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ESSAY: Insiders, Outsiders, & Fair Access: Identifying Culpable Insider Trading

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Insiders, Outsiders, & Fair Access

IDENTIFYING CULPABLE INSIDER TRADING

Jonathan D. Glater†

INTRODUCTION

The federal prohibition on insider trading is adrift. This is not to suggest that the ban is likely to vanish, as some scholars have argued it should,[1] but that the gulf between the analysis deployed by the Supreme Court in response to allegations of this particular misconduct, on the one hand, and both the doctrinal rationale and the underlying intuition justifying the prohibition[2] on the other, has grown rather wide. The Court does not begin with the premise that insider trading is inherently unfair, undermines confidence in securities markets, and therefore should be prevented.[3] Rather, the justices direct their energies—and those of lower courts—to assessment of whether a person with inside information violated a duty by trading on it or[4] received a "personal benefit" as a result of trading by someone

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1 *See, e.g.*, Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 861 (1983) (arguing that allowing insider trading "may be an efficient way to compensate corporate managers").

2 *See, e.g.*, STEPHEN M. BAINBRIDGE, INSIDER TRADING LAW AND POLICY 6 (2014) ("Courts and regulators typically justify the prohibition on fairness or other equity grounds.").

3 Michael Perino, *The Lost History of Insider Trading*, 1–3 (St. John's Sch. of Law Legal Studies Research Paper Series, No. 18-001, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3099682 [https://perma.cc/H9Y6-5X9B] (showing that such concerns date back more than a century).

4 It is not even clear whether this should be an "or." It may be that improper inside trading, according to the Supreme Court, requires a showing of both violation of a duty and receipt of a personal benefit. Michael D. Guttentag, *Selective Disclosure and Insider Trading*, 69 FLA. L. REV. 519, 543 n.125 (2017).

else whom the insider tipped off.[5] Unfairness to other market participants does not figure in this analysis.[6]

The drift from an anchoring notion of fairness[7] is the result of the Court engaging in doctrinal contortions to distinguish impermissible conduct, like exploiting personal access to corporate information for individual gain, from affirmatively desirable conduct, like investment research that may enhance the efficiency of capital markets.[8] Some of the cost is tangible, in the form of failed efforts to rein in trading with illicit motives, and some is intangible, in the form of cynicism about investing overall, because every investor knows that on the other side of a transaction may be a counterparty with a superior, even unmatchable, informational advantage. The game looks rigged.[9]

Investing in securities markets is not just a game of chance and insider trading may be more than cheating. The rules that govern investor conduct do not aim solely at preservation of fairness. To some extent this is consistent with a pragmatic approach to capital market regulation: it is likely impossible, and certainly would be very costly, to compensate for all the differences across the population of investors. Some have more experience, some have more wealth, which enables the purchase of advice from others with more experience or with better information.[10] Given the cost of compensating for such diversity and the dubious normative case for trying to, there is

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[5] Salman v. United States, 137 S. Ct. 420, 421 (2016).

[6] Indeed, the Court explicitly rejected as overbroad the notion that all trading on inside information must be prohibited. Chiarella v. United States, 445 U.S. 222, 235 (1980) ("We hold that a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information.").

[7] There is not agreement that the insider trading prohibition has its roots in concerns over fairness. *See infra* note 53. The lack of consensus even on this point suggests that perhaps Congress must act to clarify the contours of the law—admittedly an unlikely effort as of this writing. But there is a strong case to be made that the intuitive notion of fairness must play a role in interpretation of Section 10(b) and Rule 10b-5.

[8] *See* Dirks v. Sec. & Exch. Comm'n, 463 U.S. 646, 658 (1983) (citing importance of analysts' pursuit of and access to material information).

[9] Preet Bharara, former United States Attorney for the Southern District of New York, has described insider trading as "rampant." *See* Jason M. Breslow, *Preet Bharara: Insider Trading Is "Rampant" On Wall Street*, PBS: FRONTLINE (Jan. 7, 2014), http://www.pbs.org/wgbh/frontline/article/preet-bharara-insider-trading-is-rampant-on-wall-street/ [https://perma.cc/6HZC-WSRE]. There is also empirical support for the claim that insider trading has become more common. *See generally* Laura N. Beny & Nejat Seyhun, *Has Insider Trading Become More Rampant in the United States? Evidence from Takeovers* (U. of Mich. L. Sch. Scholarship Repository, L. & Econ. Working Paper No. 50, 2012), http://repository.law.umich.edu/law_econ_current/50/ [https://perma.cc/E4SM-5UV2]. This dark view of investing is not new. *See* Perino, *supra* note 3 (describing "[c]artoons from the late nineteenth and early twentieth centuries [that] frequently used gambling imagery to represent how stock trading worked").

[10] *See* James D. Cox, *Insider Trading and Contracting: A Critical Response to the "Chicago School"*, 1986 DUKE L.J. 628, 628 n.3 (1986).

a strong argument that capital market regulation should strive for allocative efficiency. Yet this is conspicuously not the approach taken by securities regulation. The continuing ban on insider trading reflects a profound belief that fairness as a norm has and should have continued relevance. This essay does not aim to take on the question of what goal regulation of capital markets should pursue but accepts the normative premise that fairness matters and so addresses the distinct question of how to determine when restrictions on insider trading have been violated.[11]

An analogy is instructive. In poker, equality of opportunity across players is a fundamental presumption. If one player deliberately obtains information about another player's cards with the aid of a confederate, few would question whether that advantaged player should be penalized or ejected from the game or both. If that same player gains the information by careful monitoring of all the cards played in the course of the game, however, drawing on information available to all players, then the impropriety becomes less clear.[12] If the player inadvertently obtains such information and, knowing of its importance and accuracy, acts upon it, the case becomes less clear still. And if the player inadvertently obtains and acts upon such information but is unsure of its provenance or accuracy, the case is yet murkier. This series of fact patterns is not unlike that of insider trading cases resolved by the Supreme Court, with an important caveat: Players acting on information that confers an unfair advantage in a casino take for granted that if they are caught, they will be penalized. Thus, they not only understand that their conduct is inappropriate, they also understand that a regulator with broad power to punish is looking out for unfair schemes. This shared understanding of the demands of fairness is suggestive.

This essay develops two arguments. First, the essay contends that Justices Blackmun and Marshall were correct

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[11] To be yet more explicit, this essay does not seek to join the debate over the goals of securities regulation. Whether lawmakers or the Securities and Exchange Commission or both should try to enhance market efficiency or address information asymmetries or pursue some other goal is beyond the scope of this project. The narrower focus here is how to make insider trading doctrine more coherent. It may be that focusing on the lawfulness of access to information may lend coherence to the fairness rationale for the prohibition on insider trading, but that is not the goal.

[12] Disagreement over the propriety of card counting is evident in the gambling industry. In Nevada, casinos' practice of throwing out payers suspected of card counting has long survived, while in New Jersey, such exclusion of players is forbidden. I. NELSON ROSE, GAMBLING AND THE LAW 204–5 (1986) (describing Uston v. Resorts International Hotel, Inc., 445 A.2d 370 (1982), in which the state supreme court ruled that because the New Jersey Casino Control Commission had the authority to set rules for participation in games and had adopted no rule permitting exclusion of card counters, casinos had to let them play; in Nevada, casinos' practices are not so circumscribed).

when they emphasized in their dissent in *Chiarella v. United States* that accessibility of information should be dispositive in the determination of whether improper insider trading has occurred.[13] In this way, this essay contends, the justices illustrate that it is possible and indeed necessary to reserve a place for notions of fairness in insider trading doctrine. The essay argues for adoption of a fair access norm as a guide to identifying wrongful insider trading. By so doing, the Court could close the gap between lay intuitions about the wrongfulness of trading on inside information and, perhaps, increase faith in financial markets. This would not represent such a tremendous doctrinal move, the essay further contends, because it is possible at least to reconcile current doctrine with a fair access norm and, further, to unearth a fair access norm in jurisprudence. Indeed, doing so helps to explain puzzling kinks in the development of doctrine.

Second, the essay suggests a way to improve fairness of access—not the same thing as equal distribution of information—by exploitation of the technology of modern securities trades, which can be completed "in fractions of a second."[14] The essay proposes that insiders be required to make prophylactic disclosure of trades, reporting their intentions—though not the reasons for them[15]—beforehand. Such disclosure would be exploited by high-frequency traders, news of their trades in turn would affect the price of the underlying stock at near-light speed, and as a result the likelihood of profit by the insider would decline. While disclosure of the substance of inside information may pose serious problems for its possessor, disclosure of the fact that an insider is trading does not; in fact, such disclosure is already required.[16] As will be discussed further below, however, the disclosure does not occur nearly as quickly as it could or indeed as it must, if it is to counter the insider's incentive to trade in the first place. This reform does not provide a complete solution to the problem of insider trading, to be sure, but it both enhances doctrinal coherence and leverages how modern markets work.

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[13] Chiarella v. United States, 445 U.S. 222, 251 (1980) ("[P]ersons having access to confidential material information that is not legally available to others generally are prohibited . . . from engaging in schemes to exploit their structural informational advantage . . . .").

[14] Yesha Yadav, *Insider Trading and Market Structure*, 63 UCLA L. REV. 968, 975 (2016).

[15] This point matters because to require disclosure of the substantive information prompting the insider to act could compel violation of fiduciary duties of confidence to the source of the information. *See infra* Section II.C.

[16] 17 C.F.R. § 249.104 (2017).

Versions of some of the arguments made in this essay have been made before.[17] Scholars periodically raise arguments of fairness. This essay's contribution lies in linking and updating them—noting the virtue of the pre-disclosure requirement in a market moment in which near-instantaneous reactions to news are possible, for example. The essay also refines the notion of "equal access," often caricatured as requiring that information be made available to all, with development of "fair access," which would not require information be affirmatively provided to all and make price an indicator of risk tolerance only, but would instead mandate that information be equally accessible by lawful means.[18]

Both to make the subject manageable and to focus on the institution best placed to define the scope and limits of insider trading doctrine, the essay is directed to the Supreme Court's jurisprudence on the application of the Securities and Exchange Commission's (SEC or the Commission) Rule 10b-5 in cases involving allegations of insider trading.[19] This is well-trod

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[17] In particular, Kim Lane Scheppele argued for a "contractarian approach to the ethics of insider trading focuse[d] on what has happened to those who are harmed." Kim Lane Scheppele, *"It's Just Not Right": The Ethics of Insider Trading*, 56 L. & CONTEMP. PROBS. 123, 155 (1993). The critique holds yet more force today, after years of consistent doctrinal movement away from consideration of the harm of insider trading and toward the duties of the inside trader. *See, e.g.*, Ian B. Lee, *Fairness and Insider Trading*, 2002 COLUM. BUS. L. REV. 119, 121 (2002) (attempting to "rehabilitate fairness as a concept relevant to the debate about insider trading"); *but see* Jonathan R. Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9, 10–11 (1984) (arguing that "notions of 'fairness' and 'equity'" are "vague and ill formed" justifications for the prohibition and that "fairness considerations of earlier years are better analyzed in contractual terms").

[18] Indeed, this idea comes out in the writing of T.F. Woodlock, a financial writer at the turn of the last century who approved of investors' use of "legitimately obtained . . . information," and whose effort to distinguish "expert knowledge of values" and "early information" is described by Professor Perino. Perino, *supra* note 3, at 21 (quoting Thomas F. Woodlock, *Morality in Wall Street*, MESSENGER, July 1905, at 1, 13).

[19] 17 C.F.R. § 240.10b-5 (2017). This provision does not explicitly reference, let alone define, insider trading; it states in its entirety:

> 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 the 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.

Id. The force of Rule 10b-5 derives from Section 10(b) of the Securities Exchange Act of 1934, which makes it unlawful for any person ground. The discussion of high court precedents here aims both to critique the justices' perception that dedication to the principle of equal access to information is unworkable and to show that in each case, they have had to twist doctrine to ensure a morally acceptable outcome given distinct facts. The effort is complicated by the availability of criminal liability as well as civil liability; the line between cases is not always clear.[20] This essay does not try to clarify the division but instead attempts to distinguish between conduct that is culpable and conduct that is not. For this reason, the essay does not separately address cases involving allegations of criminal misconduct and those involving only civil liability.

The discussion that follows has two parts. Part I outlines the basic forms of insider trading, then traces the development of Supreme Court doctrine, and analyzes the divergence between initial intuition about wrongfulness and the elements of the misconduct or crime as doctrinally defined. Part II develops the argument for explicit adoption of a fair access norm and offers a proposal for modification to the doctrinal framework to restore the force of the initial intuition that the prohibition of insider trading rests on core notions of fairness, offers a specific regulatory reform intended to promote greater fairness, and applies the rule to the facts of recent cases to illustrate its efficacy.

