV. 1397 (1981); Falon, *On Legislative Courts, Administrative Agencies, and Article III*, 101 HARV. L. REV. 916 (1988); McLucas & Romanowich, *SEC Enforcement Proceedings Under Section 15(c)(4) of the Securities Exchange Act of 1934*, 41 BUS. LAW. 145 (1985); Steinberg, *SEC Subpoena Enforcement Practice*,

contract and tort would be sufficient to protect individuals from harm. Property law may also be used, given that insider information has been identified as a property right.[12]

Lowe v. SEC[13] illustrates the potential abuse of free speech that might result when the SEC is given the authority to regulate securities trading. In *Lowe*, the SEC attempted to prevent an "unsavory" individual from publishing a newsletter that gave investment advice and commentary, alleging that he violated the Investment Advisers Act of 1940. The district court held that his right to publish was protected by the first amendment and that he should be permitted to publish as long as he complied with the provisions of the Act.[14] The Supreme Court held that Lowe did not have to be a registered investment adviser to publish his newsletter because the information was given impersonally to anyone who subscribed rather than on a person-to-person basis.[15]

Whether insider trading is fraudulent is questionable. St. Thomas Aquinas said that fraud can be perpetrated in three ways, either by selling one thing for another or by giving the wrong quality or quantity.[16] A more modern definition is "intentional deception to cause a person to give up property or some lawful right."[17] A more general definition is that fraud is perpetrated when a person knowingly or intentionally makes a false representation of fact to another with the intent that the other party rely on the representation, and that the other party actually did rely upon the false statement to his loss, detriment or damage.[18] Some courts have extended liability to include

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11 J. CORP. L. 1 (1985); Note, *SEC Investigations—SEC Need Not Notify Target of Third-party Subpoenas—SEC v. Jerry T. O'Brien, Inc., 104 S. Ct. 2720*, 75 J. CRIM. L. & CRIMINOLOGY 940 (1984); *SEC vs. the Constitution*, Wall Street Journal, Dec. 6, 1988, at A-24, col. 1.

12. *See* Manne, *Insider Trading and Property Rights in New Information*, 4 CATO J. 933 (1985), *reprinted in* ECONOMIC LIBERTIES AND THE JUDICIARY 317-27 (Dorn and Manne eds. 1987); Morgan, *Insider Trading and the Infringement of Property Rights*, 48 OHIO ST. L.J. (1987).

13. 472 U.S. 181 (1985).

14. 556 F. Supp. 1359 (E.D.N.Y. 1983).

15. Lowe v. SEC, 472 U.S. 181, 211 (1985).

16. G. DALCOURT, THE PHILOSOPHY AND WRITINGS OF ST. THOMAS AQUINAS 105 (1965); ST. THOMAS AQUINAS, SUMMA THEOLOGICA, Pf. II-II, Q.77 Art. 3, obj. 4 (Fathers of the English Dominican Province trans. 1947).

17. WEBSTER'S NEW WORLD DICTIONARY OF THE AMERICAN LANGUAGE (college ed. 1964).

18. Kaufman Inv. Corp. v. Johnson, 623 F.2d 598 (9th Cir. 1980), *cert. denied*, 450 U.S. 914 (1981); Meader v. Francis Ford, Inc., 286 Or. 451, 595 P.2d 480 (1979);

negligent or inadvertent misrepresentation.[19] According to this theory, there is no fraud if there is no loss. And because much so-called insider trading does not involve any identifiable loss, the practice is not fraudulent. Even in cases where there is loss, it still has to be proved that all the elements of fraud are present before an inside trader can be found guilty of the offense.

A typical case of insider trading occurs when a buyer with inside information calls his stock broker and tells him to buy, knowing that the stock price is likely to rise as soon as the inside information becomes public. In this case, the buyer does not deceive the seller into giving up property. Indeed, the buyer does not even know who the seller is, and the seller would have sold anyway, anonymously. The seller's action would have been the same whether or not an inside trader was the other party to the transaction. If the inside trader had not purchased the stock, someone else would have. Yet this "someone else" would not be accused of reaping unjust profits even if the identical stock was purchased for the same price the insider would have paid. Consequently, insider trading does not seem to fit the definition of fraud.

According to Aquinas, there is no moral duty to inform a potential buyer that the price of the good one is trying to sell is likely to change in the near future.[20] Aquinas discusses a wheat merchant who:

> carr[ies] wheat to a place where wheat fetches a high price, knowing that many will come after him carrying wheat; . . . if the buyers knew this they would give a lower price. But . . . the seller need not give the buyer this information . . . . [T]he seller, since he sells his goods at the price actually offered him, does not seem to act contrary to justice through not stating what is going to happen. If however he were to do so, or if he lowered his price, it would be exceedingly virtuous on his part: although he does not seem to be bound to do this as a debt of justice.[21]

Metal Tech. Corp. v. Metal Techniques Co., Inc., 74 Or. App. 297, 703 P.2d 237 (1985); 2 RESTATEMENT (Second) of Torts § 525ff, *cited in* Foley, *"Insider Trading": The Moral Issue*, 37 THE FREEMAN 409 n.7 (1987).

19. Weiss v. Gumbert, 191 Or. 119, 227 P.2d 812, *reh'g denied*, 191 Or. 139., 228 P.2d 800 (1951); 3 RESTATEMENT (SECOND) OF TORTS §§ 552-552C, *cited in* Foley, *"Insider Trading": The Moral Issue*, 37 THE FREEMAN 409 n.8 (1987).

20. SUMMA THEOLOGICA, *supra* note 16; Barath, *The Just Price and the Costs of Production According to St. Thomas Aquinas*, 34 NEW SCHOLASTICISM 420 (1960); Bartell, *Value, Price, and St. Thomas* 25 THE THOMIST, 359-60 (1962).

21. SUMMA THEOLOGICA, *supra* note 16, Obj. 4, Reply Obj. 4.

A similar example is discussed by Cicero where a merchant is bringing grain from Alexandria to Rhodes. He knows that the residents of Rhodes are starving and that other grain merchants will arrive shortly. If he discloses this fact, the price for his own grain will fall. Should he disclose?[22]

An insider who knows the stock price is likely to change in the near future has no "moral" duty to inform potential buyers of this fact. Where there is no moral duty, certainly there should be no legal duty either. In fact, the U.S. Supreme Court has ruled at least twice that those in possession of nonpublic information do not have a general duty to disclose the information to the marketplace.[23] The

22. CICERO, THE OFFICES Bk. III, ch. xiii (E. Rhys ed. 1909). Lawson discusses this passage in *The Ethics of Insider Trading*, 11 HARV. J.L. & PUB. POL'Y 727, 738-39 (1988). This passage is also mentioned in Barry, *The Economics of Outside Information and Rule 10b-5*, 129 U. PA. L. REV. 1307, 1361 n.206 (1981). For a critique of the Lawson article, see Macey, *Comment: Ethics, Economics, and Insider Trading: Ayn Rand Meets the Theory of the Firm*, 11 HARV. J.L. PUB. POL'Y 785 (1988). The passage from Cicero, as cited in Lawson, is as follows:

> 'I have imported my stock,' Diogenes' merchant will say; 'I have offered it for sale; I sell at a price no higher than my competitors—perhaps even lower, when the market is overstocked, Who is wronged?'
>
> 'What say you?' comes Antipater's argument on the other side; 'it is your duty to consider the interests of your fellow-men and to serve society; you were brought into the world under these conditions and have these inborn principles which you are in duty bound to obey and follow, that your interest shall be the interest of the community and conversely that the interest of the community shall be your interest as well; will you, in view of all these facts, conceal from your fellow-men what relief in plenteous supplies is close at hand for them?'
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> 'It is one thing to conceal,' Diogenes will perhaps reply; 'not to reveal is quite a different thing. At this present moment I am not concealing from you, even if I am not revealing to you, the nature of the goods or the highest good; and to know these secrets would be of more advantage to you than to know that the price of wheat was down. But I am under no obligation to tell you everything that it may be to your interest to be told.'
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> 'Yea, Antipater will say, 'but you are, as you must admit, if you will only bethink you of the bonds of fellowship forged by Nature and existing between man and man.'
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> 'I do not forget them,' the other will reply; 'but do you mean to say that those bonds of fellowship are such that there is no such thing as private property? If that is the case, we should not sell anything at all but freely give everything away.'

