Insider Trading: Why to Commit the Crime From a Legal and Psychological Perspective

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INSIDER TRADING: WHY TO COMMIT THE CRIME FROM A LEGAL AND PSYCHOLOGICAL PERSPECTIVE

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INTRODUCTION

Insider trading,1 a crime that often involves the wealthy getting wealthier, is a behavior associated with cheating and greed.2 It is also a crime that is apparently difficult to deter.3 This phenomenon can be illustrated by exploring current events. Insider trading hit the newsstands again last year with the scandal involving the ImClone Systems Inc. corporation ("ImClone") and celebrity businesswoman Martha Stewart.4 This note uses that example as an

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1 Although not defined in any statute or regulation, for the purpose of this note insider trading is "the use of material, nonpublic information in trading the shares of a company . . . ." BLACK’S LAW DICTIONARY 798 (7th ed. 1999). For the purpose of this note, only the distinct crime of inside trading will be analyzed. Other forms of white collar crime will not be addressed.
2 See discussion infra Part II.B.1.b (discussing the connection between insider trading and behavior associated with cheating and greed).
3 See discussion infra Part II (discussing why the normative and legal costs associated with insider trading fail to effectively deter the crime).
4 See JAMES WILLIAM COLEMAN, THE CRIMINAL ELITE 89 (2d ed. 1989) (listing prominent businessmen as defendants in the 1987 insider trading scandal: "a partner in Goldman Sachs; the Director of Kidder, Peabody; the head of risk arbitrage for Merrill Lynch; Vice Presidents from Paine Webber, E. F. Hutton, Kidder, Peabody, and Shearson Lehman Brothers . . . "); see also Holman W. Jenkins Jr., Business World: An Autumnal Resolution: Give Martha a Break, WALL ST. J., Sept. 4, 2002, at A23 (putting the coverage of Martha Stewart on par with impending war with Iraq). This scandal will be used in a hypothetical context as an illustration of the theories explored by this note. See
illustration of why people engage in the crime of insider trading and why the behavior is not being effectively deterred.\(^5\)

In Part I, this note examines how criminal causation theories apply to insider trading. Since insider trading is a crime limited to a particular kind of criminal, one who has achieved financial and social success, the causation model of rational choice is applied.\(^6\) In Part II, this note, using the rational choice theory, weighs the potential benefits of illegal trading with inside information against potential costs from a psychological perspective. The potential costs are normative, social, and legal. The cost of violating social norms may be significant but, in the context of American culture, the normative costs of trading with inside information are low.\(^7\) In addition, the potential legal costs are examined and although found to be significant, they are rendered ineffective by their inability to adequately address the harms caused by insider trading and their failure to consistently punish all types of insider trading.\(^8\) This note suggests that people choose to engage in insider trading because the incentives to trade with inside information outweigh the deterrents.

Confounding the problem of ineffective costs is the possibility of justification.\(^9\) A person that rationally chooses to commit the crime of insider trading can justify his behavior in three ways:

\(^5\) See The Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (stating a maximum jail term of ten years). Although Insider Trading may also incur civil and administrative liability, this note will discuss only the criminal aspect of insider trading. See THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 658-60 (4th ed. 2002) (discussing the various means of enforcement of securities laws).

\(^6\) See infra note 24 and accompanying text (applying rational choice theory).

\(^7\) See discussion infra Part II.B.1 (comparing the norms espoused by American culture and the traits that are associated with insider trading).

\(^8\) See discussion infra Part II.B.3 (discussing the failure of the law to adequately address the harms of insider trading). The low legal costs fail to stimulate higher conformity to the normative costs. \textit{Id.}

\(^9\) Justification is used in this note to explain the internal process of rationalizing a crime. See infra Part III. This has, however, no bearing on justification as a legal defense.
believing that insider trading is not actually illegal, believing that it is not harming anyone, or simply refusing to accept responsibility for the trade. The justification can resolve any conflicts the person may feel about violating societal norms or breaking the law. Therefore, Part II concludes that the decision to trade on inside information is in fact a rational one. The potential benefits outweigh the potential costs, and any conflict felt by the behavior can be neutralized through justification. Finally, in Part III, this note posits that the most plausible solution for deterrence of insider trading is a clarification of the existing laws such that the legal cost of the crime can compensate for low normative barriers.

I. CRIMINAL CAUSATION IN THE CONTEXT OF INSIDER TRADING

Insider trading is committed by people who have achieved a certain amount of success in society. This is a necessary conclusion because by definition, an “inside” trader must have a close enough connection to the financial world to receive access to the information. This link is often through an elevated employment position in a corporation, the position as a financial or legal advisor, or through a social relationship with someone in an inside position. This point is exemplified by the insider trading scandals of the late 1980s involving prominent people and by the current allegations against Martha Stewart. In light of the

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10 See infra Part III (discussing how more effective legal costs could deter insider trading).

11 ELIZABETH SZOCKYJ, THE LAW AND INSIDER TRADING: IN SEARCH OF A LEVEL PLAYING FIELD 5 (1993) (defining the insider as someone who receives inside information through their employment, relationship with the company, or is tipped by others).

12 Id.

13 Id. at 116 (discussing the opportunity that executive officers, directors, and majority shareholders have for trading on inside information and depicting the stereotypical dissemination of inside information at the golf course). Printer employees also have contact with inside information. See Chiarella v. United States, 445 U.S. 222 (1980) (finding that printer who traded on inside information had no duty to abstain from the trade); infra Part II.B.3.a (discussing Chiarella).

14 See COLEMAN, supra note 4, at 89 (discussing previous scandals).
conclusion that people committing the crime of insider trading have already achieved relative success, it is important to look at why they are willing to commit the crime and put their status and wealth at risk.  

There are many competing theories on why people commit crime. This note applies the rational choice model of criminal causation. While many other theories may, in whole or in part, explain the behavior of people who commit crime and disassociate from society, these theories often fail to explain the behavior of people who commit the specific act of insider trading but otherwise conform to the law.

It has been posited that certain people have an innate criminality resulting from biological or physiological characteristics. Similar to that theory is the claim that criminals have a different psychological make-up and possess a sickness, mental pathology or personality disorder that causes them to repeatedly engage in crime rather than conform to the rules of society. An innate physical, mental or psychological characteristic may explain the actions of those who commit a myriad of offenses or dishonest acts throughout their lifetimes, but it does not explain those who conform to the law in general, but trade on inside information because an opportunity presents

15 See supra note 4 and accompanying text (listing people who put their wealth and status at risk by committing the crime of insider trading).
16 See, e.g., CLAYTON A. HARTJEN, CRIME AND CRIMINALIZATION 41-51 (1978) (discussing the different theories of criminal causation as physiological, psychological, environmental factors or cost/benefit).
17 See infra note 24 (discussing rational choice theory).
18 See SZOCKYJ, supra note 11 (discussing the types of relationships involved with being an insider).
19 Id. at 42-44 (discussing the theory that crime is caused by predisposed biological factors). This theory has received recent support in the study of repetitive antisocial behavior and is better suited to the study of crimes that are the result of maladaptive behavior such as violent crimes. Diana H. Fishbein, Biological Perspectives in Criminology, in THE CRIMINAL THEORY READER 92-93 (Stuart Henry & Werner Einstadter eds., 1998).
20 See HARTJEN, supra note 16, at 58 (discussing the different theories of criminal causation).
itself.\textsuperscript{21} In fact, personality factors that have been associated with people that commit insider trading hardly seem to be factors that evidence a mental pathology or biological abnormality.\textsuperscript{22}

Instead, personality factors associated with the crime of insider trading often coincide with personality factors that are common to people who achieve success.\textsuperscript{23} A study that examined the influence of personality factors on ethical decision-making found a positive correlation between insider trading and the factors of competitiveness, youth and the male gender.\textsuperscript{24} Insider trading is a crime of opportunity that, unlike other crimes of opportunity\textsuperscript{25} such as stealing cars or embezzlement,\textsuperscript{26} does not bar the perpetrator

\begin{itemize}
\item \textsuperscript{21} Although this note uses the ImClone Scandal to illustrate the rational choice involved in the decision to commit the singular crime of insider trading, it is necessary to acknowledge that Dr. Waksal, the CEO of ImClone, has allegedly committed other infractions throughout his lifetime. See, Geeta Anand, \textit{In Waksal’s Past: Repeated Ousters}, \textit{Wall St. J.}, Sept. 27, 2002, at A-1 (discussing Dr. Samuel Waksal’s repeated ousters from respected research laboratories because of possibility of falsified results and dishonest work suggesting a history of nonconformity). Perhaps Waksal’s behavior went undeterred because his dishonest means to succeed did in fact conform to societal norms. See discussion \textit{infra} Part II B.1 (discussing the prevalence of dishonesty and cheating in American society).
\item \textsuperscript{22} COLEMAN, \textit{supra} note 4, at 201 (“It is generally agreed that personal pathology plays no significant role in the genesis of white collar crime.”).
\item \textsuperscript{24} \textit{Id}. It is also difficult to claim that people commit the act of insider trading because they face outside factors such as poverty or other like hardships. This would be unlikely because the ability to obtain inside information depends on a certain amount of wealth and status.
\item \textsuperscript{25} Rational choice theory argues that criminals weigh the costs and benefits of a crime when they are faced with situational factors that present an opportunity to commit crime. See Derek B. Cornish & Ronald V. Clarke, \textit{Understanding Crime Displacement: An Application of Rational Choice Theory}, \textit{in The Criminology Reader}, 46 (Stuart Henry & Werner Einstadter eds., 1998).
\item \textsuperscript{26} Embezzlement is distinguishable from insider trading because although both occur in the corporate environment, embezzlement does not possess the same legal gray areas as insider trading nor does it possess the social aspect of insider trading in which tips are spread among family and friends.
\end{itemize}
from participation in high society.\textsuperscript{27} Therefore, criminal law theories that use biological, psychological or environmental factors to understand the commission of crime are not useful to understand insider trading. Instead, this note conducts a cost-benefit analysis of insider trading.\textsuperscript{28}