I. DOCTRINAL DRIFT

Intuitively, insider trading is inherently unfair because one side of the transaction possesses information that the other side cannot access. Yet it does not take much analysis to find ambiguity both on the morality of the insider's conduct and on the practicability of a prohibition. Some scholars have suggested that allowing insiders to trade on the basis of the information to which they have exclusive access enhances market efficiency, a goal potentially in tension with market fairness.[21] Recognition of

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> 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 [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities Exchange Act of 1934, Pub. L. No. 73-291, § 10(b), 48 Stat. 881, 891 (codified as amended at 15 U.S.C. § 78j(b) (2012)). In addition, SEC Rule 14e-3, 17 C.F.R. § 240-14e-3, applies to trading on inside information related to a tender offer. The present essay is limited to Rule 10b-5.

[20] *See* Samuel W. Buell, *What Is Securities Fraud?*, 61 DUKE L.J. 511, 517 (2011).

[21] *See* Carlton & Fischel, *supra* note 1, at 858–59.

the harm suffered by the third party transacting with the insider is slippery, too, because the third party has the opportunity to repurchase or re-sell instantly, avoiding any loss; not until the insider's information affects the market price does the third party suffer a quantifiable injury. And it is inevitable that different market participants will have information of varying quality; surely not all such differences mandate regulatory intervention. Thus, competing policy goals, conceptual difficulties, and practical obstacles have all dogged insider trading enforcement from the beginning.

This Part first offers what aspires to be a clean explanation of the form of insider trading, in the abstract, in order to put the messy facts of the cases that have reached the Supreme Court into a clear context. The second Section provides a concise history of the evolution of the Supreme Court's insider trading jurisprudence, briefly analyzing five critical cases, all of which will be intimately familiar to scholars of this area of law. The third Section briefly offers a critique of this evolution, suggesting that although a majority of the Court has explicitly sought to abandon concern with fairness, notions of fairness do and should remain salient.

A. The Inside Trade

A visual representation of the basic forms of insider trading helps to appreciate the evolution of the Court's doctrine in this area. It also helps to appreciate criticism by scholars over the years, as the Court has reacted to permutations of the basic elements: nonpublic information, someone with access to that information, and a trade by that person or someone tipped off by that person. For simplicity's sake, assume that the person with access to the inside information is in fact an insider, such as an officer or director of a publicly traded corporation, and the corporation is the owner of the information. The relationship between this person and the corporation has doctrinal significance.[22] Then the paradigmatic inside trade looks like this:

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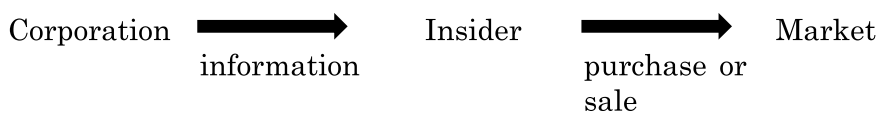
[22] *See* Chiarella v. United States, 445 U.S. 222, 230 (1980) ("[L]iability is premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction.").

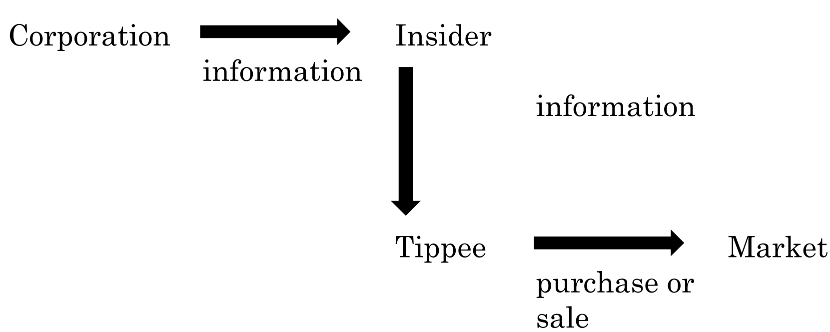
FIG. 1. CLASSIC.



The identity of the third-party buyer or seller of the security here does not matter; if the security is sold or bought in a transaction on an exchange, the insider almost certainly has no relationship with the counterparty and does not even know who that counterparty is.[23]

If the insider does not trade directly but instead passes the information to a tippee, an intermediary who sells or buys shares of the corporation, then the transaction looks like this:

FIG. 2. TIPPEE.



There may be a series of tippees, each passing the information on to the next person, until someone in the chain eventually engages in a purchase or sale of securities.

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[23] The early idea was that if the counterparty trading with an insider is a shareholder of the company that is the insider's employer, then the insider would be breaching a fiduciary duty to the shareholder by trading. Because it seemed neither sensible nor feasible to rest the prohibition on the question of whether the third-party trader was a shareholder of the company, reliance on the rationale expanded to cover insider transactions with anyone. Donald C. Langevoort, *Insider Trading and the Fiduciary Principle: A Post-*Chiarella *Restatement*, 70 CALIF. L. REV. 1, 7–9 (1982). The extension is vulnerable, though, to the extent that the root of wrongfulness of insider trading is the existence of a relationship between insider and third party, such that the former owes a duty to the latter.

These two[24] schema convey both "classic" insider trading, which involves a trade by an insider who uses information for personal gain; and "misappropriation" insider trading, which involves a trade by someone who, though not an insider, enjoys access to the nonpublic information as a result of an employment or other legally significant relationship.[25] This is appropriate; classical cases can be recharacterized easily as misappropriation cases.[26] The second figure reflects trades by a tippee.

As these two possible, basic forms make clear, a court reviewing the facts of alleged insider trading may focus on the nature and implications of two or three relationships, depending on whether the insider traded directly, as depicted in the first diagram, or indirectly, as depicted in the second diagram. In a direct case, there are two potentially significant relationships: one between the corporation and the insider and the other between the insider and the third party buying or selling on the market. In an indirect case, there are three potentially significant relationships: one between the principal and the insider, as before; another between the insider and the tippee; and a third between the tippee who trades and the counterparty to that trade.

The analysis in the next Section illustrates how early cases involving direct trades focused on both the relationship between the corporation and the insider *and* the relationship between the insider and the third-party outsider. Over time, however, the Court has eschewed attention to the relationship between the insider and the outsider and that between the tippee and the outsider. As a result, the Court has focused on the possibility that the insider directly, or indirectly through the tippee, betrayed the corporation and has abandoned consideration of fairness and the importance of faith in the market. By classifying it as a form of agent misconduct in a principal-agent relationship, the Court has narrowed the definition of insider trading. But the Court has shied from complete adoption of the language of agency, not least because

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[24] The theoretical justification for treating the classical theory and the misappropriation theory as distinct is not entirely clear and as discussed below, the Supreme Court has come to apply the same analysis of each type of fact pattern, looking for an insider's breach of a duty. Both a classical case and a case involving a tipper/tippee could be recast as misappropriation cases, so the boundaries are blurry.

[25] For example, an outside lawyer for the principal, who enjoys access to the nonpublic information as a result of serving as an advisor to the client. *See generally* United States v. O'Hagan, 521 U.S. 642 (1997) (these were the basics facts at issue in *O'Hagan*).

[26] And Zachary J. Gubler argues that misappropriation theory should supplant the classical theory because it offers the best chance of restoring coherence and consistency to insider trading doctrine. Zachary J. Gubler, *A Unified Theory of Insider Trading Law*, 105 GEO. L.J. 1225, 1229–30 (2017).

of the difficulty of applying agency principles to fact patterns involving tippees many times removed from the inside source of information. The next Section demonstrates the doctrinal contortions the Court has engaged in to assess the conduct in such cases involving increasingly complicated and attenuated relationships between corporation and insider.[27] The doctrinal shift to focus on the wrongfulness of the insider's conduct relative to the principal makes sense, given the lack of a basis for finding a fiduciary breach in the transaction with a third party to whom the insider owes no duty.[28] But the move still seems to miss the forest for the trees.

B. *The Path Taken*

Understanding why the justices focus now on the aspects of insider cases that they do, let alone understanding their resolution of recent trading cases, requires an appreciation of the evolution of the Court's jurisprudence. This Section provides such an overview, analyzing odd turning points in the evolution of doctrine as the justices have tried to distinguish permissible from improper uses of inside information. There is disagreement among scholars over which Supreme Court cases should constitute the canon of insider trading doctrine and the discussion below does not pretend to be comprehensive, but does strive to illustrate significant moves in the Court's jurisprudence. The proper starting point for this doctrinal history, however, is a case that did not reach the Court but that nonetheless provided the basic framework that courts have accepted in insider trading cases.[29] With *In re Cady, Roberts &*

[27] And to the extent that the Court has cited agency principles in this context, there are clear shortcomings to its approach. Richard Epstein, *Returning to Common-Law Principles of Insider Trading After* United States v. Newman, 125 YALE L.J. 1482, 1504–05 (2016).

[28] William H. Painter, *Inside Information: Growing Pains for the Development of Federal Corporation Law Under Rule 10b-5*, 65 COLUM. L. REV. 1361, 1373 (1965) ("In this context a concept of privity—in the sense of contractual privity—is obsolete . . . ."). Potential recovery by the third party transacting with the insider, the issue that the author addressed, is outside the scope of this essay, which is concerned with the definition and recognition of the misconduct.

[29] The dividing line between civil and criminal liability for insider trading is imprecise. John C. Coffee Jr., *Paradigms Lost: The Blurring of the Criminal and Civil Law Models—And What* Can Be *Done About It*, 101 YALE L.J. 1875, 1890 n.41 (1992) ("[T]he first case to define and proscribe insider trading was an administrative decision, and courts have uniformly deferred to it since . . . ."). In cases involving criminal charges, the justices cite as precedent cases that, like *In re Cady, Roberts* and *Dirks v. Sec. & Exch. Comm'n*, were civil. *See infra* Sections I.B.1, I.B.3. In cases involving civil claims, the justices cite as precedent criminal cases. *See* Sec. & Exch. Comm'n v. Zandford, 535 U.S. 813, 823 (2002) (relying on principles articulated in *O'Hagan* to find civil liability). As a matter of law, the difference between civil and criminal violations lies in

Co.,[30] the SEC "built the foundation on which the modern law of insider trading rests," as Professor Donald C. Langevoort has aptly put it.[31] The United States Court of Appeals for the Second Circuit attempted to steer doctrine along the path set by the Commission in *Securities and Exchange Commission v. Texas Gulf Sulphur*, so the two cases are discussed together below.

1. *In re Cady, Roberts & Co.* (1961) and *Sec. & Exch. Comm'n v. Texas Gulf Sulphur Co.* (1968)

The facts of this early case are amenable to concise summary. On the morning of November 25, 1959, a representative of Cady, Roberts & Co. (Cady, Roberts), a brokerage firm,[32] attended a meeting of the board of a publicly traded company, Curtiss-Wright Corporation (Curtiss-Wright). The representative was also a director of Curtiss-Wright. During a break in the board meeting, this director telephoned a broker at Cady, Roberts.[33] The director told the broker that Curtiss-Wright's board had approved payment of a lower dividend than in prior quarters.

Before news of the dividend reduction appeared on the Dow Jones newswire, the broker entered orders on the New York Stock Exchange to sell Curtiss-Wright shares owned by more than twenty client accounts.[34] The sales were completed before the price of Curtiss-Wright shares fell due to the news of the decision by the company's board.[35] The SEC concluded that the

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whether the conduct of the defendant was willful. Section 32 of the Exchange Act and Section 24 of the Securities Act clearly state that "willful[ ]" violations of provisions of either law are subject to criminal sanction. 15 U.S.C. §§ 77x, 78ff(a) (2012). Professor Samuel Buell addresses the vagueness of standards for securities fraud, but the present essay focuses on cases involving allegations of criminal misconduct and resorts to those involving civil claims only as necessary to illustrate critical doctrinal developments. *See* Buell, *supra* note 20, at 520.

[30] *See In re* Cady, Roberts & Co., 40 S.E.C. 907 (1961).

[31] Donald C. Langevoort, *"Fine Distinctions" in the Contemporary Law of Insider Trading*, CLS BLUE SKY BLOG (Jan. 28, 2013), http://clsbluesky.law.columbia.edu/2013/01/28/fine-distinctions-in-the-contemporary-law-of-insider-trading/ [https://perma.cc/DH25-TU9U].

[32] Cady, Roberts was registered as a brokerage pursuant to the Securities Exchange Act of 1934 (the Exchange Act), which requires those who "effect[ ] transactions in securities for the account of others" to register with the Commission. Securities Exchange Act of 1934, Pub. L. No. 73-291, § 3(a)(4), 48 Stat. 881, 883 (codified as amended at 15 U.S.C. § 78c(a)(4) (2012)) (definition of broker); *id.* § 15 (codified as amended at 15 U.S.C. § 78o) (mandatory registration for broker dealers); *see also In re Cady, Roberts & Co.*, 40 S.E.C. at 907 n.1.

[33] *In re Cady, Roberts & Co.*, 40 S.E.C. at 909.