23. Chiarella v. United States, 445 U.S. 222, 230 (1980) (silence in connection with the purchase or sale of securities may operate as a fraud only where there is a duty to disclose that arises from a relationship of trust and confidence between the parties to the transaction); Dirks v. SEC, 463 U.S. 646 (1983). *See also* Macey, *The*

Fourth Circuit Court of Appeals recently held that a corporation has no duty to disclose tentative merger plans to stockholders before it buys their stock.[24]

In *Chiarella v. United States*,[25] the Supreme Court held that "one who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so."[26] Chiarella was an employee of a printing company. Part of his job was to print confidential documents for corporations. In the course of his employment, he was able to determine that certain companies were going to be the target of takeovers and he bought stock in those companies. He did not have any fiduciary relationship to the company's stockholders. The Supreme Court held that he was not guilty of violating Rule 10b-5 because he did not commit any fraud against the party who sold him the stock.[27]

In *Dirks v. Securities and Exchange Commission*,[28] the Supreme Court held that the insiders have a fiduciary duty to the shareholders and must either disclose material inside information or not trade in the securities of the corporation.[29] It also held that a tippee who

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SEC's Insider Trading Proposal: Good Politics, Bad Policy (Cato Institute Policy Analysis No. 101 Mar. 31, 1988). For a discussion of these two cases, see Aldave, *Misappropriation: A General Theory of Liability For Trading on Nonpublic Information*, 13 HOFSTRA L. REV. 101 (1984); Heller, *Chiarella, SEC Rule 14e-3 and Dirks: Fairness Versus Economic Theory*, 37 BUS. LAW. 517 (1982); Morgan, *Insider Trading and the Infringement of Property Rights*, 48 OHIO ST. L.J. 79 (1987). For other discussions of *Chiarella* and the misappropriation theory, see Anderson, *Fraud, Fiduciaries, and Insider Trading*, 10 HOFSTRA L. REV. 341 (1982); Branson, *Discourse on the Supreme Court Approach to SEC Rule 10b-5 and Insider Trading*, 30 EMORY L.J. 263 (1981); Langevoort, *Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement*, 70 CALIF. L. REV. 1 (1982); Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9 (1984); Martin, *Insider Trading and the Misappropriation Theory: Has the Second Circuit Gone Too Far?* 61 ST. JOHN'S L. REV. 78 (1986); Morgan, *The Insider Trading Rules After Chiarella: Are They Consistent with Statutory Policy?* 33 HASTINGS L.J. 1407 (1982). For a summary of the literature on the "wrongness" of insider trading, see generally B. RIDER & L. FFRENCH, THE REGULATION OF INSIDER TRADING (1979). Other discussions on the subject may be found in Brudney, *Insiders, Outsiders and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322 (1979); Dooley, *Enforcement of Insider Trading Restrictions*, 66 VA. L. REV. 1 (1980); Scott, *Insider Trading, Rule 10b-5, Disclosure and Corporate Privacy*, 9 J. LEGAL STUD. 801 (1980).

24. Taylor v. First Union Corp. of So. Carolina, 857 F.2d 240 (4th Cir. 1988).
25. 445 U.S. 222 (1980).
26. Chiarella v. United States, 445 U.S. 222, 228 (1980).
27. *Id.* at 234-35.
28. 463 U.S. 646 (1983).
29. Dirks v. SEC, 463 U.S. 646, 653 (1983).

receives material nonpublic information from an insider and trades on it violates Rule 10b-5 if the insider breaches any fiduciary duty by disclosing the information, provided the tippee either knew or should have known that there was a breach.[30] But an insider is deemed to breach a duty only if he personally benefits from the disclosure, either directly or indirectly. Dirks was a securities analyst. He received his inside information from a company's employees who told him that the company was engaged in massive fraud. Dirks told his clients to sell their stock in the company. The employees who told Dirks the insider information did not act for personal gain. They wanted to expose the fraud. Because the employees did not breach a fiduciary duty to any shareholders, Dirks could not be found guilty of violating Rule 10b-5.

Chiarella and *Dirks* represent a major split with the SEC because these cases held that there is no general duty to disclose nonpublic information. The SEC had been contending that the law required information between traders to be equal, based on the flawed decision in *Texas Gulf Sulphur*.[31] In *Taylor v. First Union Corp. of So. Carolina*,[32] the Fourth Circuit held that neither the acquiring nor the selling corporation has a duty to tell shareholders that they are engaging in merger discussions.[33]

B. WHOSE RIGHTS ARE VIOLATED BY INSIDER TRADING?

While the transaction of buying and selling stock by an insider does not meet either the dictionary's or Aquinas' definition of fraud, the question of justice still remains. If no one's rights are violated, the act is not unjust; if someone's rights are violated, the act is unjust. The obvious question to raise is: Whose rights are violated by insider trading?

The most obvious potential "victims" of insider trading are the potential sellers who sell their stock anonymously to an inside trader. But, as was mentioned above, they would have sold anyway; whether the inside trader buys from them or not does not affect the proceeds they receive from the sale.[34] If the sellers are hurt by having an inside trader in the market, it is difficult to measure the damage, and it appears that there is none. In fact, academic literature recognizes that

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30. *Id.* at 660.
31. *See supra* note 4 and accompanying text.
32. 857 F.2d 240 (4th Cir. 1988).
33. Taylor v. First Union Corp. of So. Carolina, 857 F.2d 240 (4th Cir. 1988).
34. This privity argument is discussed in PRINCIPLES AND POLICIES, *supra* note 1, at 661.

The (relatively) free market economy of the United States has found a way to pierce the protective veil that insulates unresponsive management from the wrath of small shareholders —the takeover. The corporate takeover is practically the only way that entrenched management can be shaken up and either forced to be responsive to shareholder interests or fired. This market for corporate control does not exist to any great extent in any country except the United States, which provides a competitive advantage over other countries because the threat of takeover provides corporate management an extra incentive to work for shareholder interests rather than its own. Thus, shareholders of United States companies receive a higher return on investment than can investors in companies that are not subject to a takeover threat, all other things being equal.[45] The attack on Drexel Burnham, and the threat of an attack on anyone else who tries to facilitate the market for corporate control with junk bonds, is bound to harm the market for corporate control and thus decrease the already weak voice that shareholders have. Management of companies that do not have to fear a takeover will have less incentive to be efficient, which also hurts employees and consumers.

The shareholders who sell at the time the arbitragers are buying may also benefit. The increased demand generated by the arbitragers increases the price the sellers receive when they sell. Without the leakage of the insider information to the arbitragers, the demand for the stock in question would have been lower, so the sellers (who would probably have sold anyway) would have received a somewhat lower price for their stock.[46] Shareholders who do not sell also benefit because the price of their shares rises as a result of insider trading.

A goal of most corporate managements is to increase shareholder wealth—in other words, increase the stock's price. Because insider trading has a tendency to increase the stock's price, inside traders assist management in achieving its goal. Inside traders may benefit the corporation in another way as well.

> A decision by the board or its delegates to 'tip' inside corporate information to certain outsiders, to facilitate trading by them, could also be in the best interests of the corporation. For

MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932), *cited in* Manne & Ribstein, *The SEC v. The American Shareholder*, NATIONAL REVIEW, 26, 27 (Nov. 25, 1988) [hereinafter *American Shareholder*].

45. Manne and Ribstein make this point. *See American Shareholder, supra* note 44, at 29.

46. *See* PRINCIPLES AND POLICIES, *supra* note 1, at 689.

> example, where the corporation has received valuable services from an outsider, one way of providing indirect compensation for those services is by providing the outsider with the authorized use of inside information owned by the corporation. Thus, if one accepts the notion that inside information is property of the corporation, even the tipping of that information to others ought not be regarded as improper, if the board of directors or other authorized corporate decision maker has determined that such tipping is in the best interests of the corporation.[47]

D. WHO IS HARMED BY PROHIBITIONS ON INSIDER TRADING?

Who is harmed by prohibitions on insider trading? The obvious answer is the inside traders themselves. If insider trading is not viewed as "immoral," then punishing insiders by preventing them from using their knowledge becomes an unjust act in itself.

There is a case to be made that the company's shareholders may be harmed by placing prohibitions on insider trading.[48] For example, the Williams Act, the part of the Securities Exchange Act of 1934 that requires anyone contemplating a tender offer to announce the intention well in advance (sections 13d and e, and sections 14d, e, and f), makes it easier for target managements to thwart a takeover. Several authors have argued that shareholders tend to benefit by takeovers. Therefore, making it easier to thwart a takeover may be against the stockholders' interest.[49]

47. Morgan, *Insider Trading and the Infringement of Property Rights*, 48 OHIO ST. L.J. 70, 98 (1987).

48. Carlton & Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 866-72 (1983). Stockholders often like to do business with an inside trader. Buckley relates the story of one broker who was suspended for 20 days as punishment for participating in insider trading. The broker used his time off to vacation in Florida. Upon his return, he was "busier than ever, pursued by clients who thought he was precisely the kind of broker they wanted." PRINCIPLES AND POLICIES, *supra* note 1, at 696.