II. A COST-BENEFIT ANALYSIS OF INSIDER TRADING

Insider trading, like other corporate crimes of opportunity, is best analyzed through the framework of the classical school of criminal law.\textsuperscript{29} The classical school views the human being as a rational decision maker with a free will.\textsuperscript{30} This framework discounts factors such as biological, psychological, or environmental abnormalities, which are proposed by competing criminal theories.\textsuperscript{31} Criminal conduct is viewed as a rational choice derived through a cost-benefit analysis.\textsuperscript{32} According to the legal theorist Jeremy Bentham, “[n]ature has placed mankind under the governance of two sovereign masters, pain and pleasure. It is for them alone to point out what we ought to do, as well as to determine what we shall do.”\textsuperscript{33} Put another way, crime is committed when potential benefits outweigh potential costs.\textsuperscript{34}

\textsuperscript{27} See Szockyj, supra note 11, at 113-14 (discussing the social and employment rewards that may stem from insider trading).
\textsuperscript{28} See supra note 25 (describing rational choice theory).
\textsuperscript{29} Hartjen, supra note 16, at 54-55. The classical school employs a rational choice theory. Like other crimes of opportunity, insider trading can be explained by examining the hypothetical cost-benefit analysis a person would engage in before committing the act.
\textsuperscript{30} Id. (noting that the classical school of thought developed from judicial reform in the eighteenth century Europe).
\textsuperscript{31} See supra note 25 (discussing rational choice theory).
\textsuperscript{32} Id.
\textsuperscript{33} Jeremy Bentham, An Introduction to the Principles of Morals and Legislation (1789), reprinted in Joseph E. Jacoby, Classics of Criminology 61 (1979). More primitively, this can be described as a balance between pain and pleasure.
\textsuperscript{34} Hartjen, supra note 16, at 42 (relating the degree of punishment to the degree of deterrence). Modern criminal law recognizes rational choice theory when it attempts to deter potential criminals through the high cost of
The benefits of insider trading outweigh the costs for the group of people that engage in the behavior. The cost-benefit analysis utilized when deciding whether or not to commit a crime is similar to that which is used in economic decisions. The nonexclusive potential benefits associated with insider trading are increased wealth, avoidance of loss, possible career growth, social status, and maintenance of social relationships. The potential costs of insider trading on inside information are violation of one’s own moral beliefs, violation of social norms, violation of the law, and the consequences that follow.

A. Potential Benefits

The benefits of insider trading can be illustrated using the ImClone scandal. A hypothetical analysis illustrates why the members of the ImClone scandal may have committed insider trading. The facts are alleged as follows: In December of 2001, imprisonment. This is not to say, however, that deterrence is the only reason for imprisonment. Id. See also id. at 54-55 (stating that crime is the result of a cost-benefit analysis).


36 SZOCKYJ, supra note 11, at 113-14.


38 See Charles Gasparino & Jerry Markon, Merrill Aide Will Plead Guilty, Cooperate on Martha Stewart, WALL ST. J., Sept. 26, 2002, at A1 (naming players in scandal and their relative positions). See SZOCKYJ, supra note 11, at 116-22 (discussing common positions held by insider traders). The ImClone scandal is a useful example because the alleged participants cover a broad range of people likely to trade on inside information: a corporate officer, an investment broker, friends, and family.

39 At this time only Dr. Samuel Waksal, former CEO of ImClone, has pled guilty and been sentenced. See Jerry Markon & Geeta Anand, Waksal Pleads
before the news was released that the FDA would not review ImClone’s application for the new cancer drug Erbitux, former ImClone CEO, Dr. Samuel J. Waksal attempted to sell some of his shares in his corporation before the announcement caused a subsequent fall in price. He tipped off family members and close friends about the FDA’s decision not to review Erbitux. One of those friends was Martha Stewart. Her Merrill Lynch broker, Peter Bacanovic, subsequently sold Stewart’s shares of ImClone. The benefits each alleged inside trader would have gained if successful were substantial. With the knowledge that the company stock would plummet significantly when the news was released about the FDA’s refusal to accept Erbitux, the traders would avoid substantial pecuniary losses by trading before the information was released and the market value of the stock was drastically reduced. By avoiding the loss, the traders would not endanger the social status they enjoyed as wealthy individuals. Peter Bacanovic could have enjoyed potential career advancement associated with sharing inside information with an important client.

Guilty as U.S. Widens Probe, WALL ST. J., Oct. 16, 2002, at C1, C15. All other parties are merely alleged to have traded on inside information. Id.


41 See supra note 40 and accompanying text (discussing the facts of the Martha Stewart scandal).

42 Id.

43 Id.

44 See Anand, supra note 21, at A10 (discussing the fact that Erbitux was ImClone’s leading prospect and had been responsible for the company’s previous success).

45 Id. at A1 (stating that as of September 26, 2002 ImClone’s stock fell to less than nine dollars a share compared with more than seventy-five dollars a share preceding the announcement regarding the rejection of Erbitux). Hypothetically, if the traders had information that the stock would rebound at a later date, they could then buy back their shares at a huge profit.

46 See Szockey, supra note 11 (discussing benefits associated with insider trading).
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such as Martha Stewart. Dr. Waksal, by tipping off friends and family, would have strengthened his social relationships with them.47

B. Potential Costs

The most significant costs involved with committing the crime of insider trading are the violation of one’s own moral beliefs, social norms, and the law.48 To get a complete picture of the costs a rational actor would face, it is helpful to evaluate the strength of these informal and formal costs individually and then examine the strengthening or weakening effect of the costs on each other.

1. Violation of Moral Beliefs and Social Norms

Informal costs associated with committing a crime can be both internal and external.49 Norms control people’s behavior internally by affecting one’s view of oneself as a moral being and externally by influencing the way others view their behavior.50 The cost of violating a moral belief or social norm is perhaps even more influential on behavior than the cost of breaking the law.51 The internal cost associated with committing a crime is the violation of one’s own moral beliefs.52 This violation reduces the ability to view oneself as a moral being.53 Internal costs are closely related to external costs because internal morals are often formed from

47 See Markon, supra note 38 (describing Waksal’s crimes). It is the author of this note’s conclusion that Waksal received social reinforcement when tipping his friends and family members. This conclusion is derived from the fact that insider trading may serve as a form of social networking. See SZOCKYJ, supra note 11, at 117 (illustrating how insider trading is often committed in a social context).
48 See Robinson, supra note 37 (explaining the costs associated with breaking the law).
49 Id. at 1861 (discussing types of informal costs).
50 Id.
51 Id.
52 Id. at 1862.
53 Id. (noting that people generally want to see themselves as moral beings).
An example of this is a child that adopts his parent’s view of right and wrong.55

An external cost of committing a crime is a violation of social norms.56 Social norms define the line between socially acceptable behavior and unacceptable behavior.57 They create an obligation to act or not act in a particular way.58 Costs of violating a social norm include a loss of decent public image, employment position and social acceptance.59 Howard S. Becker, a distinguished sociologist, posited that “[d]eviance is not a quality that lies in behavior itself, but in the interaction between the person who commits an act and those who respond to it.”60 In other words, it is society’s reaction to behavior that acts as a deterrent. In terms of insider trading, it is not the actual effect on the market that would deter a potential inside trader, but the fact that he or she would be viewed as a deviant by society.61

The costs associated with breaking an internal or external norm, whether or not it is also a law, heavily influence an individual’s decision to commit a crime.62 A useful explanation of this influence is the “Esteem Theory” which states:

If many people agree that a behavior deserves disapproval, if there is an inherent risk the behavior will be detected, and

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54 See Robinson, supra note 37, at 1862 (stating that people come to hold the moral standards with which they are raised as their own).
55 Id.
56 Id. (describing the power of social norms to deter crime).
57 RICHARD A. CLOWARD & LLOYD E. OHLIN, DELINQUENCY AND OPPORTUNITY (1960), reprinted in JOSEPH E. JACOBY, CLASSICS OF CRIMINOLOGY 171 (1979) (noting that norms define what is legitimate behavior in society versus what is illegitimate).
58 Id.
59 Id. (discussing costs that occur even if not arrested for crime).
61 In applying the above hypothesis to the crime of insider trading the assumption is made that societal norms provide deterrence rather than the possible bad effects of the crime itself.
62 Robinson, supra note 37, at 1863 (discussing research that found internal and societal control have stronger deterrent effect than legal sanctions).
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if this agreement and risk are well-known, then the pattern of disapproval itself creates the cost to the behavior. When sufficiently large, these costs produce a norm against the behavior. People conform their behavior to receive positive esteem or avoid a negative reaction. Therefore, in order to understand whether insider trading is sufficiently deterred, it is helpful to ascertain whether society disapproves of insider trading, and if so, whether there is a well-known risk of detection.

a. Is Insider Trading Fair?