[34] *Id.*

[35] *Id.* at 909–10.

broker had violated Rule 10b-5[36] and upheld the proposed penalty: a twenty-day suspension from trading and a $3,000 fine.[37] Notably, the director did not leak information to the broker as part of a "preconceived plan" and "probably assumed . . . that the dividend action was already a matter of public information."[38]

The intuition underlying the opinion by the chairman of the Commission, William L. Cary, is that the transaction between the possessor of inside information, on the one hand, and outsider investors, on the other, was unfair: Outsiders did not and could not obtain access to information that might affect their willingness to engage in the transaction. Cary wrote that "insiders must disclose material facts which are known to them by virtue of their position but which are not known to persons with whom they deal and which, if known, would affect their investment judgment."[39] If the insider cannot disclose, "the alternative is to forego the transaction."[40] This obligation, now known as the "disclose or abstain" rule, applied in cases involving

> a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and . . . the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.[41]

The doctrinal challenge to framing the problem this way results from the lack of any special relationship between the insider and the outsider: In the absence of a duty created by a legally significant relationship and in the absence of fraud, why may the insider not exploit superior knowledge? After all, some investors are smarter than others, or are better able to develop insights based on publicly available information. Inevitably, financial market participants vary in the degree of skill, intellect, and experience that they possess. The Commission dismissed this concern summarily, noting that it "ignores the plight of the buying public—wholly unprotected from the misuse

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[36] The Commission also found that the broker, Robert M. Gintel, had violated Section 17(a) of the Securities Act of 1933, which prohibits—in language virtually identical to that of § 10(b) of the Exchange Act and Rule 10b-5—any person "to employ any device, scheme, or artifice to defraud" in the "offer or sale of any securities." *Compare* Securities Act of 1933, Pub. L. No. 73-22, § 17(a)(1), 48 Stat. 74, 84–85 (codified as amended at 15 U.S.C. § 77q(a)), *with* Securities Exchange Act of 1934, § 10(b), *and* 15 C.F.R. § 10b-5 (2017); *see also In re Cady, Roberts & Co.*, 40 S.E.C. at 912.

[37] *In re Cady, Roberts & Co.*, 40 S.E.C. at 917–18.

[38] *Id.* at 917.

[39] *Id.* at 911.

[40] *Id.*

[41] *Id.* at 912.

of special information."[42] Thus in this foundational case, the Commission endorsed the view that a general duty to disclose exists, in order to protect counterparties transacting unknowingly with insiders or parties informed by insiders. The Commission viewed the prohibition as necessary to prevent "abuses in the exchange markets," or, put differently, to preserve faith in their fairness.[43]

The Second Circuit acted on this understanding of the prohibition in *Sec. & Exch. Comm'n v. Texas Gulf Sulphur Co.*,[44] a case involving insider use of information about a mining company's discovery of lucrative deposits in Canada.[45] Sitting en banc, a majority of the Second Circuit cited the need to maintain the "justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information"[46] before finding that several of the defendants failed to comply with the rule that they disclose the material, inside information they possessed, or abstain from trading.[47] In adopting this position, the appellate panel made two significant moves. First, the judges pronounced a particular understanding of the legislative intent underlying the prohibition on securities fraud as applied to insider trading. "It was the intent of Congress that all members of the investing public should be subject to identical market risks,—which market risks include, of course the risk that one's evaluative capacity or one's capital available to put at risk may exceed another's capacity or capital."[48]

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[42] *Id.* at 913. In this way, Cary avoided grappling with the question of whether, in the absence of a duty, the conduct of the insider constituted a "scheme or artifice to defraud" under Rule 10b-5. Recall that fraud itself can be established if one party to a transaction misrepresents or lies. But here, the insider did neither; the broker did not disclose. At the same time, a party to a transaction typically is not under an obligation to disclose every piece of potentially relevant information of which that party is aware, as the Supreme Court later reminded. Chiarella v. U.S., 445 U.S. 222, 233 (1980).

[43] *In re Cady, Roberts & Co.*, 40 S.E.C. at 914 n.25.

[44] Sec. & Exch. Comm'n v. Tex. Gulf Sulphur Co., 401 F.2d 833 (2d Cir.1968) (en banc).

[45] *Id.* at 840–42.

[46] *Id.* at 848.

[47] *Id.*

[48] *Id.* at 852. The court went on to apply this reasoning to the specific facts of the case:

> [The defendants] alone were in a position to evaluate the probability and magnitude of what seemed from the outset to be a major ore strike; they alone could invest safely, secure in the expectation that the price of [Texas Gulf Sulphur (TGS)] stock would rise substantially in the event such a major strike should materialize, but would decline little, if at all, in the event of failure, for the public, ignorant at the outset of the favorable probabilities would likewise be unaware of the unproductive exploration, and the additional exploration costs would not significantly affect TGS market prices. Such inequities based upon unequal access to knowledge should not be shrugged off as inevitable in

Second, the panel offered a clean, clear definition of the reason insider trading in the case was wrongful: What was unfair was not the disparity in possession of information but the disparity in the ability to access it. "The insiders here were not trading on an equal footing with the outside investors."[49]

The judges recognized the harm as resulting from the individual insiders' use of "information intended to be available only for a corporate purpose and not for the personal benefit of anyone."[50] They did not address the question of how information must be accessible in order to ensure "equal access." Although the Second Circuit thus endorsed an equal access theory of insider trading, the judges did not offer a nuanced explanation of when information is unequally available.[51] For example, may an insider exploit information legally accessible to an outsider, but provided to the insider as a result of an official position? The *Tex. Gulf Sulphur* opinion, which also emphasizes the importance of disclosure by the insider,[52] suggests that the answer might well be no.[53] But the court did not provide clear instructions on how to distinguish information that has been

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> our way of life, or, in view of the congressional concern in the area, remain uncorrected.

Id.

[49] *Id.* at 852.

[50] *Id.* at 848 (quoting *In re* Cady, Roberts & Co., 40 S.E.C. 907, 912 (1961)).

[51] Perhaps a distinction could be drawn between what the Second Circuit characterized as "equal access" and what this essay argues for, fair access. The distinction lies in the recognition of the relevance of the legal accessibility of the information that the insider has, which in turn accepts the logic of the Supreme Court's later opinions focusing on the breach of a duty by the insider. *See infra* Section I.B.3.

[52] *Tex. Gulf Sulphur Co.,* 401 F.2d at 849 ("The only regulatory objective is that access to material information be enjoyed equally, but this objective requires nothing more than the disclosure of basic facts so that outsiders may draw upon their own evaluative expertise in reaching their own investment decisions with knowledge equal to that of the insiders.").

[53] This is one reason that the Second Circuit's opinion continues to be the subject of scholarly criticism arguing against the practical viability of an equal access theory. Professor Bainbridge has argued that the theory "lack[s] support in the legislative history and relevant precedents," for example. Stephen Bainbridge, *Texas Gulf Sulphur at 50: The Unworkable Equal Access to Information Principle*, STEPHEN BAINBRIDGE'S J. OF L., RELIGION, POL., & CULTURE (Aug. 3, 2017, 10:22 AM), http://www.professorbainbridge.com/.m/professorbainbridgecom/2017/08/texas-gulf-sulphur-at-50-the-unworkable-equal-access-to-information-principle.html [https://perma.cc/277A-QU7E]. An equal access principle, Professor Bainbridge warns, could make criminal "much legitimate and, indeed, beneficial market activity," including share purchases by a would-be acquirer transacting because of awareness of its own acquisitive goals, careful research by investment advisers, or the savvy, coincidental observer who notes conduct indicative of an investment opportunity (like mining company trucks visiting a parcel of property). *Id.* It is this last example, involving exploitation of access open to anyone who looked, that distinguishes "equal access" as Professor Bainbridge appears to define it from "fair access" as developed in this essay. The coincidental observer has fair access because the observation is achieved without violation of law. *See infra* Section II.A.

equally accessible and information that has not—perhaps the judges intended to develop the concept of equal access in subsequent cases.

The Supreme Court denied the petition for certiorari in *Texas Gulf Sulphur*,[54] but subsequently showed great discomfort with the broad prohibition espoused by the Second Circuit.

2. *Chiarella v. United States* (1980)

Here, the person who traded on the basis of inside information worked at a financial printer and from documents prepared for printing deduced the identities of target companies in four future takeovers and one future merger.[55] Vincent Chiarella was convicted of insider trading in violation of Section 10(b) and Rule 10b-5; a panel of the Second Circuit affirmed.[56] In *Chiarella v. United States*, however, a majority of the Supreme Court concluded that Chiarella's conduct did not constitute prohibited insider trading, even though his position afforded him access to "material, nonpublic information," because he was under no obligation to disclose the information to the counterparties with whom he traded.[57] The majority concluded that he was not an insider and so was not subject to the disclose-or-abstain regime of *Cady, Roberts*.[58] The majority stated that Chiarella could not be under a duty to the "market as a whole."[59] In the absence of a duty to disclose, there could be no deception, and without deception, there could be no fraud.[60] In terms of the second diagram above,[61] there was no doctrinally significant relationship between the corporation and the insider or between the investor and the third-party outsider. Consequently, Chiarella neither acted improperly nor failed to act when required to do so.[62]

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54 Coates v. Sec. & Exch. Comm'n, 394 U.S. 976 (1969).

55 Chiarella v. United States, 445 U.S. 222, 224 (1980).

56 *Id.* at 225.

57 *Id.* at 230 ("[L]iability is premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction.").

58 *Id.* at 227.

59 *Id.* at 231.

60 *Id.* at 232 (citing Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 474–77 (1977)); *see also Santa Fe Indus., Inc.*, 430 U.S. at 474 ("[T]he [challenged] transaction, if carried out as alleged in the complaint, was neither deceptive nor manipulative and therefore did not violate either § 10 (b) of the [Exchange] Act or Rule 10b-5."). The Court's opinion in *Chiarella* and language in *Santa Fe Industries* suggest that a duty to disclose, if imposed by regulation, would then move nondisclosure into the realm of the fraudulent.

61 *See supra* Figure 2.

62 The Court declined to consider as an alternative theory of liability the misappropriation by Chiarella of information that belonged to the acquiring company. *Chiarella*, 445 U.S. at 236–37. The Court could have yet further limited the obligation

The Court's opinion represents a doctrinal inflection point, revising its prior endorsement of the Commission's definition of insider trading. Perhaps the move could be justified as a matter of statutory interpretation: insider trading is securities fraud, which in turn implicates common law fraud. Failure to disclose may constitute fraud if the silent insider otherwise has a duty to disclose the information that would enable a counterparty to assess a proposed transaction properly.[63] But this interpretation does not honor the language or spirit of *Cady, Roberts*. The *Chiarella* Court's understanding of *Cady, Roberts* is selective. While the Commission addressed the fairness of using information that a non-insider would have no "access" to,[64] the Court in *Chiarella* dismissed this as a broad "parity-of-information" requirement and summarily rejected it.[65] Yet fair access and parity of information are not equivalent; equal opportunity to access information is not the same as possession of equal information. Nor is information that is "inaccessible" identical to information that is "nonpublic."[66]

The majority opinion in *Chiarella* highlights the justices' discomfort with an interpretation of the insider trading prohibition that could deter efforts by investors to gather

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by noting that insiders have the requisite relationship with shareholders of the company through which the insider obtained information and so the insider could freely transact with third parties who were not shareholders and to whom the insider owed no duty. The Court rejected this path, concluding that in modern securities markets, which are characterized by anonymity between buyers and sellers, identifying the third party and that third party's relationship to the insider's employer presented insurmountable obstacles. *See id.* at 232–33; *see also id.* at 239–45 (Burger, C.J., dissenting). In his dissent, Justice Burger argued that the more important question is whether the person trading on inside information violated the law in obtaining it, and that the printer employee knowingly used the acquiror's information to trade. *Id.* at 244. (This analysis differs somewhat from that of Justice Blackmun in his dissent because Justice Blackmun contended that the misappropriation theory was not necessary to find Chiarella criminally liable. *Id.* at 245–46.)

[63] *See* Buell, *supra* note 20, at 547 ("[T]he law of securities fraud is not clear—across all forms of its civil and criminal remedies—on the extent to which nondisclosure and conduct alone [i.e., in absence of a duty] can support a claim of fraud.").

[64] *See In re* Cady, Roberts & Co., 40 S.E.C. 907, 912 (1961) (noting that the obligation to disclose or abstain "rests on two principal elements; first, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing") (footnote omitted).

[65] *Chiarella*, 445 U.S. at 233. The Court returns to the question of when an obligation to disclose or abstain arises in its discussion of *Chiarella* in Dirks v. Sec. & Exch. Comm'n, 463 U.S. 646, 654 (1983); *see also infra* Section I.B.3.