49. A number of authors have addressed this point in recent years. *See* Bubb, *Hostile Acquisitions and the Restructuring of Corporate America*, 36 THE FREEMAN 166 (1986); Buttarazzi, *Corporate Takeovers: What is the Federal Role?*, 606 BACKGROUNDER (The Heritage Foundation, Washington, D.C., Sept. 29, 1987); Coffee, Grundfest, Romano & Weidenbaum, *Corporate Takeovers: Who Wins; Who Loses; Who Should Regulate?*, 88 REGULATION 23 (1988); Jarell, Brickley & Netter, *The Market for Corporate Control: The Empirical Evidence Since 1980*, J. ECON. PERSP. 49 (Winter 1988); Jensen, *Takeovers: Folklore and Science*, HARV. BUS. REV. 109 (Nov.-Dec. 1984); Johnson, *Antitakeover Legislation: Not Necessary, Not Wise*, 35

information in the first place, and the market would suffer as a result.[57] Such coercive actions would also be unjust to the analyst whose property rights are being impinged.[58]

F. CIVIL LIBERTIES ISSUES

There are also civil liberties issues. Enforcement and punishment must necessarily be discretionary and discriminatory.[59] There are just too many individuals who are violating the law to find and prosecute

57. Fama & Laffer, *Information and Capital Markets*, J. BUS. 289 (July 1971); Ronen, *The Effect of Insider Trading Rules on Information Generation and Disclosure by Corporations*, 52 ACCT. REV. 438 (1977).

58. Envy also plays a part in the prohibition against insider trading. Many people resent it when they see others become wealthy with little (visible) effort, while they are living from paycheck to paycheck. Demagogues are not above whipping up and encouraging such sentiment. They would like to see inside traders punished or deprived of their property, not because the property is an ill-gotten gain, but because the inside traders were able to acquire it whereas the envious person was not. U.S. Federal prosecutor Rudolph Giuliani even went so far as to brag that he not only wanted to bring inside traders to justice but also wanted to destroy their reputation. *See* McMenamin, *Witchhunt*, 20 REASON 39 (1988).

Timothy Tabor, Richard Wigton and Robert Freeman represent three cases on point. Each of these respectable Wall Street arbitragers was arrested and charged with insider trading. A few months later, the charges were dropped for lack of evidence, but by that time their careers were destroyed. A cloud is still hanging over their heads because the government has promised to indict them again although it had no more evidence when it made the threat than it did when it indicted them initially. *See* McMenamin, *supra*, at 34; *see also Political Prosecutor*, 310 THE ECONOMIST, Jan. 14, 1989, at 72.

Envy is a vice that has existed since time immemorial. The Bible calls it one of the seven capital sins. It is at the root of much legislation, such as the progressive income tax and death taxes. *See generally* R. NOZICK, ANARCHY, STATE AND UTOPIA (1974); H. SCHOECK, ENVY (1966); R. SHEAFFER, RESENTMENT AGAINST ACHIEVEMENT: UNDERSTANDING THE ASSAULT UPON ABILITY (1988). It encompasses the idea that people who have more property than you do should have it taken away from them. The fact that they might have earned it only adds to the ill feeling, and the fact that they might have earned it with little effort is worse yet.

Insider trading also engenders resentment. For a discussion of envy as applied to insider trading, see Foley, *"Insider Trading": The Moral Issue*, 37 THE FREEMAN 409, 410 (1987). Inside traders can earn in a few weeks what it takes most people several lifetimes to earn. They earn it with little visible effort. There is something "shady" about how they earn it. The information is secret and they often obtain it through a "good old boy" network. The perception that the inside trader's actions were based on greed rather than altruism makes the act appear reprehensible, where in fact it is just a modern example of Adam Smith's "Invisible Hand" at work. *See* A. SMITH, THE WEALTH OF NATIONS (1776).

59. Manne, *Insider Trading and the Law Professors*, 23 VAND. L. REV. 547, 554 (1970).

them all. As is the case whenever a large number of people are breaking the law, government power can be abused through selective enforcement. Because the SEC does not have the resources to prosecute all violators, it may tend to prosecute those offenders who are in the least favor with the prosecutor.

The SEC case against R. Foster Winans is a case in point.[60] In that case, a *Wall Street Journal* reporter traded on information that he would later use in his column. He and some friends bought some stock shortly before his column appeared in print and sold it shortly thereafter. The information contained in his column caused the stock's price to rise. The SEC claimed that his use of this information was a violation of its Rule 10b-5. This case was seen as having a potential chilling effect on the first amendment freedom of the press because it was attempting to regulate a reporter's behavior. Even if Winans was guilty of misappropriating his employer's property (the insider information), there are adequate state remedies for such offenses. He could be prosecuted for theft or misappropriation of property.[61] There is no need for the federal government to intrude into an area that has traditionally been a state offense.

In the *Dirks* case,[62] a financial analyst used nonpublic information to alert his clients that something was wrong at Equity Funding, and he advised them to sell their stock. He blew the whistle after he alerted his clients. Rather than being regarded as a hero for disclosing information that led to the Equity Funding scandal, the analyst was prosecuted by the government and he temporarily lost his right to continue in his employment. In addition, he was forced to spend tens of thousands of dollars in legal fees to defend himself against an alleged crime that the United States Supreme Court eventually held was no crime at all.[63] Prosecuting people such as Dirks for uncovering and disclosing fraud places a chilling effect on the future actions of all individuals. They will not "blow the whistle" if they fear being prosecuted, and they will not expend the effort to discover information

60. United States v. Carpenter, 791 F.2d 1024 (2d Cir. 1986), *aff'd*, 484 U.S. 19 (1987).

61. For a discussion of property rights in information and the misappropriation theory, see Aldave, *Misappropriation: A General Theory of Liability for Trading on Nonpublic Information*, 13 HOFSTRA L. REV. 101 (1984); Manne, *supra* note 12; Martin, *Insider Trading and the Misappropriation Theory: Has the Second Circuit Gone Too Far?*, 61 ST. JOHN'S L. REV. 78 (1986).

62. Dirks v. SEC, 463 U.S. 646 (1983). This case is discussed in PRINCIPLES AND POLICIES, *supra* note 1, at 698.

63. *Dirks*, 463 U.S. at 665 ("Under the inside-trading and tipping rules set forth above, we find that there was no actionable violation by Dirks.").

if they fear that such information will result in punishment.

The free speech aspect of insider trading has been neglected. To the extent the SEC prevents individuals from speaking, or threatens to punish them for speaking, or tells them how to speak or what to say, it places a chilling effect on the right of free speech. Wolfson points out[64] that if Winans' failure to disclose his financial interest in his column constituted a violation of the securities laws, then the only way for Winans to avoid liability would be to disclose in his column the financial interest he had acquired, or for the newspaper not to run the article. In effect, the SEC would be dictating what he should include in his story. If Winans could constitutionally be prosecuted on the misappropriation theory, there is no limit to the extent to which the government can intrude into all areas of communications.

It is not inconceivable that government could require a reporter who covers a steel strike to reveal the fact that he owns steel company stock.[65] However, it is more likely that the radio or television station covering the story would suppress such information to avoid potential liability or loss of its license. Such suppression was exactly what happened when the United States Congress passed the Fairness Doctrine.[66] Any such regulations have a chilling effect on the first amendment right to free speech and press, and on the public's right to know. However, this chilling effect may not necessarily render regulation constitutionally impermissable. For example, government has regulated commercial speech, and there is a body of case law to support such regulation,[67] although many of these rulings seem to violate the right of free speech.

The Investment Advisers Act of 1940[68] is a case in point. In one recent case, Christopher Lowe, a registered investment adviser, was prosecuted and convicted of violating this Act.[69] His registration was

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64. Wolfson, *Civil Liberties and Regulation of Insider Trading*, in ECONOMIC LIBERTIES AND THE JUDICIARY, 329-34 (J. Dorn and H. Manne eds. 1987).

65. *Id.* at 331.

66. *See* L. POWE, AMERICAN BROADCASTING AND THE FIRST AMENDMENT 108-20 (1987).

67. *See, e.g., Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n*, 447 U.S. 557 (1980); McMenamin & Gorenc, *Subverting the First Amendment*, REASON 23 (Jan. 1983).

68. Investment Advisers Act of 1940, 15 U.S.C. § 80b-3(c) (1988).

69. Lowe v. SEC, 472 U.S. 181 (1985). This case has been discussed by several commentators. One of the more recent discussions is Comment, *The Right to a Free Press and the Regulation of Securities Newsletters: The Controversy Continues*, 56 U. CIN. L. REV. 1445 (1988). *See also* Aman, *SEC v. Lowe: Professional Regulation and the First Amendment*, 1985 SUP. CT. REV. 93; Coffhan, *Lowe v. Securities and*

revoked, and he was prohibited from publishing his newsletter, even though the SEC did not address the issue of whether anything he published was false or misleading. Such prior restraint erodes an individual's freedom of speech, even if the newsletter was technically the product of a closely held corporation rather than an individual.