The harm most commonly associated with insider trading is that it produces an unfair result. The claim that insider trading is unfair derives from the belief that trading on inside information destroys the integrity of the marketplace by giving an informational advantage to a select group of insiders. This informational advantage harms the outside uninformed investors and causes instability in the marketplace. The idea that insider trading is fundamentally unfair draws on the proposition that all investors should have equal access to information and the benefits of investing in securities. The trader using inside information

64 Id. at 356.
66 See HAZEN, supra note 5, at 640. Unlike other corporate crimes, such as looting the assets of a company, insider trading, standing alone, affects stock price by affecting the supply and demand of the shares rather than removing value from the underlying company. See JONATHAN R. MACEY, INSIDER TRADING: ECONOMICS, POLITICS, AND POLICY 25 (1991) (discussing the effect on a company’s shares when a corporate insider trades on nonpublic adverse information).
68 MACEY, supra note 66, at 28.
trades at the wrong price because the price of the security does not yet reflect the inside information. Likewise, the uninformed investor is unable to benefit from the nonpublic information. Thus, the uninformed investor is unable to trust the price of the security as reflecting its true value and investor confidence will suffer.

There some lack of consensus as to whether trading with inside information deserves disapproval, however. To counter the argument that insider trading is unfair and harms outside uninformed shareholders, there is an economic argument that insider trading helps shareholders both by setting an advantageous market price and by transmitting the information into the share value. The argument claims that insiders benefit shareholders by boosting share prices when they trade on information that a company is going to have a future gain. This boost in price is beneficial to outside uninformed shareholders whether they sell at the time insiders are buying or if they hold onto their stock and sell when the insiders sell. Likewise, a shareholder that buys shares during the time that insiders are selling in advance of knowledge that the company is going to have a future loss is benefited by the decreased share price at the time of the buy. The buyer,

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69 Hang, supra note 67, at 634.
70 Id.
71 Id. at 633.
73 MACEY, supra note 66, at 24.
74 Id.
75 Id.
76 Id. at 25. The argument that the share price will fall as a result of insider trading assumes that the insiders are selling a large enough quantity to flood the market with shares and therefore lower the share price before the inside
hypothetically, would have bought the stock regardless of the insider activity and therefore reduces his loss when the stock falls because the difference between the buy and sell price is reduced. The uninformed outside trader that does not react to the insider activity and merely holds onto his shares is neither helped nor harmed by the insider trading.

There is also an argument that legalizing insider trading would provide benefits for shareholders by lowering the cost of management. Proponents of legalizing insider trading argue that individual companies could decide whether to permit trading on their own inside information and even offer it as part of a compensation package to managers and directors. Allowing managers and directors to trade on inside information involves no more risk than allowing managers and directors to set their own salaries and bonuses. In essence, this economic argument not only rebuts the claims that trading on inside information is unfair and harms the market, but actually proposes that insider trading creates a more fair and accurate market by disseminating information into the share price more quickly.

The argument that insider trading can actually help the market conflicts sharply with the idea that insider trading is so unfair that information becomes public. If the quantity traded by insiders is not sufficient to affect the price of the security then the uninformed investor will not be affected. Id. (noting that it is the pressure put on the market by the insiders that would affect the price).

77 Id.
78 Id.
79 MACEY, supra note 66, at 25.
80 Id. at 28-29 (arguing that including insider trading rights in a compensation package would benefit shareholders by lowering managers’ and directors’ demands for monetary compensation).
81 Id. at 30-31. This argument is premised on the argument that managers sufficiently motivated by profits to harm shareholders through insider trading would also be sufficiently motivated to harm shareholders through demands for excessive compensation. Id.
82 Id. at 24-31. The argument, however, ignores other issues that may make regulation of insider trading practical such as the difficulty of deregulated monitoring, uneven compliance, and international pressure to regulate global markets.
it should be punishable by an extended prison sentence. Therefore, because there are such sharply opposed schools of thought in the debate of how to treat insider trading, it is unclear whether a person weighing the costs associated with insider trading would perceive the crime to deserve disapproval from society.

b. Is There a Different Set of Norms?

Furthermore, it is possible that the class of people likely to commit insider trading subscribe to a different set of norms. The potential benefits associated with insider trading signify that behavior associated with insider trading may actually be viewed as positive among the type of people likely to commit the crime. The example of a corporate director passing along insider stock tips to his friends at a golf course illustrates the potential for positive social reinforcement for the behavior. That director may receive positive feedback such as elevated status, gratitude from friends or the promise of future inside information from other members of his group. A person in this social group is encouraged to trade on inside information because of positive social

83 See Hang, supra note 67 (saying that insider trading is “fundamentally unfair”).

84 For the purpose of this note, it is the perception of disapproval that is important because it is this perception that will potentially deter the person from trading with inside information. If that person is able to justify the act of insider trading as fair or as failing to create a true harm, then the cost of violating social norms will not be sufficiently high to deter the crime. See discussion infra Part III (discussing the power of justification).

85 See Szockyj, supra note 11 (discussing the likelihood that perpetrators of insider trading have achieved significant social or monetary success). See also Toni M. Massaro, Shame, Culture, and American Criminal Law, 89 Mich. L. Rev. 1880, 1933-34 (1991) (discussing the difference between middle class and the wealthy in relation to public shame). Massaro found that the middle class is much more responsive to the threat of public shame than the wealthy because they need society’s approval to achieve success, whereas the wealthy are already outliers of mainstream society. Id.

86 See supra Part II.A (discussing the benefits of insider trading).

87 See Szockyj, supra note 11 (discussing the relationships involved in insider trading).
reinforcement, not dissuaded from the activity because of a fear that society would view them as engaging in unfair behavior. An illustration of this type of reinforcement is the insider that is immersed in the business world driven by financial gain. In a study involving students in various business schools it was determined that a person would be likely to commit corporate crime if the crime was supported by their corporate environment. This propensity to commit crime was not explained by a feeling of invulnerability to legal sanctions, but instead by a feeling that behavior was deemed necessary or acceptable by their workplace. The study found that people were especially likely to commit crime for their workplace when the company was doing poorly or faced with international competition. This may indicate that people that trade with inside information may be influenced by a different set of social values—the values of their particular social group or corporate society. Similarly, an individual may also be influenced by the ethics of his profession to commit acts that harm the corporation. Corporate managers or directors may want to match the monetary success of their contemporaries and may put their own needs above their duty to the corporation in order to achieve exorbitant ends.

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88 See, e.g., Raymond Paternoster & Sally Simpson, Sanction Threats and Appeals to Morality: Testing a Rational Choice Model of Corporate Crime, 30 LAW & SOC’Y REV. 549, 573-74 (1996) (finding that employees are more likely to commit crime when it is reinforced by their corporate society).
89 Id.
90 Id. at 574. This propensity to commit crime for the benefit of the employer is illustrative of the more relaxed ethical standards of the business world. Id. (providing examples of when the business world espouses more relaxed ethics).
91 Id. at 568.
92 See Lisa G. Lerman, The Slippery Slope From Ambition to Greed to Dishonesty: Lawyers, Money, and Professional Integrity, HOFSTRA L. REV. 879, 889 (2002) (detailing the decline in legal ethics in response to the increase in legal earnings).
93 See Matt Murray, Rachel Emma Silverman, & Carol Hymowitz, GE’s Jack Welch Meets His Match in Divorce Court, WALL ST. J., Nov. 27, 2002, at A1 (noting that after divorce proceedings revealed exorbitant retirement perks, Welch was forced to relinquish 2.5 million to the corporation). This example
The low normative cost can also be understood when looking at the positive and negative aspects of insider trading in the context of American culture as a whole. Insider trading is often thought of as cheating, unfair and greedy. Although none of the above named traits sound especially moral or positive, American culture does reinforce self-interested, competitive behavior and highly values material gain. Especially in the business world, unfair and greedy behavior is accepted as commonplace. Greed has been considered so commonplace that “rather than be an aberration, this attitude reflects business ethics and practices throughout North American history.” Cheating, despite its negative connotations, shows how a member of the business world may be influenced to act against the interest of the corporation in contrast to the employee that commits crime for the benefit of the corporation.

See infra notes 100-07 and accompanying text (discussing the values of a capitalist society). It is worthwhile to note that other countries with market economies also have insider trading, however, many of the other countries do not condemn insider trading as much as the American legal system does, and some of the countries did not start regulating insider trading until recently under pressure from the United States.

See William R. McLucas et al., Common Sense, Flexibility, and Enforcement of the Federal Securities Laws, 51 BUS. LAW. 1221, 1233 (1996) (stating that “insider trading pure and simple, is cheating”); see also Peter M. Donnelly, The Insider Trading and Securities Fraud Enforcement Act of 1988 and Controlling Person Liability: Can Firms Outside the Securities Industry Risk Not to Adopt Insider Trading Safeguard?, 67 U. DET. L. REV 261, 265 (1990) (finding the unfairness argument to be based on the premise that insider trading is cheating). See supra Part II.B.1.a (discussing insider trading as fundamentally unfair). See S ZOCKYJ, supra note 11, at 113 (noting the large monetary gains that can result from trading with inside information). It is the author of this note’s conclusion that insider trading is perceived as greedy.