[66] *Chiarella*, 445 U.S. at 241 (Burger, C.J., dissenting). Indeed, as is addressed in more detail in *Dirks v. Sec. & Exch. Comm'n*, discussed below, by defining inside information as that which is material and nonpublic, the Court created a new challenge, because the determination of what is material is itself potentially controversial; determining what is legally accessible would be more straightforward. *See Dirks*, 463 U.S. at 655; *see also infra* Section I.B.3.

information that, while not publicly announced, was lawfully accessible. Perhaps this reflects the concern that the intent to obtain information not generally available is not *per se* unlawful, even though it could be classified as willful. Every investor wishes to gain an advantage relative to other investors. Such basic self-interest helps make markets work. Only sometimes, under some circumstances, does the intent to gain an advantage correlate with conduct that crosses a moral line. What makes the majority's *Chiarella* opinion frustrating, in a case manifesting the concurrence of intent and action, is the additional requirement of a breach of duty in order to identify wrongful conduct.

The counterfactual that the majority rejected is instructive. The justices in the majority worried that to hold Chiarella liable would be tantamount to adopting a mandatory disclosure rule.[67] Preferable in their eyes was "detailed and sophisticated regulation that recognizes when use of market information may not harm operation of the securities markets."[68] The majority declined at this time to adopt the "'misappropriation' theory" of insider trading, which presumably would have required a finding that Chiarella exploited information that did not belong to him because it was property of the would-be acquirer in the transactions described in the documents.[69] The majority rejected also consideration of the manner by which Chiarella received the inside information and, by extension, consideration of the fairness of his access relative to trading counterparties.[70] Justices Blackmun and Marshall strongly criticized the majority's move and it is in their dissent, discussed in more detail below,[71] that an alternative conception of the wrong of insider trading and of the goal of its prohibition is to be found.

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[67] This was rejected in *Dirks*, 463 U.S. at 654 ("'[A] duty to disclose under § 10b does not arise from the mere possession of nonpublic market information[,]' . . . [but] rather from the existence of a fiduciary relationship." (quoting *Chiarella*, 445 U.S. at 235)); *see also infra* Section I.B.3.

[68] *Chiarella*, 445 U.S. at 233.

[69] *Id.* at 236, 237 n.21. The majority reasoned that because the misappropriation theory was not presented to the jury, it was not properly before the Court as a possible basis for upholding Chiarella's conviction. *Id.* at 236. Justice Burger's dissent, however, suggests that the record could be read to support an argument that the misappropriation theory was presented to the jury, it simply was not flagged as such. *Id.* at 243 (Burger, C.J., dissenting) ("The Court's reading of the District Court's charge is unduly restrictive.").

[70] *Id.* at 231. Justice Blackmun, dissenting, wanted to provide the basis for conviction on a finding of trading on the basis of information not legally available to others in the market. *Id.* at 247 (Blackmun, J., dissenting).

[71] *Id.* at 240–48 (Burger, C.J. & Blackmun, J., dissenting); *see also infra* note 148 and accompanying text.

3. *Dirks v. Sec. & Exch. Comm'n* (1983)

The influence of the Court's opinion in *Dirks* on the direction of insider trading doctrine is difficult to overstate. *Dirks* offered a twist on insider trading, in that the person who was the source of the information that drove sales of shares of the affected company apparently was not motivated by greed, but acted to blow the whistle on corporate fraud. The justices had to figure out how to address implications of prior decisions that might have produced a result they did not want. The role of motive lurks in the shadow of the Court's analysis.

Ronald Secrist, a former employee of Equity Funding of America (Equity Funding), a corporation that sold life insurance and mutual funds, told Raymond Dirks, an analyst at a New York broker-dealer, that Equity Funding had engaged in massive fraud.[72] Dirks investigated by visiting the company's headquarters and interviewing current and former employees.[73] Senior management denied wrongdoing but other employees corroborated Secrist's story.[74] Dirks, convinced of the truth of Secrist's information, tried to persuade a *Wall Street Journal* reporter to write about potential fraud at the company, but the reporter did not believe the allegations could be true.[75] Dirks also shared his findings with "clients and investors," some of whom sold shares of the company worth millions of dollars.[76] Over the two-week period of Dirks's investigation, the price of the company's shares fell, leading the New York Stock Exchange to suspend trading, state regulators to launch an investigation, and the SEC to file a complaint.[77] Finally, the *Journal* published an article on the fraud.[78]

After its investigation, the SEC charged Dirks with, among other things, violating Section 10(b) of the Exchange Act and Rule 10b-5,[79] and censured Dirks. Dirks challenged the censure in the United States Court of Appeals for the District of Columbia Circuit.[80] Although he lost there, he won on appeal in the Supreme Court.[81] Writing for the majority, Justice Powell

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[72] *Dirks*, 463 U.S. at 648.

[73] *Id.* at 649.

[74] *Id.*

[75] *Id.* at 649–50.

[76] *Id.* at 649.

[77] *Id.* at 650. The facts of the case also raise the intriguing question of how the line is and should be drawn between civil and criminal liability for insider trading, a subject of a future project.

[78] *Dirks*, 463 U.S. at 650.

[79] *Id.* at 650–51.

[80] *Id.* at 653.

[81] *Id.*

defined insider trading as trading by someone acting on "material, nonpublic information"[82] either obtained as a result of access afforded by the trader's official position or provided by someone in such a position who improperly disclosed in violation of a fiduciary duty,[83] meaning for the purpose of personal gain.[84]

Requiring a finding that the insider received a "personal benefit" gave Justice Powell a way to distinguish the conduct of the insiders who disclosed corporate misconduct to Dirks from that of the paradigmatic insiders who leak to greedy and unscrupulous traders. The justice needed to navigate a doctrinal obstacle course, created by prior opinions, to get to the desired outcome: no liability for Dirks or his informants. After all, under *Cady, Roberts*, Dirks could well be liable, and under *Chiarella*, the sources of Dirks's information could be, too.[85] Justice Powell circumvented these challenges by finding that neither Dirks nor his sources at the company violated a fiduciary duty in disclosing information to investors who subsequently traded; there was no violation because as tippers in this case, their motive was to expose fraud and they received no personal benefit from their disclosure.[86] *Dirks* thus repeated the move in *Chiarella* to dismiss equal opportunity of access as an unworkable goal and elevated the "personal benefit" requirement in analysis of the propriety of trading informed by material, nonpublic information.

From a more abstract perspective, the majority in *Dirks* directed its energy to exploring the nature and implications of the relationship between the trading individual(s) and the company, the source of the information.[87] The majority ignored the implications of its perspective for others, who did not have access to the information provided to and by Dirks and who entered transactions involving shares of the company. This is troubling, not least because the clients of Dirks that did sell their holdings knew that they had information other investors did not and intended to exploit their advantage. For purposes of culpability, the question that counterparties to those sales might

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82 *Id.* at 655.

83 *Id.* at 660.

84 *Id.* at 662.

85 This is so because in *Chiarella*, the Court looked for a fiduciary relationship, and the insiders who disclosed to Dirks had both a relationship to the source of the information and a relationship to existing shareholders of the company with whom they might trade or might have traded. *See* Chiarella v. United States, 445 U.S. 222, 234–35 (1980) ("[A] duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information.").

86 *Dirks*, 463 U.S. at 666.

87 Professor Kenneth R. Davis characterizes this as an "[i]rrelevant precondition[ ] to liability." Kenneth R. Davis, *The Equality Principle: How Title VII Can Save Insider Trading Law*, 39 CARDOZO L. REV. 199, 201 (2017).

want answered is, did Dirks's clients believe that the information they benefitted from had been obtained improperly—that is, not just that access was exclusive but that by operation of law, it was impossible for others?[88] Elsewhere in criminal law, this would be dispositive, establishing the requisite mens rea concurrent with the actus reus of trading.[89] Yet neither the majority nor, interestingly, the dissent, addressed this possibility.

While scholars raised concerns over the reasoning applied in *Dirks* shortly after the opinion was written,[90] subsequent changes in securities regulation and in the complexity of market transactions have added more. The Commission's adoption of a rule, Regulation FD, prohibiting selective disclosure of information by an issuer of securities, undermines the need for the Court's respect for selective disclosure by issuers to favored investors.[91] Regulation FD broadly prohibits this practice.[92] As a result, there is no longer need for doctrinal contortion seeking to distinguish selective disclosures that do not constitute insider trading from selective disclosures that do. Further, technology has dramatically eased the broad dissemination of corporate information. No longer is it the case, as the Court asserted in *Dirks*,[93] that "[i]t is the nature of this type of information, and indeed of the markets themselves,

[88] Of course, from the majority's perspective, the disclosure was not wrongful because those doing the disclosing intended to expose fraud. *Dirks*, 463 U.S. at 667. So, if Dirks's clients understood that this was the tippers' motivation, then the clients' intentions could conceivably be deemed less culpable. But that is slippery reasoning, depending as it does on the motives of the tippers to assess the conduct of the tippees.

[89] *See* CYNTHIA LEE & ANGELA P. HARRIS, CRIMINAL LAW: CASES & MATERIALS 149 (3d ed. 2014) ("Most crimes in the United States consist of four basic elements: (1) a voluntary act (or omission when there is a legal duty to act) that results in some kind of social harm (in legalese, an 'actus reus'); (2) a prohibited mental state (in legalese, a 'mens rea,' or guilty mind); (3) a chain of causation that links the defendant's actions with the social harm; and (4) concurrence between the mens rea and the actus reus.").

[90] *See, e.g.*, Laurie Ann Black, Mark Andrew Segal, & James Carroll Stewart, Jr., Dirks v. SEC: *A Gain for Dirks, a Loss for the Market*, 35 MERCER L. REV. 981, 997 (arguing that the personal-benefit test is both overbroad, capturing desirable conduct, and underinclusive, failing to capture culpable conduct).

[91] 17 C.F.R. § 243.100 (2017). Regulation FD requires "simultaneous[ ]" public disclosure of information by an issuer that intends to disclose and "prompt[ ]" public disclosure by an issuer that inadvertently disclosed. *Id.* On the point about the impact of the rule, see Guttentag, *supra* note 4, at 551–52 (arguing, among other things, that Regulation FD obviates the need for the Court's personal benefit requirement in insider trading cases that involve disclosure by an issuer); *see also* Donna M. Nagy, *Beyond* Dirks: *Gratuitous Tipping and Insider Trading*, 42 J. CORP. L. 1, 40–41 (2016) (also arguing that Regulation FD weakened the rationale for selective disclosure endorsed by the Court in *Dirks* and noting that the rule "sucked out most of the air from the very space that *Dirks* created for insider-analyst communications").

[92] 17 C.F.R. §§ 243.100–243.103 (2017).

[93] Without, incidentally, including either any discussion of feasibility or any citation to research on the question.

that such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally."[94] Today, it is the nature of this type of information and of markets themselves that such information can be made simultaneously available to the public generally, and at near-light speed.[95]

How might the analysis have worked, had the Court in *Dirks* focused on the relationship between the insider or tippee acting on the insider's information, on the one hand, and third parties transacting with them on an exchange, on the other? The case is still difficult, because Dirks obtained information from prior and current employees who might well have chosen not to speak to anyone else. Thus, Dirks may have enjoyed access that other investors could not have, and Dirks by virtue of his employment had time and resources to investigate that other investors certainly did not have. But these obstacles are not of the sort that made Dirks's conduct *per se* improper; it was not unlawful for him to investigate as he did. This distinguishes his conduct from that of, for example, a hacker who accesses an investment firm's computer and obtains confidential corporate information that confers a trading advantage.[96] On the other hand, Dirks's clients may have been culpable, to the extent that they believed that they received information that was not lawfully obtainable by other investors. Note that this is not to ask whether disclosure to Dirks violated a fiduciary duty but whether the trading parties *believed* that it did.[97] If equal opportunity to access serves as touchstone, then Dirks's conduct, and that of the investors he advised, may not constitute impermissible insider trading, but *not* because of any relationship he or his sources had or any duty they owed to the company, or indeed to anyone else. This perspective informs the prescriptive portion of this essay below.[98] The Court, though, by emphasizing breach of fiduciary duty in its analysis and, as a result, the significance of a personal benefit to the source of inside information, left open the question of how an investor

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[94] Dirks v. Sec. & Exch. Comm'n, 463 U.S. 646, 659 (1983).

[95] Yadav, *supra* note 14, at 971.

[96] Guttentag, *supra* note 4, at 566–67.

[97] This distinction is subtle but important. If a tippee knows that a tip includes information not lawfully accessible to others, then transactions by that tippee are improper. Focus on the trading party recognizes that fairness to third parties does not turn on the actual existence of fiduciary obligations of the tipper. In insider trading cases, the Court shows some reluctance to try to guess what is going on inside investors' heads, but this is uncharacteristic of criminal law more generally, which often enough requires the court to mine the intent and beliefs of a defendant to determine guilt and to weigh possible claims of exculpatory beliefs.