There is also an argument to be made that regulating stock transfers can impinge on freedom of association.[70] Stock certificates represent a membership interest in an organization. Placing restrictions on buying and selling such membership interests and on communicating information between members constitutes a restriction of the freedom of association.

Another threat, not just to civil liberties, but to major sectors of the economy, is the Racketeer Influenced and Corrupt Organizations law (RICO),[71] which allows a federal prosecutor to freeze a company's assets before it has been proved that a crime has been committed. Punishment is inflicted before anyone has been found guilty of any crime.

The most recent example, and perhaps the greatest abuse of this law, is the Drexel Burnham case.[72] In this case, United States Attorney

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Exchange Commission: The Deterioration of Financial Newsletter Regulation, 10 NOVA L.J. 1267 (1986); Desch, *Lowe v. SEC: Guaranteeing the Right to Publish Investment Newsletters Through Statutory Construction*, 64 WASH. U.L.Q. 577 (1986); Draughon, *SEC v. Lowe: Redefining the Bona Fide Newspaper Exclusion*, 14 SEC. REG. L.J. 291 (1987); Garver, *Lowe v. SEC: The First Amendment Status of Investment Advice Newsletter*, 35 AM. U.L. REV. 1253 (1986); Gora, *Supreme Court Report: Five Wins and Nine Losses for Free Speech Fans*, 71 A.B.A. J. 116 (1985); Law, *Regulation of Investment Newsletter Publishers: The SEC's Power Reaches a New "Lowe,"* 11 VT. L. REV. 175 (1986); Lee, *The Effects of Lowe on the Application of the Investments Advisers Act of 1940 to Impersonal Investment Advisory Publications*, 42 BUS. LAW. 507 (1987); Levant, *Financial Columnists as Investment Advisers: After Lowe and Carpenter*, 74 CALIF. L. REV. 2061 (1986); Mohr, *Lowe v. SEC: Avoidance of the Commercial Speech Definition—The Right Result for the Wrong Reasons*, 17 U. TOL. L. REV. 1007 (1986); Nites, *The SEC's Regulation of the Financial Press: The Legal Implications of the Misappropriation Theory*, 52 BROOKLYN L. REV. 43 (1986); Norquist, *SEC v. Lowe: The Constitutionality of Prohibiting Publication of Investment Newsletters Under the Investment Advisers Act*, 69 MINN. L. REV. 937 (1985); Thompson, *Lowe v. SEC: Investment Advisers Act of 1940 Clashes with First Amendment Guarantees of Free Speech and Press*, 21 U. RICH. L. REV. 205 (1986).

70. Wolfson, *supra* note 64, at 334.

71. 18 U.S.C. §§ 1961-1968 (1988).

72. This case has been discussed in numerous articles in the financial and popular press. *See, e.g., The RICO Racket*, THE ECONOMIST, Dec. 17-24, 1988, at 14; *Nailing the Junk Kings*, NEWSWEEK, Jan. 2, 1989, at 44; *What Hath Drexel*

Rudolph Giuliani threatened to freeze Drexel Burnham Lambert's assets if it did not plead guilty to six felony counts and pay a $650 million fine for allegedly violating the insider trading laws. Had Drexel decided to exercise its right to a trial, it could have been shut down by Giuliani, because having the company's assets frozen is tantamount to having it close its doors and go out of business. Now that Drexel is a confessed felon (even though it may have committed no felony), it is subject to a barrage of civil lawsuits. It stands to lose all its federal, state, and local government business. In fact, it has since sought protection under the bankruptcy laws. The Federal Savings and Loan Insurance Corporation no longer allows Drexel to underwrite its junk bond issues. New York City and Wisconsin no longer allow Drexel to participate in bond issues. There is a possibility that no entity requiring state licensing will be able to do business with Drexel.[73]

RICO was originally intended to prevent racketeers from hiding their assets between the time of indictment and conviction. While it can be argued that even yet-to-be-convicted gangsters are entitled to have their day in court before having their assets frozen, the case is even more clear when the accused cannot reasonably be classified as a racketeer and the accused stands to suffer substantial loss if assets are frozen before trial. Drexel clearly is not a gangster in the traditional sense even if it was actually guilty of committing a crime (we

Wrought?, FORTUNE, Jan. 16, 1989, at 10. For more scholarly analyses of RICO, see Barnett, *The End of Court Imposed Limitations to Civil RICO—Sedima S.P.R.L. v. Imrex Co., 105 S. Ct. 3275 (1985)*, 1986 ARIZ. ST. L.J. 521 (1986); Bridges, *Private RICO Litigation Based Upon "Fraud in the Sale of Securities,"* 18 GA. L. REV. 43 (1983); Bridwell & Cooper, *Hard Law and Bad Cases: The Fourth Circuit Limits Civil RICO*, 22 WAKE FOREST L. REV. 715 (1987); Driscoll, *United States v. Sutton: Reining in on Runaway RICO*, 42 U. PITT. L. REV. 131 (1980); Goldsmith & Keith, *Civil RICO Abuse: The Allegations in Context*, 1986 B.Y.U. L. REV. 55; Gorenc, *United States v. Sutton: The Sixth Circuit Curbs Abuse of RICO, the Federal Racketeering Enterprise Statute*, 28 CLEV. ST. L. REV. 629 (1979); Helger, *Criminal Forfeiture and the Necessity for a Post-Seizure Hearing: Are CCE and RICO Rackets for the Government?*, 57 ST. JOHN'S L. REV. 776 (1983); Hettinger, *Due Process in Preliminary Proceedings Under RICO and CCE*, 83 COLUM. L. REV. 2068 (1983); Jennette, *Forfeiture of Attorneys' Fees Under RICO: An Affront to a Defendant's Right to Counsel and to a Fair Trial*, 12 U. DAYTON L. REV. 553 (1987); Stallings, *Criminal Law—Are Governmental Entities Appropriate RICO Enterprises?*, 13 MEM. ST. U.L. REV. 96 (1982); Valukas & Walsh, *Forfeitures: When Uncle Sam Says You Can't Take It With You*, 14 LITIGATION NO. 2 31 (1988); Warren, *RICO Forfeitures and the Rights of Innocent Third Parties*, 18 CALIF. L. REV. 345 (1982).

73. *Drexel Burnham Lambert: Unfinished Business*, THE ECONOMIST, Jan. 14, 1989, at 72.

will never know, because the case will never get to court). It is not about to hide its assets to protect them from seizure. The RICO law gives prosecutors a weapon that no one should have—the power to cause an accused substantial harm before trial. In the Drexel case, the accused was threatened with death, in the financial sense, if it exercised its right to its day in court.[74]

The SEC's attack on Drexel stands to have more far-reaching consequences than just a financially weaker Drexel Burnham Lambert. Clobbering Drexel with RICO stands to weaken the U.S. economy and make it less competitive internationally, which hurts consumers everywhere.

II. OTHER REMARKS

To say that insider trading has a bad press and is commonly held in ill repute would be the understatement of the century. Dennis B. Levine, a thirty-three year old New York City investment banker, was recently indicted on charges of insider trading.[75] He is accused of

74. A number of commentators have pointed out the possibility of abuse of this statute. *See, e.g.*, Bridges, *Private RICO Litigation Based Upon "Fraud in the Sale of Securities,"* 18 GA. L. REV. 43 (1983); Bridwell & Cooper, *Hard Law and Bad Cases: The Fourth Circuit Limits Civil RICO*, 22 WAKE FOREST L. REV. 715 (1987); Dombrink & Meeker, *Racketeering Prosecution: The Use and Abuse of RICO*, 16 RUTGERS L.J. 633 (1985); Goldsmith & Keith, *Civil RICO Abuse: The Allegations in Context*, 1986 B.Y.U. L. REV. 55; Lacovara & Aronow, *The Legal Shakedown of Legitimate Business People: The Runaway Provisions of Private Civil RICO*, 21 NEW ENG. L. REV. 1 (1985); Valukas and Walsh, *Forfeitures: When Uncle Sam Says You Can't Take It With You*, 14 LITIGATION NO. 2, 31 (1988); Note, *The End of Court Imposed Limitations to Civil RICO—Sedima S.P.R.L. v. Imrex Co., 105 S.Ct. 3275 (1985)*, 1986 ARIZ. ST. L.J. 521; Comment, *RICO Forfeitures and the Rights of Innocent Third Parties*, 18 CAL. W.L. REV. 345 (1982); Note, *United States v. Sutton: The Sixth Circuit Curbs Abuse of RICO, the Federal Racketeering Enterprise Statute*, 28 CLEVE. ST. L. REV. 629 (1979); Note, *Due Process in Preliminary Proceedings Under RICO and CCE*, 83 COLUM. L. REV. 2068 (1983); Comment, *Forfeiture of Attorney's Fees Under RICO: An Affront to a Defendant's Right to Counsel and to a Fair Trial*, 12 U. DAYTON L. REV. 553 (1987); Note, *United States v. Sutton: Reining in on Runaway RICO*, 42 U. PITT. L. REV. 131 (1980); Gutis, *Judge Dismisses Racketeering Case Over LILCO Rates: Sees Misuse of RICO Law*, The New York Times, Feb. 12, 1989, at 1L, col. 3.