Coleman, supra note 4, at 203 (“[T]he culture of industrial capitalism tends to encourage values, attitudes, and personality structures conducive to white collar crime.”). The culture of industrial capitalism encourages people to strive for material success of the individual in a highly competitive atmosphere. Id. In contrast to a culture that encourages success for the group or sharing of wealth, industrial capitalism leads one to act for one’s own benefit potentially at the expense of others. Id.

See Paternoster, supra note 88 (giving examples of when corporate society encourages crime to get ahead).

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may not be a significant enough deviation from normative behavior to impose a high enough cost to outweigh the benefits of insider trading.

Although insider trading is labeled unfair, unfairness is actually a societal norm. A capitalist economy values self-interest over public interest. Although considered to be immoral by some, promotion of self-interest is at the heart of the American economy and culture. In American culture the individual is placed above the group and must be both aggressive and competitive to survive. Some people have unfair advantages over others because American society reflects a huge disparity between the wealthy and the poor. If one is born with material advantages, one can receive a better education, often have better access to employment opportunities, and exert more influence over social

99 Although the acceptance of this unfairness maybe grudging in some cases, the author posits that unfairness is an inherent characteristic of a capitalist society where all people are not economic equals.

100 Capitalism is defined as “[a]n economic system that depends on the private ownership of the means of production and on competitive forces to determine what is produced.” BLACK’S LAW DICTIONARY 202 (7th ed. 1999). Therefore, by definition the American economy encourages a society in which individuals compete against each other to increase production and material success. See JOYCE KOLKO, AMERICA AND THE CRISIS OF WORLD CAPITALISM XIV (1974) (labeling America as capitalist).

101 IAN TAYLOR, CRIME IN CONTEXT: A CRITICAL CRIMINOLOGY OF SOCIETIES 64 (1999).


103 GABOR, supra note 98, at 52 (discussing the pursuit of winning and self-interest as central themes in history).

104 Id. at 222-23 (describing how American culture influences crime).

and political policy.\textsuperscript{106}

Although cheating has more negative connotations than unfairness and is at times considered unacceptable business practice, cheating does not have an extremely high moral cost.\textsuperscript{107} Cheating can be seen as immoral because it is profiting at the expense of other’s moral behavior and gleaning an unfair advantage.\textsuperscript{108} Achieving that unfair advantage in American society, however, is not necessarily in violation of social norms.\textsuperscript{109} Whether or not cheating truly violates social norms varies along a

\textsuperscript{106} See Lawrence E. Mitchell, Corporate Irresponsibility 256-57 (2001) (looking at German and Japanese corporations and stating that “it is not the case that all advanced industrial countries treat material wealth as the end, at least anywhere near the degree that Americans do.”). Many countries have a large disparity between the rich and the poor, though it is arguable that American culture is distinguishable from other advanced industrialized countries as more individualized and materialistically driven. See Coleman, supra note 4, at 203 (discussing the values of a capitalist country). Although insider trading occurs and is illegal in both Germany and Japan, and although insider trading just became illegal in Germany in 1992, neither country punishes insider trading with the level of seriousness that the United States does. See Victor F. Calaba, The Insiders: A Look at the Comprehensive and Potentially Unnecessary Regulatory Approaches to Insider Trading in Germany and the United States, Including the SEC’s Newly Effective Rules 10b5-1 and 10B5-2, 23 Loy. L.A. INT’L & COMP. L. REV. 457, 469 (2001) (discussing Germany’s recent promulgation of insider trading regulations under pressure to compete with foreign markets); Ramnzi Nasser, The Morality of Insider Trading in the United States and Abroad, 52 Okla. L.Rev. 377, 381 (1999) (noting that Japan did not enact criminal sanctions for insider trading until 1988 despite “rampant” insider trading, and also noting that Japan had only sentenced one trader to jail at time of article’s publication). It is unclear and a potential area for research to determine if this lack of punishment means that insider trading is not as disruptive on the Japanese and German markets because of a more responsible corporate culture or whether it is just not perceived to be as great a wrong. See Calaba, supra; Nasser, supra.

\textsuperscript{107} Stuart P. Green, Why It’s a Crime to Tear the Tag Off a Mattress: Overcriminalization and Moral Content of Regulatory Offense, 46 Emory L.J. 1533, 1552 (1997) (categorizing cheating as a prima facie immoral act). This note will show that although cheating may be “a prima facie immoral act” it is relatively acceptable in our society.

\textsuperscript{108} Id.

\textsuperscript{109} See supra Part II.B.1.b (discussing the norms in American culture).
continuum of behavior. At one extreme, cheating in such a way that produces a dangerous outcome must be considered wrong.\footnote{See Grimshaw v. Ford Motor Co., 174 Cal. Rptr. 348, 370 (Cal. Ct. App. 1981) (finding that Ford did not include a bladder in the fuel system that could have prevented harm at a cost of four to eight dollars per car to realize a savings of 20.9 million dollars).} At the other extreme, however, certain forms of cheating are considered to be acceptable because the harm is not identifiable or the harm is expected.\footnote{Examples of cheating that do not have a high normative cost could be looking at the answers while completing a puzzle or taking extra “post it” notes from the company supply closet. \textit{Cf.} \textit{GABOR, supra} note 98, at 57-60 (looking at dishonest acts committed by law abiding citizens).}

At both extremes the person’s dishonesty is in fact cheating another person out of value owed.\footnote{See supra notes 110-11 (giving examples of cheating behavior).} Likewise insider trading varies from a small dollar amount with little or no effect on the market to a large trade that will drastically affect share prices.\footnote{See discussion \textit{supra} Part II.B.1 (noting the harms caused by insider trading). \textit{See also SZOCKYJ, supra} note 11, at 59 (quoting a SEC official stating that only the larger trades get picked up by surveillance and that only a tiny fraction of the smaller illicit trades are caught).} Many forms of cheating thus do not have a high normative cost. Therefore, at least at the lower end of the continuum, insider trading is not in clear violation of societal norms. Insider trading can be considered a relatively morally neutral behavior.\footnote{This note argues that although insider trading is considered cheating behavior, cheating is in fact considered acceptable in many situations. Green, \textit{supra} note 107, at 1547 (quoting Peter Arenella in defining morally neutral conduct as behavior that does not “violate any religious doctrine or community-based moral norms”). This is a helpful definition of morally neutral behavior although Green comes to the conclusion in his article that insider trading does in fact violate the community based norm of cheating. \textit{Id.}}

2. \textit{Interaction between Societal Norms and the Law}

The costs associated with moral belief and societal norms are low. It is also probable that much insider trading goes undetected
because of the secretive nature of the crime.\textsuperscript{115} The difficulty of detection in combination with the fact that insider trading is an ill-defined offense fail to provide the “well known risk” necessary to generate the pattern of disapproval espoused by the “Esteem Theory.”\textsuperscript{116} Therefore, it is likely that despite the great influence societal norms have on human behavior, there is not a strong normative cost to committing insider trading.

The amount of influence a norm has on the decision to commit a crime can be strengthened or weakened by the law.\textsuperscript{117} Since this analysis has concluded that there is not a sufficiently high normative cost, an effective legal cost would be necessary to offset the benefits of insider trading.\textsuperscript{118} The legal consequences for

\textsuperscript{115} Szockyj, supra note 11, at 55 (insinuating that although the SEC has publicly prosecuted a high profile case they have been unable to detect the majority of insider trading). See id. at 59 (noting that SEC is unable to proactively detect many of the illicit trades because they are too small to register on the surveillance system). See also Stephen M. Bainbridge, Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition, 52 Wash. & Lee L. Rev. 1189, 1262 (1995) (noting that it is difficult to detect when insider trading is taking place, who is making the trades, and if detected it is difficult to build a case against the trader); Stephen M. Bainbridge, Insider Trading Under the Restatement of the Governing Lawyers, 19 J. Corp. L. 1, 29 (1993) (citing that it has been estimated that one in five cases of insider trading is successfully prosecuted and that it is very difficult to tell when insider trading is taking place). A contributing factor to the problem of detection may be the SEC’s lack of funding. See Peter M.O. Wong, Insider Trading Regulation of Law Firms: Expanding ITSFEA’S Policy and Procedures Requirement, 44 Hastings L.J. 1159, 1163 (1993) (citing the SEC’s lack of funding as contributing to problems of detection). See also Molly Ivins, Mutual Funds Managers Ambush the Middle Class, Chi. Trib., Nov. 6, 2003, at 31 (saying that the SEC is underfunded); Craig D. Rose, Only a Few Bad Apples? Despite Reforms, Investors Haven’t Seen the Last of Corporate Greed, San Diego Union-Trib., May 4, 2003, at H-1 (noting that the SEC is underfunded and understaffed).

\textsuperscript{116} See supra note 63 and accompanying text (discussing the Esteem Theory).

\textsuperscript{117} McAdams, supra note 63, at 347 (finding that “(1) sometimes norms control individual behavior to the exclusion of the law, (2) sometimes norms and law together influence behavior, and (3) sometimes norms and law influence each other”).

\textsuperscript{118} Robert Cooter, Symposium: Normative Failure of Law, 82 Cornell L.
behavior increase the social view that the behavior is not acceptable. Social norms can also strengthen or weaken compliance with the law. If a law is passed expressing values that the culture already espouses, then conformity to the law will be strengthened. If the legal sanction does not coincide with normative values and is not perceived as a sincere risk, however, the legal sanction may not be perceived as a high enough cost and will have little or no deterrent effect.