[98] *See infra* Section II.A.

could be liable for insider trading in the absence of a fiduciary relationship with a trading counterparty.

4. *United States v. O'Hagan* (1997)

In *O'Hagan*, the Court took up a question explicitly avoided in *Chiarella*: whether the enterprising printing office employee could have been ensnared under an alternative theory of liability. Applying this "misappropriation" theory, the Court found a lawyer criminally liable for trading activity informed by information about merger targets of a client of his firm. The justices needed an alternative to the "classical" theory because the lawyer had no relationship with the target companies and so his trading in securities implicated no fiduciary obligation. The adoption of the misappropriation theory represented another doctrinal workaround necessary because the Court had previously ruled out consideration of the impact on third parties of insider access to information as sufficient to support liability in the absence of a duty.[99]

James Herman O'Hagan, a partner in the Minneapolis office of Dorsey & Whitney, learned of the plans of Grand Metropolitan PLC (Grand Met), a client of the firm, to acquire Pillsbury Company (Pillsbury).[100] In September 1988, Dorsey & Whitney ceased representation of Grand Met about three months after the firm's retention, but in October, Grand Met continued with its plans and announced its tender offer a few weeks later.[101] While his law firm still represented Grand Met, O'Hagan bought shares and call options on shares of Pillsbury.[102] After the announcement of the tender offer, O'Hagan sold his options and stock, making a profit in excess of $4.3 million.[103] A subsequent investigation led to the filing of a fifty-seven-count indictment against O'Hagan[104] and a jury convicted him of numerous crimes,[105] including securities fraud.[106]

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[99] *See* Chiarella v. United States, 445 U.S. 222, 230 (1980); *see also supra* note 57 and accompanying text.

[100] United States v. O'Hagan, 521 U.S. 642, 647 (1997).

[101] *Id.*

[102] *Id.*

[103] *Id.* at 648.

[104] *Id.*

[105] The other charges are not relevant for purposes of this essay and the discussion will consequently not address 17 C.F.R. § 240.14e-3, which O'Hagan violated because his insider trading related to a tender offer. *Id.* at 676 (finding that the SEC had authority to promulgate Rule 14e-3 and that the rule applied to the "type of misappropriation charged against O'Hagan").

[106] *Id.* at 648–49.

After O'Hagan was convicted, a three-judge federal appellate panel reversed.[107] O'Hagan had not committed "classical" insider trading, the majority concluded, because the underlying theory of liability did not "reach those individuals who trade securities based on material, nonpublic information and who owe no fiduciary duty to the shareholders of the company whose securities are traded; these persons are the so-called 'outsiders.'"[108] Finding O'Hagan liable under a misappropriation theory, the panel majority continued, would require finding deception—necessary to establish fraud—and O'Hagan neither misrepresented nor failed to disclose when under a duty to do so.[109] The panel "reject[ed] the misappropriation theory, in part, because it permits the imposition of § 10(b) liability based upon the mere breach of a fiduciary duty without a particularized showing of misrepresentation or nondisclosure."[110]

Doctrinally, the appellate panel had a defensible interpretation of the reach of insider trading law. But intuitively, its conclusion was deeply unsettling. In reversing and then endorsing the misappropriation theory, the Supreme Court thus modified doctrine to capture conduct likely to offend a lay audience. "Under this theory, a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information," the majority wrote.[111] The prohibition under the misappropriation theory required a breach of a duty to the source of the information, but not necessarily a duty to the third-party purchaser or seller of securities.[112] Thus the Court preserved the critical role of fiduciary duty but expanded the scope of the insider trading prohibition to reach instances in which that duty ran[113] to a person or entity other than shareholders of the company whose shares the insider bought or sold.

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[107] United States v. O'Hagan, 92 F.3d 612, 628 (8th Cir. 1996), *rev'd* 521 U.S. 642 (1997).

[108] *Id.* at 616 (citing Sec. & Exch. Comm'n v. Clark, 915 F.2d 439, 443 (9th Cir. 1990)).

[109] *Id.* at 618.

[110] *Id.*

[111] *O'Hagan*, 521 U.S. at 652.

[112] Recall that the Court's *Chiarella* decision based the finding of deceptive conduct, and resulting liability, on the insider's breach of the "relationship of trust and confidence [that exists] between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation." Chiarella v. United States, 445 U.S. 222, 228 (1980). But O'Hagan occupied no position of trust with respect to the acquisition target. *O'Hagan*, 92 F.3d at 647–48.

[113] One possible implication is, if the owner of the information consented, the insider would be able to exploit the inside information by trading.

While the Court characterized the classical and misappropriation theories of liability as "complementary,"[114] it is not difficult to classify cases of classical insider trading as cases of misappropriation.[115] After all, under either theory, the information that would affect the price of the securities bought or sold by the insider did not belong to that insider but was misappropriated in violation of a duty; the source of the information was deceived and this deception would satisfy the definition of fraud. In this case, O'Hagan deceived the would-be acquiror. The result of the Court's torturous analysis is a finding of liability consistent with a concern for fairness, but carefully based on another rationale. There is an important implication here: If the fiduciary breach is the root of misconduct by an insider who trades on material, nonpublic information, then liability should attach regardless of whether the insider profits from the trade. There are myriad reasons why it is hard to find such cases,[116] but perhaps one is that fairness to third parties still is a concern animating the prohibition. If the insider did not win, then the outsider did not lose.

5. *Salman v. United States* (2016)

The above-described cases helped to set the stage for *Salman v. United States*, which the Court heard in order to resolve "tension" over the definition and scope of conduct covered by the phrase "personal benefit."[117] Recall that the Court in *Dirks* had distinguished permissible from improper disclosure of nonpublic, potentially material information by asking "whether the insider personally will benefit, directly or indirectly, from his disclosure."[118] If the insider received no such personal benefit, then the insider breached no duty to shareholders.[119] But the Court did not define "personal benefit" for lower courts.

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114 *O'Hagan*, 521 U.S. at 652.

115 *See, e.g.*, Adam C. Pritchard, United States v. O'Hagan: *Agency Law and Justice Powell's Legacy for the Law of Insider Trading*, 78 B.U. L. REV. 13, 17 (1998) ("[T]he misappropriation theory encompasses almost all of the conduct proscribed by the classical theory, and more."). The Court itself later acknowledged in a footnote that the facts of a case could be framed as either a classical or misappropriation case. *See* Salman v. United States, 137 S. Ct. 420, 425 n.2 (2016).

116 As one practical matter, such cases may be harder to detect than those in which an investor earned notable returns. For another, what would the appropriate monetary sanction be in such cases?

117 *Salman*, 137 S. Ct. at 425. Some have argued that this tension was illusory. *See* Jonathan R. Macey, *The Genius of the Personal Benefit Test*, 69 STAN. L. REV. ONLINE 64, 72 (2016) https://www.stanfordlawreview.org/online/the-genius-of-the-personal-benefit-test/ [https://perma.cc/V7XK-YDNW].

118 Dirks v. Sec. & Exch. Comm'n, 463 U.S. 646, 662 (1983).

119 *Id.*

In the absence of a precise definition, it was inevitable that lower courts would adopt different interpretations, some adopting an expansive definition of personal benefit to capture relatively amorphous and attenuated benefits to the insider and others adopting a narrower definition that would absolve the insider who did not receive a tangible, quantifiable benefit. For defendants, much rode on the definition adopted. The Second Circuit adopted a narrow definition of "personal benefit" in a 2014 case, *United States v. Newman*. In *Newman*, a three-judge panel reversed a pair of insider trading convictions because the government did not establish either (1) that the tippers who passed on inside information received a personal benefit, defined as "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature,"[120] or (2) that the tippees who traded *knew* that the tipper received a personal benefit, an aspect of mens rea that the Second Circuit panel concluded was necessary in order to establish that the tippee knew that the tipper breached a duty by engaging in the selective disclosure.[121] The facts of the case, the Second Circuit panel concluded, did not establish that the tippees even knew the source of the information that conferred on them such a lucrative trading advantage,[122] let alone whether the tippers received a personal benefit.[123]

A couple of years later, the Ninth Circuit endorsed a broader definition of personal benefit in *Salman*. The defendant in the case, Bassam Yacoub Salman, attempted to turn *Newman* to his advantage. Salman faced criminal charges that he had committed securities fraud by trading on material, nonpublic information he received from Mounir Kara, who in turn obtained

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[120] United States v. Newman, 773 F.3d 438, 452 (2d Cir. 2014), *abrogated by Salman*, 137 S. Ct. 420.

[121] The Second Circuit panel addressed the mens rea question first, ruling that the government had to prove that the tippee knew that the tipper received a personal benefit. *See id.* at 449. This was one step in the panel's reasoning: if receipt of a personal benefit makes the disclosure by the tipper wrongful, and the tippee only inherits the tipper's *Cady, Roberts* duty if the tippee knows that the disclosure was wrongful, then the tippee's conduct is wrongful only if the tippee knows that the tipper received a personal benefit. *Id.* But for purposes of the discussion in this essay, the critical observation is the degree to which the attention of courts has shifted from fairness or access to more tangential questions developed over time to sort those instances of trading on inside information that are acceptable from those that are prohibited.

[122] *See id.* at 442.

[123] And the Second Circuit's opinion led to an uproar. *See, e.g.*, Ben Protess & Matthew Goldstein, *Appeals Court Deals Setback to Crackdown on Insider Trading*, N.Y. TIMES: DEALBOOK (Dec. 10, 2014, 10:19 AM), https://dealbook.nytimes.com/2014/12/10/appeals-court-overturns-2-insider-trading-convictions/ [https://perma.cc/535A-5JRX] (reporting that the Second Circuit decision "upended" federal prosecutors' pursuit of insider trading activity).

the information from his brother, Maher Kara, an investment banker at Citigroup.[124] A jury convicted Salman on all charges.[125] In his appeal , Salman cited the test articulated in *Newman* and argued that the insider who was the source of the tips had not received a personal benefit sufficiently "objective" and "consequential" to make the disclosures wrongful.[126] Salman contended that the inside information passed along was intended as a gift, and in any event Salman had not known of any personal benefit to Maher Kara.[127] In other words, Salman tried to argue that the Second Circuit in *Newman* had concluded that neither a mere friendship nor a family relationship were sufficient to establish a personal benefit.[128] An appellate panel of the Ninth Circuit did not accept this argument and affirmed Salman's conviction.[129] The panel returned to the language of *Dirks*, recognizing the possibility of tippee liability "when an insider makes a gift of confidential information to a trading relative or friend."[130]

The Supreme Court agreed with the Ninth Circuit and so reined in the Second Circuit.[131] The Court's unanimous opinion endorsed a broader definition of personal benefit, relying on precisely the language in *Dirks* contemplating the sharing of inside information as a gift.[132] In such circumstances, according to the justices, the giving of information "is little different from trading on the information, obtaining the profits, and doling them out to the trading relative."[133] Because it was *as if* the

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[124] Salman v. United States, 137 S. Ct. 420, 423–25 (2016).

[125] *Id.* at 425.

[126] *Id.*

[127] *Id.*

[128] United States v. Salman, 792 F.3d 1087, 1093 (9th Cir. 2015) ("Salman reads *Newman* to hold that evidence of a friendship or familial relationship between tipper and tippee, standing alone, is insufficient to demonstrate that the tipper received a benefit. In particular, he focuses on the language indicating that the exchange of information must include 'at least a potential gain of a pecuniary or similarly valuable nature.'" (quoting United States v. Newman, 773 F.3d 438, 452 (2d Cir. 2014))).

[129] *Id.* at 1093–94.

[130] Dirks v. Sec. & Exch. Comm'n, 463 U.S. 646, 664 (1983).

[131] In light of the *Dirks* reference to trading by a relative, however, it is worth noting that the two cases are not in great tension: *Newman* did not involve allegations of trades by a relative or even friend, putting more weight on the finding of a personal benefit that was tangible in order to establish that the tippee's trading was wrongful. *Dirks*, 463 U.S. at 664; *see Newman*, 773 F.3d at 443–45. The rule announced in *Salman* would not clearly mandate a finding of guilt on the facts of *Newman*.

[132] *Dirks*, 463 U.S. at 664 ("The elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.").

[133] *Salman*, 137 S. Ct. at 428. There is a difference, though, in that the recipient of the given information has a choice of whether to use it; if the insider chooses to trade on the material, nonpublic information and make a gift of the money obtained as a result,

insider used the information personally, the conduct constituted impermissible insider trading. This seems slippery reasoning, because in any case involving insider trading, the insider could have traded and made a gift of the proceeds, thereby satisfying the personal benefit requirement; the meaning of the phrase may grow more obscure rather than less. The Court's development of the personal benefit requirement was a workaround to deal with the ostensibly good motives of the insiders in *Dirks*,[134] and *Salman* looks like a workaround to the workaround, to make sure that the formal requirement of personal benefit to establish culpability does not prevent prosecution when the tippee's motives were clearly impure.[135] The relevance of a personal benefit to preserving market integrity is far from clear. Nevertheless, the outcome in *Salman*, in which the defendant was part of a deliberate, moderately sophisticated scheme to outwit the market, is intuitively more satisfying than that in *Newman*, in which the defendants similarly benefitted from a highly organized, if diffuse and attenuated, scheme to take advantage of access to inside information.