75. For more on the Dennis B. Levine case and other such cases in the popular press, see D. FRANTZ, LEVINE & CO.: WALL STREET'S INSIDER TRADING SCANDAL (1987); Castro, *Of Loose Lips and Stock Tips: Victory in the Winans Case Will Help in Snaring Insider Traders*, TIME, Nov. 30, 1987, at 63; *Insider Jail*, THE ECONOMIST, Oct. 10, 1987, at 93; Teachout, *Inside Dennis Levine*, FORTUNE, Sept. 28, 1987, at 195; *The Inside Traders Twisting in the Wind*, BUSINESS WEEK, Aug. 24, 1987, at

earning $12.6 million on fifty-four separate deals in which he unlawfully utilized information not publicly disclosed. If convicted, he could have been fined severely and been forced to spend twenty years in prison. Indeed, as part of his plea bargain, he was made to apologize for his conduct, compelled to give up a Bahamian bank account of $10.6 million, plus over $1 million in other assets, and shall now have to implicate others for the same "crime." His prosecutor, Rudolph Giuliani, has been highly praised for taking these actions.

Practically all the articles that have been written on insider trading in recent years have treated it as something evil.[76] Whenever the term

94; Weiss, Power & Crock, *Insider Trading: Business as Usual*, BUSINESS WEEK Aug. 24, 1987, at 20; Tell, *Making Punishment Fit White-Collar Crime*, BUSINESS WEEK, June 15, 1987, at 84; Elias, *Fast Moves by the Insiders Turn Wall Street Inside Out*, INSIGHT, Mar. 23, 1987, at 12; England, *Scandal's Lessons Hit the Street*, INSIGHT, Mar. 23, 1987, at 8; Muck, *The Boesky Touch*, CHRISTIANITY TODAY, Mar. 6, 1987, at 14; Koepp, *From Pinstripes to Prison Stripes*, TIME, Mar. 2, 1987, at 48; Baer, *Handcuffs on Wall Street*, U.S. NEWS & WORLD REPORT, Feb. 23, 1987, at 38; *Levine Receives Prison Term, $362,000 Fine*, Wall Street Journal, Feb. 23, 1987, at 2, col. 2; *Now Wall Street Itself is on Trial*, THE ECONOMIST, Feb. 21, 1987, at 77; *Sight of Marshals and Handcuffs Stun Workers at Kidder, Goldman*, Wall Street Journal, Feb. 13, 1987, at 10, col. 5; Stewart & Hertzberg, *Inside-Trading Scandal Implicates High Aide At Goldman, Kidder*, Wall Street Journal, Feb. 13, 1987, at 1, col. 6; *Dennis Levine: Where the Scam Faltered*, FORTUNE, Jan. 5, 1987, at 49; Kinkead, *Ivan Boesky: Crook of the Year*, FORTUNE, Jan. 5, 1987, at 48; Glaberson, Laderman, Power & Cahan, *Who'll Be the Next to Fall?*, BUSINESS WEEK, Dec. 1, 1986, at 28; *Spreading Scandal: Fall of Ivan Boesky Leads to Broader Probe of Insider Information*, Wall Street Journal, Nov. 17, 1986, at 1, col. 6.

76. The notable exception is the work of Henry G. Manne. *See* MANNE, ECONOMIC POLICY AND THE REGULATION OF CORPORATE SECURITIES (1969); MANNE, INSIDER TRADING AND THE STOCK MARKET (1966); Manne, *Insider Trading and Property Rights in New Information*, 4 CATO J. 933 (1985), *reprinted in* ECONOMIC LIBERTIES AND THE JUDICIARY, 317 (Dorn & Manne eds. 1987); Manne, *Insider Trading and the Law Professors*, 23 VAND. L. REV. 547 (1970); Manne, *A Rejoinder to Mr. Ferber*, 23 VAND. L. REV. 627 (1970); Manne, *Should Fund Managers Use Inside Information Personally?*, 1 THE INSTITUTIONAL INVESTOR 19 (May 1967); Manne, *What's So Bad About Insider Trading?*, 15 CHALLENGE 14 (Jan./Feb. 1967); Manne, *Insider Trading and the Administrative Process*, 35 GEO. WASH. L. REV. 473 (1967); Manne, *In Defense of Insider Trading*, HARV. BUS. REV. 113 (Nov./Dec. 1966); Manne, *Insider Trading and the Stock Market* (JSD dissertation, Yale University, 1966). For two particularly hostile and vociferous attacks on Manne's position, see Schotland, *Unsafe at Any Price: A Reply to Manne, Insider Trading and the Stock Market*, 53 VIRG. L. REV. 1425 (1967); Hetherington, *Insider Trading and the Logic of the Law*, 1967 WIS. L. REV. 720.

Recently, other commentators have come to the defense of insider trading. *See* Corcoran, *Insider Trading Curbs Hurt Market Efficiency*, The Financial Post, Feb.

"insider trading" is used, the average listener/reader immediately classifies it as a bad practice, or something that is immoral or unethical. Insider traders are viewed as common criminals.[77] The purpose of this article is to explore the nature of insider trading and analyze the issues to determine the positive and negative aspects of insider trading, and how policy should be changed, if at all.

Despite the foregoing, we maintain that those who engage in insider trading, such as Dennis B. Levine, should not be held to be in violation of the law; that those who prosecute them, on the other hand, should be deemed guilty of initiating violence against people who have not resorted to such uncivilized behavior (violence or fraud) in the first place. Further, we contend that the inside trader, or insider, provides benefits to society as a whole and that insider trading activities should not be punished unless there has been fraud, a breach of fiduciary duty or an illegal taking of property.

Before we can reach this conclusion, however, we must consider, and reject, a spate of objections that have been levelled against the insider. It is to this task that we now turn.

OBJECTION NO. 1: *The inside trader takes advantage of a position of superior knowledge*. To be sure, this charge is accurate. The insider does indeed utilize his own expert information sources in order to benefit himself. But what is wrong with that? No less could be said for every entrepreneur, trader, merchant, businessman, storekeeper, capitalist, executive, industrialist, dealer, financier, banker, retailer, wholesaler, and factor who ever engaged in commerce for profit. And the same holds true for those professions where the main stock in trade is expert knowledge, opinion or information. This would include such callings as teacher, doctor, lawyer, professor, scientist, researcher, detective, librarian, and so forth. All these occupations use expert knowledge or information.

And in what light are we to consider the lowly employee who quits his modestly paying job so that he can "take advantage" of a better offer down the street? We may assume that he hears about this opportunity from his wife, or brother-in-law or baseball teammate,

8, 1989, at 9 (Toronto, Ont.); Corcoran, *Insider Trading Not a Criminal Activity*, The Financial Post, Feb. 7, 1989, at 11 (Toronto, Ont.); Lawson, *The Ethics of Insider Trading*, 11 HARV. J.L. & PUB. POL'Y 727 (1988); Macey, *Ethics, Economics, and Insider Trading: Ayn Rand Meets the Theory of the Firm*, 11 HARV. J.L. & PUB. POL'Y 785 (1988); Cox, *What's So Bad About Insider Trading?*, THE PLAIN DEALER, Dec. 12, 1988, at B-5, col. 1 (Cleveland, Ohio).

77. McMenamin, *Witchhunt*, 20 REASON 34 (1988).

or in any other "privileged way," not open on an equal basis to all others. Surely, he does so on the basis of superior information than that possessed by his fellow workers. Otherwise, they would have all quit, presumably, to attain the higher salary. Shall we incarcerate such a person along with the inside trader, who also "takes advantage of a position of superior knowledge"? Similarly, if we are to punish inside stock market traders, what about others who engage in commercial activities? Does this apply to the housewife who hears from her hairdresser, who was told by her sister, the stock clerk at a department store, that a bargain sale was soon to be put into effect? If this housewife rushes down to the supermarket, should she be met by the economics police?

There is no rhyme or reason to this law, or any limitation on its application. It can, with equal logic, be applied to the child's sidewalk lemonade stand; to the customer who "improperly" ferrets out a bargain price; to the supplier, who "illegitimately" learns of their great demand for lemons, and holds out for a higher price.