In theory, criminal law can shape ambiguous social norms by highlighting the “wrongfulness of the contemplated conduct,” but insider trading has an ambiguous relationship to social norms. The behavior is a form of cheating because it uses an unfair advantage at the expense of another. Also, the positive value of the behavior benefits the individual rather than society. Although, as previously discussed, it may not be at odds with American culture, insider trading could be susceptible to being constrained by the law. Insider trading law, however, is both

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119 See Cooter, supra note 118 (discussing how the law interacts with societal view).
120 See McAdams, supra note 63 (discussing the relationship between social norms and compliance with the law).
121 Robinson, supra note 37, at 1868 (noting the failure of Prohibition laws).
122 Id. at 1864.
123 See supra note 95 and accompanying text (labeling insider trading as cheating).
124 See discussion supra Part II.A (discussing the individual benefits associated with insider trading).
125 See Cooter, supra note 118 (noting how the law may impose a beneficial social norm).
vague and contradictory. The law does not highlight the wrongfulness of the behavior because the law does not consistently punish those that produce an “unfair” result, nor does it punish all of the people who knowingly use inside information to their advantage. It fails to clearly define the offense or to provide consistent deterrence for the behavior. Therefore, it fails to strengthen the normative values or increase the cost of insider trading.

3. Violation of the Law

Violating the law puts an individual at risk of being arrested, prosecuted and convicted. Conviction includes the possibility of monetary fines or loss of freedom. The crime of insider trading carries significant civil and criminal penalties. These penalties have increased overtime presumably with the hope that deterrence would increase. The high costs of treble damages and the possibility of five to ten years in prison should outweigh the benefits to insider trading. In order to be effective, however, legal costs associated with insider trading must be perceived as a

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126 See infra Part II.B.3 (discussing ambiguity of insider trading law).
127 See Hang, supra note 67 (describing insider trading as unfair).
128 See infra note 150 and accompanying text (discussing the fact that corporate insiders are permitted to profit from inside information by holding onto their shares or tipping others to hold shares, rather than making their regular trades, if they have knowledge that prices will increase).
129 See supra Part II.B.3.a-c (discussing how the law fails to provide a clear message as to what constitutes insider trading and why some types of insider trading are allowed despite producing the same harms as illegal insider trading).
133 See supra note 131 (noting the increased penalties).
134 See supra Part II.A (describing the benefits of insider trading).
real risk and the act of insider trading must be perceived as a true crime.

Unfortunately, the law fails to adequately support the legal cost. Insider trading is an ambiguous offense that is difficult to detect and is not actually defined in any legislation. The Supreme Court’s interpretation of the legislation is often at odds with the SEC and offers confusing results. Insider trading is commonly described as a trade in which “a person, [in breach of their duty,] in possession of material nonpublic information about a company, trades in the company’s securities and makes a profit or avoids a loss.” It is often unclear, however, who has a duty, why some material nonpublic information is treated differently than other material nonpublic information, and why only some people who profit from inside information are punishable. Although all trades using inside information would affect the marketplace and the uninformed outside investor in the same way, not all trades using inside information are considered illegal. This formulation of insider trading does not adequately serve to prevent the harm caused by insider trading. Thus, unpredictable means of enforcement do little to provide society with a clear understanding

135 See supra note 131 (describing the legal penalties of insider trading).
136 See supra note 115 and accompanying text (discussing the difficulty of detecting insider trading).
137 See HAZEN, supra note 5, at 640 (saying that insider trading is not actually defined in legislation).
138 See infra Part II.B.3.a (showing the courts limitations on Rule 10b-5 liability).
140 See discussion supra Part II.B.3.a-c.
141 An example of a trade on inside information that is legal would be a person with no relationship to the corporation that fortuitously overhears a piece of material nonpublic information and buys or sells securities based on that information.
142 See supra Part II.B.1.a and accompanying text (describing the harms associated with insider trading as being unfair to outside investors and causing instability in the marketplace).
the crime of insider trading.143

The three major rules that are used to prosecute insider trading are rule 10b-5,144 rule 16b,145 and rule 14e-3.146 Rule 10b-5, which is most commonly used to prosecute insider trading is vague and unevenly applied.147 Although section 16b and rule 14e-3 appear clear, they are too narrow in scope to address the inadequacy of rule 10b-5.148 An analysis of each of the rules reveals the difficulty in defining what insider trading is and shows that the law is often unable to adequately prevent the harm associated with insider trading.

a. Rule 10b-5

Rule 10b-5, promulgated under the authority of section 10(b) Securities Exchange Act of 1934,149 does not even use the term insider trading.150 Instead the language used to prosecute insider

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143 See supra Part II.B.3 (noting that a crime must be a well defined risk to deter a rational actor in their cost-benefit analysis).
144 17 C.F.R. § 240.10b-5 (2003) (finding it unlawful to “engage in any act, practice, or course of business which operates or would operate as a fraud . . . in connection with the purchase or sale of any security”).
145 17 C.F.R. § 240.16b-5 (2003) (finding that it any short swing profit by an insider “shall inure to and be recoverable by the issuer, irrespective of any intention on the part of the beneficial owner, director or officer . . .”).
146 17 C.F.R. § 240.14(e)(3) (2003) (stating that to trade on inside information with respect to a tender offer “shall constitute a fraudulent, deceptive, or manipulative act . . .”).
147 See HAZEN, supra note 5, at 640 (stating that insider trading is not defined in legislation and that the law has failed to develop systematically or provide bright line rules).
148 See discussion infra Part II.B.3.b-c (discussing the inadequacy of section 16b and rule14e-3).
149 Section 10(b) of the Securities and Exchange Act of 1934 says in relevant part that it shall be unlawful “to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors . . .” 15 U.S.C. § 78j(b) (2003).
150 Rule 10b-5 provides:
trading is that it is illegal to knowingly “engage in any act, practice, or course of behavior which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.” Since rule 10b-5 does not actually define the crime of insider trading, the courts have interpreted the rule in a way that is often confusing in application.

The evolution of the duty element of 10b-5 liability illustrates the inconsistent application of rule 10b-5 to prevent the harm caused by insider trading. In *In re Cady, Roberts & Co.*, the SEC determined that rule 10b-5 mandated that corporate insiders have a duty to either abstain from trading on material inside information or disclose the inside information prior to trading. Since *Cady, Roberts, & Co.*, the Supreme Court has further interpreted the duty element to scale back the broad reach of rule 10b-5. In *Chiarella v. United States*, the Supreme Court exposed the inconsistent application of insider trading laws when it overturned the SEC conviction of a financial printer employee who traded on

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, in light of the circumstances under which they were 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.


152 See HAZEN, supra note 5, at 640 (stating that “the law [with regard to insider trading] has not developed systematically nor has it evolved in such a way to produce bright-line tests of when it is permissible to trade”).

153 In re Cady, Roberts & Co., 1961 WL 69638, at *3 (S.E.C. Release No. 34-6668) (stating that corporate insiders owe a duty to disclose or abstain from trading on inside information). See also United States v. O’Hagan, 521 U.S. 642, 651-52 (1997) (discussing that under the classical theory of 10(b) liability the duty derived from the relationship of trust and confidence between the insider of a corporation and the shareholders of a corporation). This duty has since been extended to include the source of the information that has been misappropriated. Id. at 653 (adopting the misappropriation theory).
confidential information regarding tender offers. The Supreme Court held that the printer did not have a duty to disclose, prior to the trade, the information he traded on under rule 10b-5 and section 10(b) of the Securities and Exchange Act of 1934. This was because the printer owed no duty to the corporation or its shareholders.

Again in 1983, the Supreme Court overturned a conviction for insider trading using rule 10b-5 and section 10(b) when it found there was no requisite breach of duty in United States v. Dirks. In Dirks, a broker, that was tipped by a corporate insider that the corporation had been engaging in fraudulent behavior, selectively disclosed that information to his clients, who were in turn able to avoid significant loss. The Court found, however, that because the corporate insider did not gain a personal benefit when he tipped Mr. Dirks there was no requisite breach of duty. Although not typical insiders, such as a director or officer, who owe a duty of disclosure to a corporation, both Chiarella and Dirks knowingly subjected the market to the potential adverse effects of insider trading. Both men took advantage of access to nonpublic inside information through their positions of employment. Both men

155 Id. at 232. A tender offer is “[a] public announcement by a company . . . that it will pay a price above the current market price for shares ‘tendered’ of a company it wishes to acquire control of.” BLACK’S LAW DICTIONARY 1468 (6th ed. 1990).
156 Id.
158 Id. at 648-49.
159 Id. at 665-66.
160 See Cady, Roberts & Co., 1961 WL 69638 at *3 (finding that corporate insiders owe a duty to disclose or abstain from trading with inside information). See also Chiarella, 445 U.S. at 227-28 (citing Cady and noting that although insiders owe a duty to the corporation through their employment, Chiarella was not under a duty to disclose his misuse of information).
161 Dirks, 463 U.S. 646; Chiarella, 445 U.S. 222. Chiarella directed traded securities with inside knowledge regarding a tender offer while Dirks passed the inside information onto his clients who then trade on the information. Chiarella, 445 U.S. at 222.
162 See Dirks, 463 U.S. at 651 (finding that Dirks passed the inside
also had an unfair advantage over outside uninformed traders. Yet, neither one was ultimately found guilty of insider trading.\textsuperscript{163}

In response to the gray areas illustrated in the duty analysis of \textit{Chiarella} and \textit{Dirks}, the Supreme Court adopted the misappropriation theory in \textit{United States v. O’Hagan}.\textsuperscript{164} \textit{O’Hagan} defined the misappropriation theory as holding that “a person commits fraud ‘in connection with’ a securities transaction, and thereby violates section 10(b) and rule 10b-5, when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information.”\textsuperscript{165} The misappropriation theory broadened the duty requirement under rule 10b-5 and imposed a fiduciary duty on investors who trade with inside information to the source of the information.\textsuperscript{166} The misappropriation theory reaches people who under previous law would be exempt from liability because they did not owe a fiduciary duty to the corporation and the corporation’s shareholders.\textsuperscript{167}

The SEC has since supplemented the misappropriation theory with the promulgation of rule 10b5-2 which defines three situations in which a person owes a duty of trust or confidence.\textsuperscript{168}

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\textsuperscript{164} 521 U.S. 642, 647 (1997) (finding that lawyer owed no duty to corporation but owed duty to law firm who worked with corporation and simultaneously holding that the SEC did not exceed rule making authority in rule 14e-3 and adopting the misappropriation theory).