C. At What Cost?

Yet what, it is fair to ask, are the consequences of the muddled state of insider trading doctrine? Judges often enough reach decisions that rest on careful, arcane reasoning that earns public scorn. There is the concern, cited by the SEC itself, that the perception of widespread insider trading carried on with impunity undermines confidence in capital markets.[136] But what

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then the insider is clearly culpable. But if the wrongdoing depends on the independent action of the recipient of the information, it would seem that the tipper's culpability is lessened. The Court may have misconstrued a detail of the case that it cited in support of its view of the equivalence of trading and giving cash, on the one hand, and giving information, on the other. "In one of their tipper-tippee interactions, Michael asked Maher for a favor, declined Maher's offer of money, and instead requested and received lucrative trading information," Justice Alito wrote for the Court, but did not go on to address why the recipient of the information actually thought that cash and information were different. *Id.*

[134] *Dirks*, 463 U.S. at 663; *see also supra* note 85 and accompanying text.

[135] *Salman*, 137 S. Ct. at 428 (ruling that *Dirks* did not require that a tipper "must also receive something of a 'pecuniary or similarly valuable nature' in exchange for a gift to family or friends" (quoting *Newman*, 773 F.3d at 452)).

[136] *See, e.g.*, Final Rule: Selective Disclosure and Insider Trading, 65 Fed. Reg. 51716, 51731(Aug. 15, 2000) (codified as amended at 17 C.F.R. §§ 240, 243, 249 (2017)), https://www.gpo.gov/fdsys/pkg/FR-2000-08-24/pdf/00-21156.pdf [https://perma.cc/L8V5-3DR2] (justifying a rule prohibiting selective disclosure of information by issuers by noting that the "practice of selective disclosure leads to a loss of investor confidence in the integrity of our capital markets").

evidence supports the claim? The argument remains murky.[137] Investors may have little choice but to rely on financial markets as they are, which raises the question of whether investor misgivings should matter. The population whose views may be most relevant, those who choose not to be investors out of concern those markets favor insiders, is difficult to survey—assuming the results of any survey could be trusted. Professor Langevoort noted nearly two decades back that there was (and is) "widespread and growing willingness to invest among the American public even though people sense that, the prohibition notwithstanding, insider trading is still fairly commonplace."[138] He goes on to suggest that protecting investor confidence may be a crucial myth that "derives from the more fundamental attitude that economic power and status demand a strong dose of self-restraint and accountability."[139]

As stated at the outset, this essay does not seek to present an argument about what the goals of securities regulation of insider trading should be, but to assess whether the doctrine in its current form achieves the goals asserted by the Court.[140] The above examination of cases critical to the development of doctrine on insider trading illustrates the meandering path the justices have taken. After initially appearing to accept the Commission's view in *Cady, Roberts*, the Court has shifted from regarding trading on inside information as wrong *per se* to viewing it as wrong only if the insider has violated a duty. While this development has pushed doctrine away from the intuitive wrong of insider trading, it is explicable. If the Court were to conclude that an insider has an affirmative duty to disclose, the justices would have to step beyond the bounds of common law fraud. Such a duty could potentially mandate disclosure of corporate confidences that an insider, as a fiduciary, would at the same time have a duty to keep secret. The next Part offers a compromise aimed at reducing the unfair advantage of the insider while still protecting corporate confidences.

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[137] *See, e.g.*, Donald C. Langevoort, *Rereading* Cady, Roberts*: The Ideology and Practice of Insider Trading Regulation*, 99 COLUM. L. REV. 1319, 1326 (1999) ("[T]here has been a strong current among scholars (even among those who tend toward the pro-regulatory side with respect to insider trading on other grounds) that the confidence point is an illusion." (footnote omitted)).

[138] *Id.*

[139] *Id.* at 1328.

[140] *See supra* note 11 and accompanying text.

II. " . . . AND A STAR TO STEER HER BY"[141]

While the Supreme Court's doctrinal treatment of insider trading has abandoned the focus on the unfairness of permitting one player in the great investing game to exploit information unavailable to other players, evidence abounds that the notion of fairness remains not only salient, but dispositive. Like a black hole, now that the Court has rejected "parity of information" among investors, concerns over fairness exert influence over courts but do so invisibly.[142] This Part argues that despite the Court's disavowal of concern for third-party, outsider investors, their potential injury still matters. The discussion below develops both a normative claim, that the Court should recognize fairness explicitly to guide identification of wrongful insider trading, and a positive claim, that in fact, notions of fairness have covertly continued to shape jurisprudence. Lastly, this Part develops a more nuanced explanation of the nature of the information that uninformed third parties need in order to invest in markets in which insiders also transact. This second Part adopts the disclose-or-abstain framework but proposes modification of the rule to identify precisely *what* an insider must disclose and, at least as important, *when* the insider must disclose it.

A. *The Case for a Fair Access Norm: The Wisdom of Justices Blackmun and Marshall*

The Commission's original conception of the wrongfulness of insider trading, which took into account the experience of other investors transacting in markets alongside investors who enjoyed access to inside information, has intuitive appeal. The SEC viewed the goal of the prohibition on insider trading as promoting the integrity and fairness of financial markets.[143] The Commission's conception also eliminated the

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[141] JOHN MASEFIELD, *Sea Fever*, *in* SALT-WATER POEMS AND BALLADS 55 (1st ed. 1916).

[142] Perhaps civil and criminal prosecution of insiders whose tips did not yield profits is rare because such cases are perceived as causing no harm to third-party investors on the other side of transactions with the insider. The failure to prosecute when there is no harm to other investors suggests that the harm to the source of the information—the fiduciary breach—is not really what matters. Of course, it also might be that the Commission tends to pursue only claims that are easier to litigate, and cases in which a defendant did not profit might result in a costly and difficult legal battle, with little prospect of an eventual payoff in the form of a financial penalty.

[143] *See* A.C. Pritchard, *The SEC, Administrative Usurpation, and Insider Trading*, 69 STAN. L. REV. ONLINE 55, 58 (2016) ("The SEC would interpret the securities laws as needed to root out information asymmetries in the secondary markets . . . .").

need for the Court's doctrinal workarounds, which have created irrelevant rabbit holes that keep lawyers busy but neither reflect nor reliably affect investor conduct. The justification for digging one of those rabbit holes, the importance of selective disclosure by issuers to facilitate analysts' role in ferreting out material information and promoting market efficiency, is unclear, if not nonexistent, in light of the Commission's adoption of Regulation FD.[144]

Furthermore, putting investors on a level playing field is consistent with one of the goals of the U. S. regulatory regime, which still seeks to facilitate investor confidence less through substantive regulation of corporate conduct than through mandated disclosures.[145] Providing information to everyone, equally, exploits differences in investor risk preferences rather than differences in investor access to information. Differences in risk preferences reflect informed choices while differences in access to information reflect relationships over which the investor may have little control. To be sure, investors' ability, like their time and resources to seek information, is not evenly distributed across the marketplace. But there is a difference between having the time and money to sit outside a corporation's factory and count how many widgets it churns out, and having a personal relationship that leads the corporation's chief financial officer to share quarterly results a few hours ahead of the market. As Professor Kim Lane Scheppele argued more than two decades ago, "[t]his does not mean that all traders must have equal information; rather, all traders should face *roughly equal search costs* in locating relevant information."[146] If an investor

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The Commission also regards protection of "fair" markets as a core mission today. SEC. & EXCH. COMM'N, *What We Do*, https://www.sec.gov/Article/whatwedo.html [https://perma.cc/6SQJ-9BV7].

144 17 C.F.R. § 240.10b5-1 (2017). Professor Guttentag develops this argument powerfully. *See* Guttentag, *supra* note 4, at 541–45.

145 Disclosure is the fundamental regulatory goal of the reporting requirements created by both the Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77bbbb. (2012)), which among other things mandates disclosure of corporate characteristics prior to issuing shares to the investing public, and the Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. § 78(a) *et seq.* (2012)), which among other duties imposes continuing reporting requirements on companies that have issued shares to the investing public. Professor Donna M. Nagy provides a persuasive discussion of this legislative history. *See* Nagy, *supra* note 91, at 6 (describing legislation targeting insider trading in the years after *Dirks* and identifying repeated references to lawmakers' concern that too many investors viewed securities markets as "rigged").

146 Scheppele, *supra* note 17, at 163 (emphasis in original). But while Professor Scheppele appears to endorse recognition of a duty to disclose when one party has unmatchable information, *ipso facto*, this essay instead contends that more desirable is a regulatory or statutory prohibition of such trades or the adoption of regulatory mechanisms that make them unprofitable.

lacks time, intellect, experience, or resources to obtain information, no one is culpable in exploiting those deficits; the insider, however, is culpable, because the insider uses information to which a counterparty has no lawful access. The insider's gain does not reward time, intellect, experience, or resources.

This was the argument made in the dissent by Justices Blackmun and Marshall in *Chiarella*.[147] Rather than using the common law requirement of fiduciary duty to constrain application of the 10(b) prohibition of insider trading, the justices argued that securities law sought to "ensure the fair and honest functioning of impersonal national securities markets *where common-law protections have proved inadequate*."[148] This reading made clear that concern for the third party, outsider investor should be understood as motivation for the prohibition on insider trading. The dissenting justices did not need the misappropriation theory to reach the conclusion that Chiarella had violated Section 10(b). Even if Chiarella had obtained permission from his firm or the firm's client, in view of the dissent the trades would have been fraudulent.[149]

The dissenting justices attacked the move by the *Chiarella* majority to view insider trading as an agent's betrayal of a principal and consequently to require a "special relationship" in order to find a violation.[150] The requirement of a special relationship limited the flexibility and reach of Section 10(b).[151] Justices Blackmun and Marshall did not object to deploying common law principles in the context of insider trading but to the choice of which common law principles to incorporate. "The common law of actionable misrepresentation long has treated the possession of 'special facts' as a key ingredient in the duty to disclose," Justice Blackmun wrote.[152] Legally unobtainable information constituted a "special fact" and recognizing it as such made the transaction "inherently unfair."[153] An obligation to disclose based on the possession of special facts would be consistent with the Commission's

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147 *See supra* Section I.B.2.

148 Chiarella v. United States, 445 U.S. 222, 248 (1980) (Blackmun, J., dissenting) (emphasis added).

149 *Id.* at 246.

150 *Id.* at 246 n.1.

151 *Id.* at 251 ("I would hold that persons having access to confidential material information that is not legally available to others generally [should be] prohibited by Rule 10b-5 from engaging in schemes to exploit their structural informational advantage through trading in affected securities. To hold otherwise, it seems to me, is to tolerate a wide range of manipulative and deceitful behavior.").

152 *Id.* at 247 (citing Strong v. Repide, 213 U.S. 419, 431–33 (1909); 1 F. HARPER & F. JAMES, LAW OF TORTS § 7.14 (1956)).

153 *Id.* at 247–48.

preferred approach, but more importantly, the obligation properly would force a reviewing court to evaluate the accessibility of the information in order to determine whether the insider was required to disclose.[154] In an important footnote, the justices further noted the distinction between "parity of information" derided by the majority and "parity of access," which would "help[] to ensure that advantages obtained by honest means reap their full reward."[155]

Others have argued for restoring consideration of uninformed, outside third parties to insider trading law. For example, shortly before the *Salman* decision, Professor Donna M. Nagy made a compelling argument that both doctrinal coherence and regulatory efficacy would be enhanced through adoption of a theory of "fraud on contemporaneous traders."[156] Under her revised, broader, and clearer conception of insider trading, the would-be trader seeking to transact on the basis of material, nonpublic information improperly obtained would *ipso facto* assume a duty of disclosure to third parties who might be on the other side of a trade.[157] She developed the argument based upon Chief Justice Burger's dissent in *Dirks*, in which he asserted that the common law rule of *caveat emptor* should be limited if one party to the transaction obtained an informational advantage improperly.[158] This perspective is sensible and its attention to the plight of third-party investors would do much to enhance jurisprudence in this area. Professor Nagy's critique of the reasoning of the *Dirks* majority helpfully highlights the manner of access to the inside information, making central its propriety.[159]

Attention to the accessibility of inside information and commitment to what this essay refers to as a norm of "fair access" would allow a court to evaluate wrongfulness to take into account just how an investor obtained the information and how much effort the investor put into getting it. A scheme that is

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[154] *See id.* at 249.

[155] *Id.* at 252 n.2.

[156] Nagy, *supra* note 91, at 7.