Obviously, the law would never be applied in such contrived cases. Those who attempted to do so would only succeed in making themselves into laughingstocks. But this should not be allowed to disguise Hayek's insight about being governed by objective law, not arbitrary man-made whims.[78]

OBJECTION NO. 2: *Insider trading is unfair to the small investor who lacks these special informational advantages; the playing field is not level for the small investor.*[79] There are serious deficiencies with this objection as well. First of all, the analogy between sports events and stock market investment is not a valid one. The former is a zero sum game—one team or player must win, the other must lose.[80] The latter is a positive sum game, where *both* parties to a voluntary trade must gain. They do so at least in the expectations sense, for neither would have agreed to an exchange (of money for shares, or shares for money) if he did not expect to thereby benefit himself. Thus, there is a strong case for a level playing field in athletic encounters.[81]

78. F.A. HAYEK, THE CONSTITUTION OF LIBERTY (1960).

79. Procrustes, in Greek mythology, was an early exponent of the level playing field (enforced equality) theory. If his house guest was too long to fit in his bed, Procrustes would cut off some body parts until his guest fit. If the guest was too short, Procrustes would put the guest on the rack until he stretched to fit. For a modern view of enforced equality, see A. FLEW, THE POLITICS OF PROCRUSTES (1981).

80. Unless, of course, there is a tie.

81. Although even here, there are times when, by mutual consent, the playing field can be tilted one way or another, to give an advantage, or handicap, to the weaker side.

Otherwise, sports fans will not be able to unambiguously credit the winning team with the victory. Only an even playing field, or one in which goals are switched at half time, can match the skills of the contending sides; and this, after all, is the whole point of the exercise. There may conceivably be reasons for employing similar equalizing techniques in the stock market, but the argument from sports will hardly be sufficient to establish them.

Second, it is by no means unfair that stock market information is not equated over all participants. Consider another analogy, this time a better one, from the field of innovations. It is patently obvious that the knowledge of all would-be inventors is highly heterogeneous. That is, information varies all the way from that possessed by scientific research institutes, with all of the latest technology and hundreds of credentialed scientists, down to that held by the basement or garage tinkerer. If it is "unfair" that stock market investors have widely disparate stores of information, is it also "unfair" that this same situation applies also to inventors?

Maybe it is unfair, but if it is, this applies equally to both stock market transactors and inventors. In any event, it is exceedingly hard to determine whether or not it is unfair because we are never vouchsafed any independent criterion upon which such a judgment could be rendered.

From where did this fetish for equal information spring? Its source would appear to be the contention that it is somewhere engraved on stone tablets that the small investor has the right to knowledge that is equal to that possessed by anyone else. But how could such a grotesque idea gain any sort of currency at all, let alone enough to support the incarceration of inside traders, just because their information is patently superior to that of most other people?

Although this is a highly speculative conjecture, one possible explanation is that this view is an implication, or an extension, of one of the tenets of the "perfectly competitive" model. This tenet, of course, is the proscription that in order for competitive conditions to hold, there must be full information made available to all market participants. Under perfect competition, knowledge is costless and immediately available to all. Ipso facto, information must be *equal*. Because everyone is assumed omniscient, everyone must be *equally* well informed. It may well be viewed as improbable that the critics of inside traders should be enthralled by a theory as unrealistic as that of the perfectly competitive model,[82] but this scenario does have

82. For an exegesis of perfect competition, with its emphasis on full, equal,

a sort of perverse appeal to it.[83]

Another possible explanation is that it stems from the move toward equality favored by certain intellectuals. If we are to "share the wealth," and penalize those who have more of something than the average person, why not equalize information as well? States Terence Corcoran in this regard, "[N]ormal, natural, logical behavior that adds to market efficiency . . . is considered immoral under the egalitarian stock market theory which makes inequality a crime."[84]

OBJECTION NO. 3: *Insider trading hurts outsiders—those who cannot call upon privileged information in their portfolio choices.* This is not a decisive argument for prohibiting the practice, for even if it does reduce the incomes of other people, there is no legitimate presumption that all economically competitive behavior that is harmful must be outlawed. For example, if A opens up a grocery store across the street from B's store and attracts some of B's customers away, A may be said to hurt B. And yet B has no right against A that he should not be victimized by harm in this way. If A marries the woman that B was courting, the welfare of B is again reduced. But there certainly can be no just law against competition in the marriage market that would disallow such conduct.

Anyone who buys (or sells) anything can, in similar manner, be understood to be harming other purchasers (vendors). For this activity raises (decreases) prices above (below) the level that would have otherwise obtained. And at higher (lower) prices, the economic welfare of all other demanders (suppliers) will be diminished. So even if it could be shown that the inside trader disadvantages outsiders, this would not justify forbidding the endeavor.

However, there is no evidence for this contention either. True, there may be stock market participants who purchased shares at elevated prices (or sold at deflated prices) because they were in ignorance of bad (good) information known only to the insider. But surely there will be outsiders who earn additional profits by holding onto shares made more valuable through the actions of insiders based on positive information. As well, there will be nonowners who prosper by holding off buying while prices plummet because of the machinations of inside traders acting on negative information. It is impossible to determine whether the gainers will outnumber the losers. And it is completely irrelevant, because, even if the latter predominate over the former, we still have no argument for prohibiting insider trading.

The point is that we have a right that no one initiate violence against our persons or property, but not that no one hurt our economic (or other) interests. Our title over goods confers ownership only over the goods themselves, in their physical manifestations. We have no rights concerning the value of our property, for this is determined by all actual or potential market participants. In this sense, inside trading is a "victimless" crime. Just as in the case of pornography, or gambling, or prostitution, there will be third parties who will claim ill effects. But there will not be, there cannot be, other people whose *rights* have been violated by the insider.

OBJECTION NO. 4: *Inside trading increases the volatility of stock price oscillations; this renders the market too hazardous for most people to enter, as they fear they will not have an equal chance to earn profits; this undermines the capitalist order.*[85] There are numerous

and indeed, perfect information, see E.H. CHAMBERLIN, THE THEORY OF MONOPOLISTIC COMPETITION (1933, 1948); J.M. CLARK, COMPETITION AS A DYNAMIC PROCESS (1961); Slichter, *In Defense of Bigness in Business*, in MONOPOLY POWER AND ECONOMIC PERFORMANCE: THE PROBLEM OF INDUSTRIAL CONCENTRATION 13 (E. Mansfield ed. 1968); Galbraith, *The Economics of Technical Development*, in MONOPOLY POWER AND ECONOMIC PERFORMANCE: THE PROBLEM OF INDUSTRIAL CONCENTRATION 36 (E. Mansfield ed. 1968); J. ROBINSON, THE ECONOMICS OF IMPERFECT COMPETITION (1965); J.M. CLARK, *Toward a Concept of Workable Competition*, 30 AM. ECON. REV. 241 (1940). Many textbooks teach this rather peculiar doctrine. *See, e.g.*, P. SAMUELSON, ECONOMICS (various eds.). For a critique of this doctrine, see I. KIRZNER, COMPETITION AND ENTREPRENEURSHIP (1973); M. ROTHBARD, MAN, ECONOMY AND STATE (1962).

83. The perfectly competitive model theory has been outmoded for years, yet politicians and others in the present generation continue to speak of it as if it were gospel. This inability to shake off outmoded theories reminds one of what John Maynard Keynes said at page 383 of his *The General Theory of Employment, Interest and Money* (1936):

> The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed, the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure that the power of vested interest is vastly exaggerated compared with the gradual encroachment of ideas. Not, indeed, immediately, but after a certain interval; for in the field of economic and political philosophy there are not many who are influenced by new theories after they are twenty-five or thirty years of age, so that the ideas which civil servants and politicians and even agitators apply to current events are not likely to be the newest. But, soon or late, it is ideas, not vested interests, which are dangerous for good or evil.

84. R. Corcoran, *Insider Trading Curbs Hurt Market Efficiency*, The Financial Post, Feb. 8, 1989, at 9 (Toronto, Ont.).

85. Buckley discusses this argument. *See* F.H. BUCKLEY AND M.Q. CONNELLY, *supra* note 1, at 705.

and grave shortcomings to this objection as well. First of all, even assuming that insider activity will raise price variance, and that this will indeed deter small traders from investing on Wall Street, the capitalist system will by no means be undermined. For, contrary to those who urge widespread stock ownership as a means of attaining the free marketplace,[86] the two are far from equivalent. If we assume that the necessary and sufficient conditions of free enterprise are a clearly defined set of private property rights (based on self ownership and homesteading) and a system of law that prohibits only the initiation of violence against nonaggressors,[87] then the ban on insiders can hardly safeguard laissez-faire capitalism. On the contrary, because this sort of commercial behavior certainly initiates violence against no one, outlawing it is clearly *contrary* to the ethic of the marketplace. The analogy between information of stock values and knowledge that enhances inventions is again apropos. It makes as much sense to assert that capitalism depends on investors thinking they have an equal chance to profit from stock market speculation as it does to claim this system depends upon tinkerers supposing that they have an equal chance to discover a new technological innovation. Namely, it makes no sense at all. It is a peculiar and idiosyncratic definition that equates free enterprise with such egalitarianism. It is possible to have a healthy and vibrant marketplace even though individuals do not possess equal intellectual capacities and identical information.