\textsuperscript{165} \textit{Id}. at 652.

\textsuperscript{166} \textit{Id}. (stating that information is misappropriated when there is a breach of duty to the source of information).

\textsuperscript{167} See \textit{Lee}, supra note 65, at 128 (noting that the property approach of the misappropriation theory did not displace duty analysis, but rather extended the reach of the securities laws).

\textsuperscript{168} Section 10(b)5-2 states in relevant part that a person owes a duty of trust or confidence:

1. Whenever a person agrees to maintain information in confidence;
2. Whenever the person communicating the material nonpublic information and the person to whom it is communicated have a history,
The three situations focus on a duty to keep a confidence either through a work relationship, past dealings or familial relations. The facts in *O’Hagan*, a case in which a partner at a law firm traded on inside information regarding an upcoming tender offer from one of the firm’s clients, clearly fit into one of these categories. O’Hagan owed a duty of trust and confidence under the misappropriation theory because of the confidence required between a lawyer, the firm at which he is employed and the client. The misappropriation theory does not, however, succeed fully in clarifying the law of insider trading because there are many situations when the duty imposed by the misappropriation theory is either unclear or insufficient.

Applying the misappropriation theory to the ImClone scandal, it is unclear whether all the actors will be found to have a duty.

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169 Id. It is possible that an employment contract with Merrill Lynch may include some confidentiality agreement. This agreement would make it easier to claim that Bacanovic owed a duty to Merrill Lynch. Id.


171 Id. at 653.

172 An example of this would be a live-in partner that does not quite fit the “familial category” or past dealings with counselor that does not impose the same type of professional duty to keep a confidence to their clients as a psychiatrist.

173 See supra note 40 and accompanying text (explaining the facts of the ImClone scandal).
INSIDER TRADING: A RATIONAL CHOICE

Dr. Waksal, the CEO of Imclone, had a fiduciary duty to the corporation and shareholders so it is unnecessary to further evaluate his behavior under the misappropriation theory. Peter Bacanovic, the Merrill Lynch broker, could be found to have owed a duty to Merrill Lynch under “a shared history, pattern or practice of sharing confidences” or even under his employment contract. Martha Stewart, however, would be difficult to fit within one of the categories unless it could be shown that her past dealings with Waksal showed a pattern of shared confidences or that she knew that Bacanovic was in breach of his duties when he advised her to sell her shares. If Martha Stewart had a familial

174 Dr. Waksal would also have a duty under traditional 10b-5 analysis because he was the CEO of ImClone and owed the corporation a fiduciary duty. See supra note 153 (noting the duty analysis introduced in In re Cady).

175 Peter Bacanovic may have a duty under traditional analysis without the necessity of the misappropriation theory. See Dirks, 463 U.S. 646. It would be, however, difficult to prove because under Dirks the court held that breach of duty required a benefit to the trader. Id. (finding broker did not breach a duty because he did not financially benefit when he tipped his customers). If Bacanovic was only executing Martha Stewart’s order and not trading for his own benefit, it would be a harder case. See supra note 159 and accompanying text (discussing the Dirks duty analysis).


177 17 C.F.R. § 240.10(b)(5)-2(1) (2001).

178 It is important to note that Martha Stewart could still be subject to 10b-5 under traditional analysis. She would be, however, subject to duty analysis under Chiarella and Dirks, which would require a finding that Dr. Waksal was in breach of his duty to ImClone that he benefited from this breach and that she knew he was in breach of his duty. See supra notes 154-59 and accompanying text (discussing the difficulties with duty analysis under Chiarella and Dirks). Reflecting the difficulty in prosecuting insider trading cases Martha Stewart has not been indicted for criminal insider trading charges. Colleen Debase, Stewart Seeks Dismissal of Charges, WALL ST. J., Oct. 7, 2003, at C12 (citing that although the government investigated Martha Stewart’s trading activity, the indictment did not reflect an insider trading indictment). It is necessary to note that the SEC has filed civil insider trading charges. Id. This indictment, however, has been criticized. See Warren L. Dennis and Bruce Boyd, Stewart Prosecution Imperils Business Civil Liberties, LEGAL BACKGROUNDER, Oct. 2, 2003, available at http://www.marthataks.com (referring to the indictment as “an unprecedented and unanticipated expansion of insider trading theory, one that gives every indication of having been crafted to snare Stewart rather than
relation to Waksal or Bacanovic, she would be easier to prosecute.\textsuperscript{179} This is an arbitrary distinction. The proposed harm of insider trading, disruption of market confidence and unfair trade practices\textsuperscript{180} is not lessened because the person trading on inside information is unrelated to the source. Therefore, as illustrated by this one example, the misappropriation theory is also under-inclusive in application.

\textit{b. Section 16(b)}

Section 16(b) of the Securities and Exchange Act prohibits corporate insiders from profiting on short swing trades.\textsuperscript{181} It only applies to a limited class of people, however, and only prohibits active trades.\textsuperscript{182} The rule considers all trades to be illegal within a period of less than six months to be insider trading unless there is a previously written schedule of trades.\textsuperscript{183} Section 16(b) does not have a scienter requirement like rule 10b-5 because it states that the profit shall inure and be recoverable “irrespective of any intention on the party of such beneficial owner, director, or

\begin{itemize}
\item \textsuperscript{179} 17 C.F.R. § 240.10(b)(5)-2(3) (2001) (listing familial relationship as one that will be presumed to encompass a duty of confidence).
\item \textsuperscript{180} See \textit{supra} Part II.B.a (discussing the harms associated with insider trading).
\item \textsuperscript{181} 15 U.S.C. § 16 78p(b) (2002). Section 16(b) provides that:
For the purposes of preventing unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase or sale, or any sale and purchase, of any equity security of issuer (other than an exempted security) or a security-based swap agreement . . . involving any such equity security within any period of less than six months . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer . . . .
\item \textit{Id.}
\item \textsuperscript{182} \textit{Id.} (applying to the “beneficial owner, director, or officer” and to the “purchase and sale” or sale and purchase” of securities).
\item \textsuperscript{183} \textit{Id.}
INSIDER TRADING: A RATIONAL CHOICE

It is too narrow in scope, however, to close the gaps in enforcement left open by rule 10b-5. The application of section 16(b) is inconsistent when compared to the harms it is designed to prevent because of its requirement that the insider must actively trade to commit the offense. Therefore, the insider, who has a permissible schedule of trades, may decide to hold his shares based on material nonpublic information. Likewise the insider could tip his friends and family to hold their shares in advance of an upcoming event that will increase the price of the shares. The insider, therefore, has an unfair advantage over the outside uninformed investor and knowingly uses inside information to dictate market activity. Nonetheless, he would not violate section 16(b) because he did not actively trade on his inside information.

c. Rule 14e-3

The enactment of rule 14e-3 under the statutory authority to

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184 15 U.S.C. § 1678p(b). Scienter is required because rule 10b-5 invokes the common law doctrine of fraud rather than actually define expressly address insider trading. 17 C.F.R. § 240.10b-5 (2002). The relevant portion states that it is illegal “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.” Id. (emphasis added).

185 See supra note 150 (applying to active purchase or sale of a security and limiting violation to a distinct group of people).

186 Id. The language of the statute specifies “a purchase or sale of a security of an issuer.” 15 U.S.C. § 1678p(b).

187 Rather than incidentally profiting with the rise of the shares or selling early and missing out on the rise of the shares like outside investors, the insiders and their respective tippees could have an advance notice of the event and hold their shares accordingly. An example of this would be a corporate director that regularly sells 1000 shares every year and decided not to sell until the resulting increase in share value after receiving inside information of a profitable business venture.