[157] *See id.* at 54 ("This 'fraud on contemporaneous traders' theory would turn on whether a securities trader, with scienter, used wrongfully obtained information in a securities transaction."). Unlike the proposal developed in this paper, Professor Nagy's proposal appears to mandate disclosure of the substance of the inside information that informed the insider's trading. *See infra* Section II.C.

[158] *Chiarella*, 445 U.S. at 240 (Burger, J., dissenting). Professor Nagy traces the roots of the chief justice's argument to a British case in which one side of a real estate transaction gained an informational advantage as a result of illegal trespass on the property. *See* Nagy, *supra* note 91, at 53.

[159] To identify a model of what equitable treatment of investors might look like, Kenneth R. Davis proposes turning to Title VII of the Civil Rights Act of 1964. *See* Davis, *supra* note 87, at 202. Professor Davis argues that insider trading doctrine should ensure equality of opportunity but not equality of outcome, as Title VII aims to achieve. *See id.*

more organized, more secretive, and more deliberate is more likely to involve gathering information in ways difficult or impossible to achieve through legitimate means. Trading informed by lawfully inaccessible information obtained through such a scheme would be that much more culpable. Taking effort into account helps to overcome the problem created by highly attenuated insider trading, when the ultimate trader might not know the provenance of the information that informs the decision to conduct a particular transaction. If the ultimate trader knows or should know that the information provided is not accessible by legal means to other investors, then that trader should not trade.[160] For a reviewing court, or even for an investor trying to determine the propriety of a specific trade, figuring out whether information is lawfully accessible is straightforward. Lawfulness of access should take the place of evaluation of the presence and extent of an insider's duty and of the nature of any benefit obtained if the insider is the source of a tip.

Again, gambling provides a useful analogy. The card player who benefits from illicit signals from a confederate observing an opponent's cards has engaged in unfair conduct, whether or not he is able to convert the intelligence into winnings. This remains so whether the card player benefits from a single confederate or a string of confederates. *And* this remains so even if, at some point, a confederate in the chain of confederates lacks knowledge of all the links making up the overall course of conduct. The lack of privity between the observed opponent and the confederates spying on that opponent's hand is utterly irrelevant to judgment of the wrongfulness of the card player's efforts. Whether the opponent loses as a result of cheating is irrelevant in assessing the wrongfulness of the conduct. The fair access norm dictates that the proper and critical question is the accessibility of the information conferring an advantage. A secondary question is the degree of effort that the beneficiary of the information put into acquiring it.

Questioning the lawfulness of access to information is more satisfying than grappling with the nature and extent of a

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[160] An innocent recipient of information—that is, one who does not know of the existence of a wrongful scheme to disseminate material, inside information—might have a defense on these facts. Such an investor would be fundamentally passive with respect to the information. The entrepreneurial investor who overhears and acts upon material inside information at a track meet, for example, might not be liable. *See* Stephen M. Bainbridge, *The Law and Economics of Insider Trading: A Comprehensive Primer* 48 (Feb. 2001) (unpublished manuscript) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=261277 [https://perma.cc/97M9-KZ3T] (describing SEC v. Switzer, 590 F. Supp. 756 (W.D. Okla. 1984)).

fiduciary duty. Examining lawfulness does not require a doctrinal workaround to encompass conduct by investors who have inside information but have no duty to traders on the other side of potential transactions. Instead, the focus is on whether the inside information was available—and in fact obtained—by lawful means. An investor who burgles the office of a large law firm to learn the intended target of a takeover effort by the firm's corporate client has violated the law. This hypothetical illustrates another virtue of directing the inquiry to lawfulness of access: it disincentivizes unlawful efforts to obtain inside information. Abandoning the search for wrongful breach of duty evidenced by receipt of a personal benefit in favor of evaluating lawfulness implements a simpler rule and one that properly distinguishes between investor research that is desirable and investor conduct that is not.

To be sure, an investor may come into possession of inside information not through deliberate and unlawful conduct but by happenstance. A defendant who overheard a careless executive discussing material inside information at a restaurant might argue that no unlawful act occurred and so subsequent trading could not violate Rule 10b-5. Any other investor could have accidentally overheard the same statement. So a tertiary question would be, what was the mens rea of the investor who overheard the inside information? If the defendant knew that what was overheard constituted inside information and that as a result, other investors would not be able to match the defendant's information advantage, then the defendant properly could be liable despite the lack of effort to obtain the information. As a practical matter, regulators may not detect and may not pursue such cases because of the difficulty of identifying the moment of inadvertent disclosure and tying it to the overhearing investor's trading; without information on how often the SEC detects suspicious trading activity but does not sue the potentially offending investors, it is difficult even to speculate on this.

B. Unearthing a Fair Access Norm in Supreme Court Doctrine

Arguing for adoption of a fairness norm is straightforward, given its alignment with intuitions about the nature of the wrong that the insider commits.[161] But it is also possible to argue that an implicit norm of fair access explains the complex path that insider trading doctrine has taken. That is, the different outcomes in cases in which the relevant conduct is doctrinally similar may reflect efforts to comport with notions of fairness to third-party investors under the constraints created by prior decisions.

Consider once again *Newman* and *Salman*. There is a persuasive argument that the Second Circuit panel was correct in its reading of *Dirks*,[162] as Professor A.C. Pritchard explained in an article published before the Supreme Court decided *Salman*.[163] Based on his analysis of Justice Powell's papers, Professor Pritchard illustrated how the justice struggled with the question of *scienter*: what someone trading on material, nonpublic information had to intend, in order to be culpable.[164] Justice Powell's default assumption was that some trading on such information was permissible, even desirable, and so had to be distinguished from trading that was unlawful.[165] Because unearthing evidence of intent of the insider might often be difficult, Justice O'Connor persuaded Justice Powell to adopt a more objective test. The opinion that Powell ultimately wrote offered a test that turned on whether the tipper received a material benefit as a result of providing the information.[166] This was not, Professor Pritchard notes, abandonment of the search for purpose, but a narrowing of the field of possible purposes that rendered the tipper culpable.[167] To the extent that the insider did receive a benefit, wrongful intent could be safely presumed.

Newman presented an unresolved question: what exactly did a tippee have to know to satisfy the requirements of Rule 10b-5 liability for insider trading? The defendants argued that the government had to prove not only that they knew that the

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[161] *See, e.g.*, Scheppele, *supra* note 17 (noting the gap between arguments about the morality of insider trading and "hard-edged arguments about specific fiduciary duties, general economic efficiency, and property rights in information").

[162] Several other thoughtful and prominent legal scholars submitted an amicus brief in the *Newman* case, arguing in favor of the interpretation of *Dirks* that the Second Circuit ended up adopting. *See* Brief of Amicus Curiae Law Professors Stephen Bainbridge, M. Todd Henderson, and Jonathan Macey in Opposition to the United States of America's Petition for Rehearing or Rehearing En Banc, United States v. Newman, 773 F.3d 438 (2d Cir. 2014) (No. 13-1837-cr(L)), 2015 WL 1064409.

[163] *See* A.C. Pritchard, Dirks *and the Genesis of Personal Benefit*, 68 SMU L. REV. 857, 861 (2015). It is worth noting that Professor Pritchard's assessment of the fidelity of the Second Circuit to *Dirks* in *Newman* did not conclusively assess the wisdom of the *Dirks* holding *per se*.

[164] *See id.*

[165] *See id.*

[166] *See id.* at 866.

[167] *See id.* at 867.

inside information they received had been disclosed in violation of a duty, but also that they knew that the source of the information received a personal benefit.[168] This view, adopted by the Second Circuit, was "more faithful to Powell's understanding of the personal benefit test and the requirement that the tippee be a participant in the insider's fraudulent breach of fiduciary duty," Professor Pritchard wrote.[169] And given the origin of the "personal benefit" requirement as a means of establishing wrongful intent, it is hard to disagree with Professor Pritchard's assessment. The Second Circuit went further in defining "personal benefit" in so concrete and tangible a fashion[170] as to preclude prosecution in many cases involving selective disclosure of material, nonpublic information to tippees who used the information to their advantage. While Professor Pritchard characterized the question of whether the Second Circuit's narrower definition of personal benefit was faithful to *Dirks* as a "close one," he concluded that the answer was yes.[171] Given the importance Justice Powell attached to finding culpable intent before imposing liability, it makes sense to interpret the personal benefit test to limit the reach of enforcement.[172]

Yet in *Salman*, the justices rejected the personal benefit test of *Newman*. While the reasoning of the high court was analyzed previously,[173] this essay's analysis so far has not attempted to answer the deeper question of *why* the justices in *Salman* interpreted *Dirks* as they did.[174] Doctrine did not mandate upholding Salman's conviction—the facts could be analogized to those of *Chiarella*—but honoring a notion of fairness to third parties certainly did. The defendant in *Salman* deliberately obtained an informational advantage, one that other investors could not legally match, and used it.[175] Had the justices determined that Salman received no "personal benefit" from trading activity informed by insider disclosures, then he

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168 United States v. Newman, 773 F.3d 438, 444 (2d Cir. 2014).

169 Pritchard, *supra* note 163, at 873.

170 According to the appellate panel, establishing receipt of a personal benefit required "proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature." *Newman*, 773 F.3d at 452.

171 Pritchard, *supra* note 163, at 873–74.

172 As Professor Pritchard puts it, the goal of the majority in *Dirks* was to "fence the [SEC] in." *Id.* at 874. Too broad a definition of personal benefit might have given the agency too much leeway to concoct "novel theories." *Id.*

173 *See supra* Section I.B.

174 Or, put another way: when Professor Pritchard makes an argument about the proper understanding of insider trading enforcement, this author, at least, finds it wise to listen with considerable care.

175 *See* Salman v. United States, 137 S. Ct. 420, 424 (2016) (describing how information got to Salman).

would have gone unpunished. That they did not take that path may indicate that, just maybe, a nagging notion of fairness played a role in their decision not to let Salman off the hook.

Working backward through the cases that shaped doctrine, it is easy to argue that the theory of wrongdoing underlying misappropriation cases like *O'Hagan* is consistent with a fair access norm. But if a fair access standard were applied, a finding of liability would result not from any wrong to the owner of the information that was misappropriated but from the unfairness created by the legal inability of third-party investors to match the informational advantage.

The same kind of analysis yields a different outcome in *Chiarella*. There, the defendant exploited access that another investor could not legally duplicate.[176] The proper result would be insider trading liability for Chiarella but not because of a breach of law or duty. Recognition of a fair access norm would not on every set of facts lead to the same conclusion that the Court has reached, though it would grant some coherence to doctrine. The norm would also help to shape investor expectations about what kind of investigative conduct is permissible and what will draw the attention of regulators and, potentially, prosecutors.[177]

Lastly, unearthing a fair access norm in *Dirks* presents little analytic difficulty and may easily lead to the same outcome that the Court did reach, but for different and analytically cleaner reasons. The question becomes not whether Dirks, the analyst, breached a duty, or whether the source of Dirks's information breached a duty. Rather, the question is *whether the information that Dirks obtained could have been accessed lawfully by a third party*, such that Dirks's use of the information was fair. And whether the information was accessible must turn not on the cost or difficulty of obtaining access, or even on hypothetical questions about whether the corporate officials who provided the information would have been as forthright with anyone other than Dirks. Accessible information is that which anyone with the time and resources can obtain without violating the law.

To analyze the accessibility of the information Dirks received requires considering whether the corporate officials who spoke with him broke the law or violated a fiduciary duty, then, but for purposes of determining whether Dirks's achieved

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[176] *See* Chiarella v. United States, 445 U.S. 222, 247 (1980) (Blackmun, J. dissenting).

[177] *Id.* at 250 (describing the investors' expectation of equal access and the role of Section 10(b) and rule 10b-5 as broad anti-fraud measures).

an unfair advantage over other investors. So, as the *Dirks* majority concluded, the fact that the corporate officials who disclosed to Dirks sought to reveal fraud and as a result violated no law and committed no fiduciary breach[178] remains meaningful but is relevant because those facts provide an answer to the question of access. Lawfulness of access is critical to analysis of fairness.

The next Section proposes a reform that restores consideration of fairness. The reform is possible because of increasing investor sophistication and the ability to use technology to react ever more quickly to new information. Rather than reining in these advanced traders, this path seeks to use regulatory tools to harness their abilities and tactics to promote fairness.

C. A Proposal to Leverage Market Sophistication

While some criticism of the Court's insider trading doctrine has focused on ways in which the justices have failed to take into account both changes in regulation[179] and changes in market practices,[180] less has focused on the question of whether and how such changes could be leveraged to mitigate the unfairness that results from possession of inside information. This Section illustrates how a reform might be implemented, through a relatively modest—though admittedly far-reaching—modification of existing disclosure requirements. But before presenting the proposal, the theoretical foundation must be laid in order to identify with greater precision what information an uninformed third party should receive in a fair marketplace in which insiders also transact.