Further, there is a contradiction implicit in this criticism of the insider. If it were true, then no small investors would dare to tread in so dangerous a venue as the stock market. But the Securities and Exchange Act of 1934 was passed to protect the owner of just a few shares.[88] If this objection were correct, there could have been no one

86. *See* L. Kelso, The Capitalist Manifesto (1958). For a critique of this doctrine, see T.P. Roth, *The Economics of Property Rights Transferral*, in Privatization: Theory and Practice (M. Walker ed. 1980).

87. This view on the role of the state has an honored and noble tradition, going back to Adam Smith, John Locke, Thomas Jefferson and a number of other classical liberals and libertarians. However, a detailed exploration of this view would take too much space. For a modern exposition of this philosophy, see R. Nozick, Anarchy, State, and Utopia (1974); M. Rothbard, The Ethics of Liberty (1982); M. Rothbard, For a New Liberty (1973).

88. The securities acts of 1933 and 1934 were enacted to restore public confidence in the securities markets after the 1929 stock market crash. The Securities Act of 1933 requires companies to make certain detailed disclosures before offering securities for sale in interstate commerce. The Securities Exchange Act of 1934 addresses the secondary distribution of securities as well as proxies, tender offers, insiders and the regulation broker-dealers. For a good, brief description of these acts,

for the SEC Act to have defended at that time! Because it is obvious that small investors were participating in the market then, it could not possibly be true that the extreme price oscillations "caused" by the insiders would be sufficient to discourage all those of moderate means who desire to invest.

So far in this analysis, we have been assuming that the insider does indeed destabilize the stock market. It is now time to call into question this assumption; i.e., the major premise of the argument we have been considering must be rejected. Far from increasing volatility, it can be shown that insider trading actually reduces it. This somewhat startling insight is directly deducible from the fact that the insider knows more about the true value of the corporation in question than anyone else. Given a profit orientation, the more information available in a market, the sooner, and the more likely, prices are to approach their long run equilibrium prices.

It is for this reason that prices are higher, and vary more, in towns where tourists are the preponderant customers,[89] than in places where long-residing citizens are the main purchasers. Travellers have far less incentive to make themselves expert in local markets than do the regular inhabitants. They cannot call upon any stores of information, and the payoff from any knowledge they manage to attain will only last for the short time they reside in the neighborhood. A merchant who charges a tourist a price far in excess of what is being offered elsewhere has a good chance of having it accepted. But it is painfully obvious that such a ploy could not be pulled on a resident. It would be rejected outright and resented, resulting in loss of good will for the vendor.

The more accurate information that underlies the concatenation of prices, the more efficient they are likely to be, and the better will be the allocation of resources that depend on them. Moreover, a market is far less likely to become "blindsided" to the degree it is based on the best possible knowledge available. Because this is precisely the sort of information said to be possessed by the insider, it follows that allowing full scope for his participation in the stock market is the last best hope for a stable price system, with minimal price volatility.

see J. Frascona, C.P.A. Law Review 865 (1977); G. Lowe, C.P.A. Bus Law Review 100 (1978). Most business law texts also cover these acts. For a history of the Securities and Exchange Commission, see R. Karmel, Regulation by Prosecution: The Securities & Exchange Commission versus Corporate America (1982).

89. G. Becker, Human Capital, 51-52 (1964).

OBJECTION NO. 5: *The inside trader violates his fiduciary responsibilities; he commits fraud, which is equivalent to theft.* It is of course illegal, and should be so, to contravene one's fiduciary duties, for example, those that exist between an executor of an estate and a minor beneficiary. The administrator in such a situation has voluntarily taken upon himself certain obligations, and failure to deal with his ward in an arm's length manner not only breaches this commitment, but sets up insoluble conflicts of interest as well.

Fiduciary responsibilities, however, do not exist in a vacuum. They do not pertain to all businesspersons, but only to those who have voluntarily taken them upon themselves. And it is simply not true that the inside trader, merely by virtue of this status, has shouldered any obligations of this sort that do not pertain to us all. It would be the rare stock market deal indeed where the insider happened to be related in this manner to the relevant outsider. And even if such a rare occurrence did come to pass, it could hardly be considered a violation of fiduciary responsibilities; rather, it would be deemed as the merest of coincidence.

It is of course true that fraud is equivalent to theft. But in the perpetration of this crime, the seller must lie about the product or deceive the buyer in some manner. The stock market, however, is extremely impersonal. The inside trader merely authorizes his stockbroker to offer certain shares for sale, and this tender is made to all market participants on an equal footing. Under such conditions, is it possible for one party to the transaction to falsify information to the other? At the time of the offer, the insider does not even know who will agree to acquire his property. Nor can he properly be said to be conveying lies or misinformation to all potential market actors, for he communicates no knowledge of any sort to anyone. He merely orders his broker to sell.

OBJECTION NO. 6: *It is unfair for an executive employee to receive more compensation from his corporation than is called for in his salary package, but one can earn far in excess of one's contracted stipend by engaging in trading as an insider; therefore, this is a way of cheating one's employer.* In response to this objection, notice first that no resort is here made to "the public interest."[90] Rather, the alleged victim is the insider's employer. This is a rather limited attack on the practice we are considering, focusing on employees of affected companies alone. Employee status, of course, is by no means a necessary condition for inside trading. Others can do it too: employers, free lance journalists, geologists, etc.[91] The objection concentrates only on the former, implicitly conceding that the latter are blameless.

A second difficulty is that, even if the charge is true, it is not a criticism of inside trading per se, but against the breaking of an employment contract. Because there is already case law dealing with violations of business agreements,[92] there would appear to be no

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90. It is a well-established principle of Anglo-American law that some contracts are void because they are against the "public interest" or "public policy." Terms like "public interest" or "public policy" would lead us to believe that public interests are somehow different from private interests. But the public interest is really just the sum of private interests. And since private interests are often in conflict with each other, "public interest" is really just a meaningless term, "an example of the fallacy of conceptual realism," as Rothbard points out. M. ROTHBARD, POWER AND MARKET 218, n.34 (1970). John Hospers has a similar view of the term "public interest."

> People speak of 'the public interest.' But what is the public interest? Strictly speaking, there is no such thing. There is only the interest of each individual human being. There are interests that many or all people share, but these are still the interests of individuals. When politicians say that something is 'to the public interest,' they usually mean that it serves the interests of some people but goes against the interests of others—and usually the interests of the people with the most political pull win out. Is it to the public interest for some to be forced to die so that others may be saved? Is it to the public interest for a hundred crazed men to lynch one man in the public square? Is it to the public interest for all the citizens of the nation to be taxed to pay for a federal dam in one section of it? In Sweden it takes a couple eight to ten years on the average before they can obtain an apartment of their own (owned by the government, rented by them); but they are not supposed to complain, because 'it's in the public interest.' Just as there are only individual rights, so there are only individual interests.

J. HOSPERS, LIBERTARIANISM 84 (1971).

"Social justice" is another meaningless term, as F.A. Hayek points out. *See* 2 F. HAYEK, LAW, LEGISLATION AND LIBERTY, THE MIRAGE OF SOCIAL JUSTICE (1976); F. HAYEK NEW STUDIES IN PHILOSOPHY, POLITICS, ECONOMICS AND THE HISTORY OF IDEAS 57-68 (1978); THE ESSENCE OF HAYEK 62-100 (C. Nishiyama & K. Leube eds. 1984). The term "social" has also been bent out of shape over the years, to the point where it has become meaningless, if not deceptive. *See* F. HAYEK, STUDIES IN PHILOSOPHY, POLITICS AND ECONOMICS 237-47 (1967). For a discussion of Hayek's view of these terms, see C. HOY, A PHILOSOPHY OF INDIVIDUAL FREEDOM: THE POLITICAL THOUGHT OF F.A. HAYEK 47-56 (1984); G. WALKER, THE ETHICS OF F.A. HAYEK (1986).

91. Yes, even geologists can engage in insider trading. *See, e.g.*, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969). This case is discussed in many places. *See, e.g.*, PRINCIPLES AND POLICIES, *supra* note 1, at 682. As Buckley points out at 665, the "abstain or disclose rule" is largely traceable to the *Texas Gulf Sulphur* case. According to this rule, insiders must either abstain from trading on the insider information or disclose the information to the investing public.

92. The rich common law tradition provides thousands of examples.

reason to change present law in any way. Certainly, this objection provides no evidence in support of the contention that legislation with regard to inside trading is somehow remiss.