189 Rule 14e-3 provides that transactions in securities on the basis of material, nonpublic information in the context of tender offers satisfy the requirements of the offense of insider trading:
regulate tender offers\(^\text{190}\) in the 1980s attempted to close the gap between what was legal versus illegal insider trading.\(^\text{191}\) Rule 14e-3 eliminates the need for a breach of fiduciary duty when trading

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\text{(a) [i]f any person has taken a substantial step or steps to commence, or has commenced a tender offer (the ‘offering person’), it shall constitute a fraudulent, deceptive or manipulative act or practice within the meaning of section 14(e) of the Act for any other person who is in possession of material information relating to such tender offer which information he knows or has reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from: (1) The offering person (2) The issuer of the securities sought or to be sought by such tender offer, or (3) Any officer, director, partner or employee or any other person acting on behalf of the offering person or such issuer, to purchase or sell or cause to be purchased or sold any of such securities or any securities convertible into exchangeable for any such securities or any option or right to obtain or to dispose of any of the foregoing securities, unless within a reasonable time prior to any purchase or sale of such information and its source are publicly disclosed by press release or otherwise.}
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\(^{190}\) Section 14(e) of the Securities and Exchange Act of 1934 gives the SEC the authority by providing:

It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request or invitation. The Commission shall, for the purpose of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.


\(^{191}\) \textit{O’Hagan} did this by extending the duty analysis to include an employee’s duty to their employer. This expansion of duty dealt with the previous problem exposed in \textit{Chiarella v. United States} in which a printer employee who traded on inside information was held not to have a duty to stockholders under section 10(b) of the Securities Exchange Act of 1934. 445 U.S. 222 (1980).
material nonpublic information relating to a tender offer. Rule 14e-3 makes it “fraudulent, deceptive, or manipulative act or practice” to engage in the trade of material, nonpublic information in relation to a tender offer without proof of any fiduciary duty. Although this rule appears to capture most situations involved in trading on material nonpublic information during a tender offer, it fails to explain why information regarding tender offers is worthy of more legal attention than other types of corporate inside information that could have a volatile effect on the stock market.

Although probably a reaction to the prevalence of takeovers and tender offers in the 1980s, the discrepancy between the specificity of Rule 14e-3 and a catch-all rule such as 10b-5 is troubling. Using the example of the ImClone scandal, a tippee such as Martha Stewart who allegedly received material nonpublic information through someone she knew to be a corporate officer will be more difficult to prosecute because the information was in relation to the FDA examination of Erbitux rather than a tender offer. If the information Martha Stewart had allegedly traded on were in relation to a tender offer, she would clearly fall under the purview of the rule. But because it was not in relation to a tender offer and therefore must be analyzed under traditional 10b-5 liability, it is necessary to prove a duty. This distinction is

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193 Id.
194 For example, news that a corporation is going to be facing expensive litigation, or that an overstatement of assets is about to be exposed could also have a dramatic effect on a stock’s market value.
195 See HAZEN, supra note 5, at 480 (stating that a new type of financing that first became available in the 1980’s became a very common method for takeovers).
196 Rule 10(b)(5)(c) merely provides in relevant part “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.” 17 C.F.R. § 240.10b-5 (2002). See supra note 150.
198 See supra Part II.B.3.a (discussing the duty requirement under 10b-5). See also Jerry Markon, Martha Stewart Could be Charged as ‘Tippee,’ WALL ST. J., Oct. 3, 2002, at C1 (stating that “[t]ypically, insider-trading cases are
illogical because, for example, in the particular situation involving ImClone, the effect of the success or failure of the cancer drug Erbitux on the stock price of ImClone is comparable to the effect of information regarding a tender offer.\textsuperscript{199}

Rule 14e-3 also fails to resolve the discrepancy between a person who uses the inside information with knowledge of the source and a person who comes across the information fortuitously.\textsuperscript{200} This is because rule 14e-3 states that the trade:

shall constitute a fraudulent, deceptive or manipulative act or practice within the meaning of section 14(e) of the Act for any person who is in possession of material information relating to such tender offer which information he knows or has reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from: (1) The offering person, (2) The issuer of the securities sought or to be sought by such tender offer, or (3) Any officer, director, partner or employer or any other person acting on behalf of the offering person.\textsuperscript{201}

This distinction may have roots in the principle that a person must have a sufficient \textit{mens rea} to commit a crime, but it does little to justify the fact that both situations will have an identical effect on the market. Therefore, although Rule 14e-3 is both highly specific as to what constitutes an offense in relation to tender offers and encompasses traders with and without a traditional duty, it is still under inclusive and inadequate in relation to the enforcement of a ban on insider trading as a whole.\textsuperscript{202} Rule 14e-3 fails to fully bring cases begun against individuals who had knowledge and traded on market-moving information—about an impending merger or a decline in earnings, for example—before it is publicly announced. Thus, any insider-trading case against Ms. Stewart could be more difficult to win than a traditional case\textsuperscript{\textsuperscript{199} See Anand, \textit{supra} note 21 (noting the huge impact Erbitux had on the value of ImClone).}\textsuperscript{\textsuperscript{200} An example of a person who receives the information without knowledge would be someone who overhears a conversation or receives the information from an acquaintance without realizing that it is nonpublic.}\textsuperscript{\textsuperscript{201} 17 C.F.R. \S 240.14(e)(3) (2002).}\textsuperscript{\textsuperscript{202} See \textit{id.} (applying only in relation to a tender offer when someone violates the provision with intent).}
address the harms caused by insider trading because it punishes some people who trade on inside information, potentially harm small investors and create instability in the market, but benefits those that create the same effect yet do not fit into the necessary categories.203

The result of the ambiguity of what constitutes illegal insider trading and the laws inability to adequately address the harms lower the effectiveness of a legal cost for the behavior. Rather than resolving the ambiguity a potential inside trader may face as to the wrongfulness of the action, the law exacerbates the problem. Like a child that is inconsistently disciplined without logical explanation, the potential trader is not deterred from engaging in the behavior.

C. Justification of Trading on Inside Information

Even if a potential trader of inside information perceives the potential normative and legal costs of insider trading, that trader can justify the behavior. Justification can ameliorate the guilt that a generally law-abiding citizen feels when breaking the law.204 Rather than giving up the potential benefits of the crime, they can still “derive . . . personal benefit by going through with the act . . . strip[ping] it of its negative connotation by casting it into a positive, or at least acceptable, light.”205 Sociologists Sykes and Matza identified five common types of justification: denial of injury, denial of victim, denial of responsibility, appeal to higher loyalties and condemning the condemner.206 Most relevant to a discussion of insider trading are the denials of injury, victims, and responsibility. Thus, even though a person is aware that trading with inside information is against the law and that society views people that commit the crime as greedy and cheating, they may

203 Id.
204 See supra Part II.B (discussing the internal costs associated with breaking the law).
205 GABOR, supra note 98, at 186.
206 SZOCKYI, supra note 11, at 104 (discussing Sykes and Matza’s theory of neutralization which explains the techniques that offenders employ to retain their positive self-image while breaking the law).
deny that they are actually doing anything wrong. Justification of law-breaking behavior is very common, especially among people who view themselves as law abiding. People often commit small acts of theft without categorizing them as stealing or may cheat on their taxes because they feel that the government does not have a rightful claim on their earnings. People may rationalize insider trading by viewing it as a “victimless” crime because they are not harming a specific person but a corporation or the market in general. The victim of insider trading, presumably the market and the uninformed shareholder, is amorphous and difficult to conceptualize. If the victim is acknowledged, then the victim, like the government in the tax scenario, may not be sufficiently sympathetic.

It is also relatively easy to deny that the trader is committing any actual harm. Not only is the offense poorly defined, leaving the perpetrator to question whether his conduct falls under the confines of the law, but many scholars argue that the insider trading helps rather than hurts the market. A person, therefore, could reasonably justify an act of insider trading as not hurting anyone or not being a crime at all. Someone who could be liable under the misappropriation theory may have merely passed on the information rather than committed the trade. That person may

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207 See supra Part II.B (discussing the costs associated with insider trading).
208 GABOR, supra note 98, at 186.
209 Id. at 73-74 (describing common theft situations such as stealing a grocery cart from the supermarket, towels from a hotel, and menus from a restaurant).
210 See SZOCKYI, supra note 11, at 104 (discussing denial of victim as a powerful justification).
211 See Hang, supra note 67(describing the victim as the uninformed shareholder).
212 Id. at 189 (discussing a robber who claimed he only robbed people who could afford it). But see supra notes 66-71 and accompanying text (discussing the argument that insider trading is fundamentally unfair and highlighting the injury to outside uninformed investors).
213 See MACEY, supra note 66, at 25-28 (discussing the relationship between insider trading and the shareholder’s welfare).
214 United States v. O’Hagan, 521 U.S. 642, 652 (1997) (holding that a person may be liable for insider trading under the misappropriation theory when
justify their actions by denying responsibility of insider trading because the actual trade rather than the mere transfer of information causes the harm.

The power of justifications is enormous. Every time a person fails to come to a complete stop at a stop sign when driving in the middle of the night because “they aren’t going to hurt anyone” or refills a drink at a restaurant without paying because “the restaurant charges too much for soda anyway,” the person is employing justifications to rationalize breaking the law. Therefore, the ability to justify insider trading lowers the incentive to comply with the law.215

III. A POTENTIAL SOLUTION

The decision to commit the crime of insider trading is a rational one because the costs a person risks when trading illegally on material nonpublic information are outweighed by potential benefits and available justifications. It is likely that successful people, such as Martha Stewart, will continue to risk losing wealth and social status and face the possibility of jail time in order to potentially protect assets and increase wealth and social status.216

“a person commits fraud in ‘connection with a securities transaction’, and thereby violates §10(b) and Rule10b-5, when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information”). This means that a person who passes inside information to another person, without personal benefit, in breach of a duty to the source and the latter person trades on that information, the former could be held liable under the misappropriation theory. See HAZEN, supra note 5, at 580 (explaining the ruling in O’Hagan). If the tippee is found to owe a duty to the source of the information, such as a duty to their employer or spouse, then the misappropriation theory will apply. Id. at 655 (discussing how a tippee could have a duty under the misappropriation theory). However, if the tippee does not owe a duty of confidence to the source of the information than Dirks and Chiarella duty analysis will apply. Id. at 653 (giving examples where the misappropriation theory will not apply).