But the most basic problem is that inside trading does not necessarily run counter to all employment contracts. If there is a provision in the agreement that prohibits a broker-employee from trading on his own account, well and good; the insider presumably should be punished—but not because of insider trading—because of contract violation. Not all companies, however, forbid this practice. Some may welcome it, perhaps on the ground that it will reduce the salary that would otherwise be needed to attract the employee.[93]

OBJECTION NO. 7: *Inside trading is an offense in the moral sense.* This may well be so, but it is irrelevant to the question we are presently addressing. The idea that not all that is immoral should be illegal goes back to the ancient Greeks, at least. Our only goal is to determine if inside trading should be proscribed by law and its practitioners subjected to fines and/or jail sentences. Surely it would not be seriously argued that all activities that offend the moral sense should be exposed to the penalties of the law. But, unless this view is taken and defended, it does not logically follow that just because (or even if) the behavior of the insider is an affront to morality, he should be made to suffer legal sanctions. Furthermore, although an analysis of morality would take us far beyond our present interests, it may not be out of place to note that inside trading is not an infringement on everyone's moral sense. That is, there are numerous ethical viewpoints that are not at all antithetical to capitalist acts between consenting adults[94]—such as inside trading.

III. A Bad Law That Should Be Repealed

The U.S. Congress recently passed the Insider Trading and Securities Fraud Enforcement Act of 1988.[95] Yet the evidence so far uncovered strongly suggests that insider trading helps the market act more efficiently while not violating the rights of any identifiable individual or group. The likely result of this legislation will be a market that operates less efficiently.

The law states that:

The Congress finds that —

> (1) the rules and regulations of the Securities Exchange Commission under the Securities Exchange Act of 1934 governing trading while in possession of material, nonpublic information are, as required by such Act, necessary and appropriate in the public interest and for the protections of investors;
>
> (2) the Commission has, within the limits of accepted administrative and judicial construction of such rules and regulations, enforced such rules and regulations vigorously, effectively, and fairly; and
>
> (3) nonetheless, additional methods are appropriate to deter and prosecute violations of such rules and regulations.[96]

The penalties for violating the Act are difficult to determine. For example, "'profit gained' or 'loss avoided' is the difference between the purchase or sale price of the security and the value of that security as measured by the trading price of the security a reasonable period after public dissemination of the nonpublic information."[97] Such open wording makes the penalty too indefinite. "Public dissemination" may occur over a period of weeks, months, or even years, depending on how some court chooses to interpret the statute's wording.

The strongest criticism that has been leveled against this new legislation is that the term "insider trading" was not defined.[98] That

93. Henry G. Manne discusses this point in several places. *See* H. Manne, Insider Trading and the Stock Market (1966); *see also* Principles and Policies, *supra* note 1, at 711. Buckley mentions the deluge of commentary and criticism this book has caused.

94. This felicitous phrase was coined by Robert Nozick. *See* R. Nozick, Anarchy, State and Utopia (1974). For more on the moral aspects of insider trading, see R. Foley, Jr., *Insider Trading: The Moral Issue*, 37 The Freeman 409 (1987).

95. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub.L.No. 100-704, 102 Stat. 4677 (1988). For a summary of the Act's provisions, see *Congress Passes Greater Penalties And Detection on Insider Trading*, N.Y. Times, Oct. 22, 1988, at 1, col. 1. For a more detailed account, see generally Fed. Sec. L. Rep. No. 1304, Part II (CCH Sept. 21, 1988). Criminal penalties include jail terms of up to 10 years and fines for individuals of up to $1 million ($2.5 million for non-natural persons). The law gives the SEC the authority to pay bounties to individuals who reveal insider trading violations. It also provides a private right of action, which allows suits to be brought by alleged victims (even though they might not have been harmed) against inside traders and tipsters just because they traded in the same class of securities at approximately the same time as the inside trader.

96. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, § 2, 102 Stat. 4677 (1988).

97. *Id.* § 3(f).

98. The 1988 law is not the first legislation that has been passed to prohibit insider trading. The Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98

omission was deliberate, perhaps because Congress could not clearly define what insider trading is.[99] The result of this serious omission will be an increase in litigation because the courts are left to form their own definition of the "crime." The "crime" of insider trading is so vague that practically any investor could be found guilty of it.[100] To charge Congress and other such legislative bodies with irresponsibility for this omission is an understatement.[101] Insider trading is officially a crime, yet nobody knows how to define the crime. Many legitimate transactions will not be made for fear of running afoul of

Stat. 1264 (1984), also provided penalties, including treble damages. *See* 15 U.S.C. §§ 21, 78 (1988). For a discussion of the 1984 Act, and punishment for insider trading in general, see Huss & Leete, *Insider Trading Regulations: A Comparison of Judicial and Statutory Sanctions*, 25 AM. BUS. L.J. 301 (1987); Janvey, *Criminal Prosecution of Insider Trading*, 15 SEC. REG. L. J. 136 (1987); Note, *Treble Damages, Deterrence, and Their Relation to Substantive Law: Ramifications of the Insider Trading Sanctions Act of 1984*, 20 VAL. U.L. REV. 575 (1986); *see also* PRINCIPLES AND POLICIES, *supra* note 1, at 659, stating the Canadian definition of insider as follows:

> Insiders were defined in the 1966 Ontario legislation to include directors, 'senior officers,' holders of more than 10% of the voting shares of the corporation, and directors and senior officers of corporations that are themselves insiders (that is, more than 10% owners) of the corporation in question. The addition of 'associates' to the civil liability provision caught an individual's immediate family, partners, controlled corporations and family trusts. The term 'affiliates' caught corporations controlling, controlled by or under common control with a corporate insider. For civil liability purposes the CBCA defined insider more inclusively than did the 1966 Ontario Securities Act. In addition to those included in the provincial legislation, the following are insiders under CBCA s. 125(1): the corporate issuer of the securities traded; all of its employees and persons 'retained' by it; and, most significantly, any person who receives confidential information from an insider and who knows his mediate or immediate source to be an insider. Members of this last group are called 'tippees.' While associates and affiliates of insiders are not specifically brought within CBCA (section) 125(1), if in possession of material undisclosed information they might be caught as 'tippers.'
>
> In the 1978 OSA, the definition of insider was expanded to embrace those who engaged or who proposed to engage in any business or professional activities with the issuer, a category which included some but not all tippees. However, 1987 amendments to the OSA extended the statute's reach to nearly all tippees. OSA §§ 75(5), 131(7).

99. Many attempts have been made by others at a definition. *See generally*, 39 ALA. L. REV. 337, 337-558 (1988) (Symposium: Defining "Insider Trading").

100. J.M. Cox, *What's So Bad About Insider Trading?*, The Plain Dealer, Dec. 12, 1988, at B-5, col. 1 (Cleveland, Ohio).

101. Justice Frankfurter would agree with this assessment. *See Hunt for Laws' 'True' Meaning Subverts Justice*, Wall Street Journal, Jan. 31, 1989, at 18, col. 3.

the new insider trading laws, and it is likely that the market will react negatively. It is not unforeseeable that dozens, or even hundreds, of individuals and brokerage firms will face prosecutions for something that the courts will find—years later and after tens of thousands or even millions of dollars of legal expenses—to be no crime at all. Lives and careers will be ruined for something that is not criminal.

The best short-term hope for preventing such travesties of justice would be for the Supreme Court to rule that the law is unconstitutionally vague.[102] But such a ruling could prove to be of only temporary relief because Congress could pass another law or federal prosecutors could continue to prosecute alleged insider trading in the absence of any law prohibiting it, as they have been doing for years. Our best long-term hope would be for further studies to be made that isolate the individuals or groups, if such groups exist, whose rights are violated by insider trading. Congress could then pass clearly-worded legislation that prevents any fraud from being committed against these individuals and groups, while allowing nonfraudulent transactions to be completed without fear of prosecution. Where there is no force, fraud, or breach of contract, it is highly questionable that placing restrictions on the trading of securities is justified. Until it can be clearly determined that someone's rights are being violated by insider trading, there should be no law or regulation restricting the practice because such restrictions could violate individual rights and will likely produce a negative market reaction.

102. Vagueness is only one of the problems with which potential inside traders must contend. Insider trading laws are also arbitrary and differ from jurisdiction to jurisdiction. Another problem, not only with insider trading laws but with all laws, is that prosecutors go beyond the wording of the law itself by examining the law's legislative history. If the legislative history is more favorable to the prosecutor's position than is the law, the prosecutor will cite whatever language from the legislative history that serves the purpose. Unfortunately, judges often consider such evidence when making their rulings. The result is that individuals may be fined or imprisoned even though they have not violated the language of the law. As far back as 1948, Justice Felix Frankfurter pointed out the danger of looking at what the legislature meant to do rather than what it actually did. *See Hunt for Laws' 'True' Meaning Subverts Justice*, The Wall Street Journal, Jan. 31, 1989, at 18, col. 3.