215 See GABOR, supra note 98, at 186 (discussing the power of justification).

216 See supra Part II (concluding that the costs associated with insider trading do not outweigh the benefits).
In order to more effectively deter this type of decision, the law must be strengthened to override the normative structure of society.

The law can override the high informal benefits and low informal costs.\textsuperscript{217} If insider trading is a behavior that the country wants to prevent, then it must be viewed as wrongful. That view must be supported through consistent legal deterrence. If, in fact, insider trading has a negative effect on the markets and is actually

\textsuperscript{217} There are other potential solutions. For example an adjustment of the informal costs and benefits associated with insider trading would influence the level of normative deterrence felt by those that illegally trade on inside information. This would be difficult, however because many of the norms that reinforce insider trading also coincide with the countries economic structure. See supra Part II.B.1.b (discussing the way the norms in a capitalist society such as the United States may fail to adequately deter insider trading). Another potential solution is to conform the law to the ambivalent societal norms and legalize insider trading. It is argued that insider trading could be controlled through a deregulated scheme by the owners of information themselves, namely the corporations. MACEY, supra note 66, at 28. In this scenario, corporations could decide whether to allow insiders to trade on their information in lieu of other benefits such as compensation and regulate those that breached a company wide ban by monitoring and threat of potential loss of employment. \textit{Id.} Although this solution is plausible, this possibility is also unlikely because insider trading has been consistently regulated since the 1930’s following the Depression. NASSER ARSHADI & THOMAS H. EYSSELL, THE LAW AND FINANCE OF CORPORATE INSIDER TRADING THEORY AND EVIDENCE 19 (1993) (discussing the history of insider trading regulation). The legalization of insider trading is also unlikely because, although not as strictly policed, much of the international community has stepped up their insider trading regulations to keep pace with the United States. \textit{See} Calabra, supra note 106, at 469 (saying that Germany made insider trading illegal in 1994 to remain competitive in the international market); \textit{see also} Nasser, supra note 106, at 377 (stating that although insider trading is illegal in Canada and Japan it is not punished as severely and that Japan did not consider insider trading punishable by imprisonment until 1997). There has also been a European Community Directive issued which proscribes a minimum uniform standard of legislation for all members to regulate insider trading. Thomas Lee Hazen, \textit{Defining Illegal Trading—Lessons from the European Community Directive on Insider Trading}, 55 LAW & CONTEMP. PROBS. 231, 236 (1992) (discussing the implementation in 1989 of the European Community Directive that defines insider trading based on trading while in possession of information). Therefore, in today’s fluid global market it would be difficult for the United States to deregulate insider trading at this time.
fundamentally unfair, then all insider trading should be deemed wrongful.\textsuperscript{218} Like other legally wrongful behavior, unintentional trading need not be punished.\textsuperscript{219} A clear definition of the offense and consistent application is necessary for sufficient deterrence. If the law is to effectively deter insider trading, the law must work to strengthen weak normative costs associated with insider trading and raise a barrier against effective use of justifications.

This cannot be accomplished by a mere increase in sanctions.\textsuperscript{220} A clear definition is necessary to allow the costs of insider trading to outweigh the benefits. It must be clear to a potential perpetrator that they will actually be committing illegal insider trading. Although not perfect, the directive issued by the European Community is a good example.\textsuperscript{221} Rather than regulating insider trading under a catchall fraud statute such as 10(b), the directive clearly defines insider trading without a duty requirement.\textsuperscript{222} The directive prohibits trading with the possession

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\item \textsuperscript{218} See Hang, supra note 67 (discussing the fairness argument of insider trading).
\item \textsuperscript{219} See Kadish, supra note 130, at 203 (discussing the concern of a perpetrator’s mental state when punishing criminal behavior). For example, if the \textit{mens rea} requirement was abandoned, then an outside investor could trade on inside information he reasonably believed to be public and inadvertently commit a crime.
\item \textsuperscript{220} See supra note 131 and accompanying text (noting the increase in legal sanctions in 1984 and 1988; a failed response to insider trading scandals of the 1980’s).
\item \textsuperscript{221} See Hazen, supra note 221 (noting the implementation of the European Community Directive on Insider Trading).
\item \textsuperscript{222} The Council Directive 89/592 Coordinating Regulations on Insider Dealing, defines the both inside information and the people who will be held liable for trading with it:
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\item ‘inside information’ shall mean information which has not been made public of a precise nature relating to one or several issuers of transferable securities or to one or several transferable securities, which, if it were made public, would be likely to have a significant effect on the price of the transferable security or securities in question.
\item ‘transferable securities’ shall mean: (a) shares and debt securities, as well as securities equivalent to shares and debt securities; (b) contracts or rights to subscribe for, acquire or dispose of securities referred to in (a); (c) futures contracts, options and financial futures in respect of
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of material nonpublic knowledge.\textsuperscript{223} The duty requirement in current American legislation is especially problematic as illustrated by \textit{Chiarella} and \textit{Dirks} and has not been completely solved by the misappropriation theory.\textsuperscript{224} The directive does not resolve all ambiguities regarding insider trading, but is a good example of legislation that offers a clear definition of insider trading.\textsuperscript{225}

Not only does the offense have to be clearly defined, but it also has to be perceived as wrong. The law must compensate for the weak societal deterrence of insider trading. A potential way to increase the perception of wrongfulness would be to transfer the legislation used to prosecute insider trading from the SEC’s

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\textsuperscript{223} Id.
\textsuperscript{224} United States v. Dirks, 463 U.S. 646 (1983) (finding that a broker did not breach a duty because he did not gain a financial benefit when tipping his customers inside information); \textit{Chiarella} v. United States, 445 U.S. 222 (1980) (finding that a printer did not owe shareholders a duty when he traded on inside information). \textit{See supra} Part II.B.3.a (discussing the difficulty of applying the misappropriation theory and finding it is unclear who it will reach).
\textsuperscript{225} \textit{See supra} note 150 and accompanying text. For example, a person must still actively trade with inside information. \textit{Id.}
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INSIDER TRADING: A RATIONAL CHOICE

administrative regulations, incorporating insider trading into federal criminal law.\textsuperscript{226} It is necessary to clearly provide what state of mind is required as well as what specific acts are required to commit the offense. A lower \textit{mens rea}, such as negligence, would widen the scope of insider trading laws.\textsuperscript{227} The law should also address all illegal use of insider information rather than just punishing those that actually purchase or sell securities.\textsuperscript{228} An insider that holds while using inside information is gaining the same unfair advantage against the uninformed investor as the insider that actively trades.\textsuperscript{229} The law needs to adequately address the harm it seeks to prevent.\textsuperscript{230} It must be exceptionally clear and consistent because the prohibition of insider trading does not necessarily coincide with the norms in this country.\textsuperscript{231} Although strengthening insider trading legislation is the most likely solution, the decision to trade on inside information, in American culture, is one that must be made more difficult if criminalization of insider trading is to be made effective.

\textsuperscript{226} It is necessary that regulation of insider trading remain on the federal level rather than the state level because of the fluidity of the market across state lines. Although criminal law is generally the responsibility of the states, in this case the federal government has authority to regulate insider trading under the commerce clause. See U.S. CONST. art. I, § 8, cl. 3; see also William Brian Gaddy, \textit{A Review of Constitutional Principals to Limit the Reach of Federal Criminal Statutes}, 67 UMKC L. REV. 209, 210 (1999).

\textsuperscript{227} For example a \textit{mens rea} requirement of negligence would address the trader that overhears inside information and trades on it without determining whether the information is public or not. Negligence is defined as “the omission to do something which a reasonable man, guided by those ordinary considerations which ordinarily regulate human affairs, would do, or the doing of something which a reasonable and prudent man would not do” \textsc{Black’s Law Dictionary} 1032 (6th ed. 1990).

\textsuperscript{228} \textit{See supra} note 187 and accompanying text (discussing the benefits and insider could achieve by holding his shares based on inside information).

\textsuperscript{229} \textit{Id.}

\textsuperscript{230} The harm most commonly associated with insider trading is that it is unfair to uninformed investors and causes instability in the marketplace. \textit{See supra} Part II.B.1.a.

\textsuperscript{231} \textit{See supra} Part II.B.1.b (finding that normative costs do not adequately deter insider trading).
CONCLUSION

A person faced with the rational choice of whether or not to trade on inside information will confront many potential costs and benefits. Many potential perpetrators will find that the benefits outweigh the costs. In addition, they can justify this criminal behavior. With the current state of the law, it is not surprising that a person with significant wealth and/or social status, such as Martha Stewart, would risk the penalties of insider trading at the possibility of achieving the benefits. In order to curb the problem insider trading the potential costs must be clearly perceived and increased. Therefore, the crime of insider trading should be more clearly defined in legislation and more consistently applied in order to compensate for weak informal costs.