Information moves experienced investors; and those making investment decisions at the large institutions that hold most of the shares of publicly traded companies[181] are experienced. Mere sales or purchases of company stock, in the absence of information or assumption or even rumor about the basis for those transactions, should not influence investor behavior or, consequently, market price.[182] News of sales or

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[178] Dirks v. Sec. & Exch. Comm'n., 463 U.S. 646, 666–67 (1983).

[179] *See, e.g.*, Guttentag, *supra* note 4, at 556–57.

[180] *See, e.g.*, Yadav, *supra* note 14, at 977.

[181] *See, e.g.*, Steven M. Rosenthal & Lydia S. Austin, *The Dwindling Taxable Share of U.S. Corporate Stock*, 151 TAX NOTES 923, 928 (2016), http://www.taxpolicycenter.org/sites/default/files/alfresco/publication-pdfs/2000790-The-Dwindling-Taxable-Share-of-U.S.-Corporate-Stock.pdf [https://perma.cc/DYX7-49AV] (finding that more than one-third of corporate stock in the United States is held by retirement plans).

[182] This is not necessarily intuitive. Were the quantity of a corporation's outstanding shares small enough, one might presume that purchase activity alone would

purchases in the context of other pieces of information does and should affect price. Consider: If a large investor liquidates its holdings in a particular company, but it is widely known that the seller lacks liquidity for its business operations, other investors may well be properly skeptical that the seller has any information suggesting that the price of the shares is about to decline and consequently the price of the company's shares is unlikely to budge. On the other hand, if an investor begins purchasing a large interest in a particular company and that investor is known for careful research on the industry, then the purchases may indeed signal that the investor believes that the price of the target company's shares is about to go up.[183] Available, additional information that purports to explain investor conduct, in both cases, gives the transaction meaning to other investors.[184]

In their discussions of the "disclose or abstain"[185] framework, the justices have not grappled with this distinction between the perception that transactions alone drive prices and the reality that information[186] does, and for regulatory purposes, this lack of precision matters. Critics of the disclose-or-abstain regime have argued that the rule amounts to an unfair prohibition on trading by insiders because disclosure of the inside information to which they are privy would likely amount to a fiduciary breach.[187] After all, delay of disclosure often is in the interest of

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drive up the price by reducing the supply, and sales would lower the price by increasing the supply. Many investors may believe this is how prices are set. *See* West v. Prudential Securities, Inc., 282 F.3d 935, 938 (7th Cir. 2002) ("Sometimes full-time market watchers can infer important news from the identity of a trader . . . or from the sheer volume of trades . . . ."); *see also infra* note 184 and accompanying text.

[183] For purposes of the argument here, it is not necessary that investor demand for a particular security respond only to information and not to changes in supply of that security. The degree of responsiveness of investor demand to different market changes is a subject of debate beyond the scope of this discussion. It is enough, for purposes of both the analysis and the proposal developed below, that knowledge of who is transacting in a particular security is potentially meaningful information to other investors.

[184] This distinction between the import of transactions and the import of information about those transactions has come up before. *See, e.g.*, *West*, 282 F.3d at 938 (plaintiff clients of stockbroker who made knowingly false assertion of impending transaction could not establish that the stockbroker's statements caused changes in price of shares that the clients bought). Judge Easterbrook in that case observed that "institutional purchases (which can be large in relation to normal trading volume) do not elevate prices, while relatively small trades by insiders can have substantial effects; the latter trades convey information, and the former do not." *Id.* at 939.

[185] *See supra* note 39 and accompanying text.

[186] Or, perhaps more precisely, ideas. *See* JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY 383 (1st Harvest/HBJ ed., Harcourt Brace, Jovanovich 1964).

[187] Chief Justice Burger, dissenting in *Chiarella*, argued for precisely this formulation of the disclose-or-abstain rule, to require "that a person who has misappropriated nonpublic information has an absolute duty to disclose that information

the corporation and its other shareholders. An impending acquisition effort may be made more expensive if news of it breaks too early, for example.

But in the context of insiders' trades, the substantive news that motivates them to act is not what uninformed, third-party investors need to know, however much they may wish to. It is enough to know that people with inside access are buying or selling.[188] This is the information that aids outsider investors and moves market prices. If an insider is selling, outsiders may well presume that this means the price of shares of the company that employs the insider are likely to fall—not because the number of shares sold affects the price but because the identity of the seller suggests that the insider knows of imminent bad news. If an insider is buying, the same analysis holds: outsiders may well presume that the insider knows of not-yet-public good news likely to push the price of the company's shares up. The status of the insider *qua* insider is what is meaningful to outsider investors. The disclose-or-abstain obligation, then, could be construed not as imposing a duty on an insider to disclose the information to which she or he is privy, but to disclose that she or he is an insider.

Disclosure of the status of the insider as an insider reduces the information asymmetry between that insider and the third-party buyer or seller. That unfairness results first from the inability of the third party to obtain lawful access to the information that the insider has, and second, from the inability of the third party to learn that the insider has access to such information. The former asymmetry cannot be corrected without revealing what the insider knows, but the latter can. Even though the third party does not know, and has no lawful access to, the information that motivates the insider, if there were preventive disclosure then the third party would know that there is a risk that the transaction is informed by information

or to refrain from trading." Chiarella v. United States, 445 U.S. 222, 240 (1980) (Burger, C.J., dissenting).

[188] And there is evidence that this is, in fact, what happens. One study that sought to determine whether insider trading has become more prevalent, for example, studied corporate share price changes in advance of public disclosure of merger activity, and found that indeed, pre-bid price increases have grown larger. Beny & Seyhun, *supra* note 9, at 39. The significant distinction is whether those price increases are the result of insiders buying shares and somehow "driving up" the price, or whether they are the result of other investors' reactions to greater frequency of purchases. If outsiders presume that the greater activity includes insiders who know something, that is information that should affect the price. And other research has certainly found that rumors about transactions can affect prices. The authors cite, for example, G. Jarrell & A. Poulsen, *Stock Trading Before the Announcement of Tender Offers: Insider Trading or Market Anticipation?*, 8 J.L. ECON. & ORG. 225, 226 (1989).

that the third party lacks. The third party then could consider that fact in deciding whether to proceed with the transaction. Thus, disclosure reduces the unfairness of the trade, without the necessity of disclosing information that might be confidential to the corporation.

The distinction between disclosure of the substance of the inside information and disclosure of information about the actor using it is, in a sense, consistent with the Court's resolution of another case, involving early and selective disclosure of the contents of a *Wall Street Journal* column known to affect investor conduct.[189] Both the trial court and the Second Circuit applied the misappropriation theory and concluded that this was prohibited insider trading: the contents of the column were proprietary to the newspaper.[190] The advantage to those trading on knowledge of the column's content did not result from their awareness of the substance, in that whatever the column reported might well have been publicly available information or might have drawn on publicly available information. Rather, the advantage resulted from advance knowledge that the newspaper would write about that information, whether the information was publicly available or not. The investors tipped off by the *Journal* columnist were able "to buy or sell based on the probable impact of the column on the market."[191] It was the choice of column topic that mattered.

The requirement that an insider's status be disclosed would avoid the problem of the absence of a fiduciary duty owed by the trader acting on material, nonpublic information to third parties on the other side of the transaction. The relationships between the company and the insider, between the tipper and tippee, between the tippee and any third-party investors, would not complicate the analysis. The regulatory fix helps to sidestep the difficult knots in the Court's doctrine. It also would strengthen the SEC's hand in any case alleging unlawful insider trading, because the agency would not need to identify a fiduciary duty and, beyond that, identify the personal benefit received by the insider and establishing a breach. Instead, the SEC could simply assess whether the information driving the trading activity was lawfully accessible.[192]

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189 *See* Carpenter v. United States, 484 U.S. 19 (1987).

190 *See id.* at 23–24. The Supreme Court was evenly divided on the question of whether these facts constituted securities fraud in violation of Section 10(b) and Rule 10b-5. As a result of this split, the lower courts' verdicts survived.

191 *Id.* at 23.

192 It is a separate question whether the SEC would further assess whether the defendant obtained the information driving the trade in a lawful fashion. Whether

A model for application of a fair access rule is easy to find. The Commission's Rule 14e-3 effectively does what this essay calls for, but in a limited context. That provision defines as insider trading transactions by any person who knowingly has material, nonpublic information about a tender offer.[193] Thus, Rule 14e-3 squarely prohibits trading on information not lawfully available to outsider investors. No consideration of breach of a duty is required to find liability. The rule is a broad and blunt prohibition, barring the specified transactions by anyone aware of otherwise unavailable, inside information.

In many cases, perhaps most, adoption of a fair access norm would lead to the same outcome that the Court reached using its analysis of fiduciary obligation and potential personal benefit. But the path to that outcome would be more direct. Applied to *Newman*, for example, the first step would be assessment of the lawful accessibility of the information that led the tippees to trade. If the information was not lawfully available—as the jury found in concluding that the sources of the inside information breached a duty by sharing what they knew[194]—then trading would be presumptively improper. In the absence of a showing that the defendant tippees did not know that (a) they had received inside information and (b) trading on material, nonpublic information constituted prohibited insider

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obtaining lawfully available information through unlawful means should still result in liability is beyond the scope of this essay, although if the goal is to punish wrongful intent, then the answer is clear. Perhaps such unlawful conduct is culpable, but the subsequent purchase or sale of securities does not constitute insider trading.

[193] 17 C.F.R. § 240.14e-3 (2017). In relevant part, the rule states:

> (a) If 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:
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> (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 or 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 such information and its source are publicly disclosed by press release or otherwise.

[194] *See* United States v. Newman, 773 F.3d 438, 444 (2d. Cir. 2014) (stating the jury instruction given by the judge who presided over the trial), *abrogated by* Salman v. United States, 137 S. Ct. 420 (2016).

trading, they would be liable. This is not the outcome the Second Circuit reached and perhaps is not the outcome that would have been mandated even had *Salman* been decided before *Newman*. But it is the outcome that tracks intuition about culpability of the defendants.

Application of the fairness norm to the facts of *Salman* is even easier because in that case it was evident that (1) the information that motivated the defendant's trades was not lawfully accessible, (2) the defendant knew of the wrongfulness of his actions, and (3) he knew that he was obtaining material inside information. The proposed rule would thus support the conclusion reached by each court that assessed Salman's case.

Imposing a disclosure obligation that preserves business confidences while allowing insiders to trade would not require the Commission to draft a controversial new rule but to modify an existing one, albeit in a manner that might be controversial. Pursuant to Section 16(a) of the Exchange Act, high-level corporate insiders and those deemed corporate insiders[195] already must disclose transactions involving securities of the companies that employ them on the Commission's Form 4.[196] As of 2002, insiders must report changes in beneficial ownership of securities "before the end of the second business day following the day on which the subject transaction has been executed."[197] Prior to the adoption of that requirement, imposed in response to a wave of corporate and accounting scandals at companies whose names are now notorious, insiders had to disclose trades by the tenth day of the month following the month in which the trade occurred, permitting a lag of up to forty days.[198] The law imposes a duty to disclose and failure to disclose when required

[195] For example, this includes officers and directors, but also those who hold more than 10 percent of the company's shares. *See* Securities Exchange Act of 1934, Pub. L. No. 73-291, § 16(a), 48 Stat. 881, 896 (codified as amended at 15 U.S.C. § 78p(a) (2012)); *see also* 17 C.F.R. § 240.16a-3(g)(1) (2017).

[196] *Form 4*, SEC. & EXCH. COMM'N, https://www.sec.gov/about/forms/form4.pdf [https://perma.cc/7EJ8-VGHL].

[197] 17 C.F.R. § 240.16a-3(g)(1) (2017).

[198] Press Release, Sec. & Exch. Comm'n, Press Release 2002-22: SEC to Propose New Corporate Disclosure Rules (Feb. 13, 2002) https://www.sec.gov/news/headlines/corpdiscrules.htm [https://perma.cc/TEB5-Z7JR]. At least one witness testifying in Congressional hearings on how to prevent corporate malfeasance advocated contemporaneous disclosure of insider trades. *See How to Protect Investors Against Another Enron: Hearing on H.R. 3763 Before the H. Comm. on Fin. Servs.*, 107th Cong. 11 (2002) (statement of James K. Glassman, Resident Fellow, Am. Enterprise Inst.), http://archives-financialservices.house.gov/media/pdf/031302jg.pdf [https://perma.cc/9GFW-5GFL] ("News of such [insider] sales and purchases is important information that could signal the true state of corporate health. Investors need to know it in minutes, not in 40 days.").

to do so constitutes fraud.[199] Significantly, when Congress established the two-day reporting requirement, lawmakers expressly allowed for the possibility that the Commission might establish a different deadline.[200]

The two-day reporting requirement is woefully inadequate to the speed and sophistication of modern financial markets. To allow other investors to respond to such disclosures and to perform a prophylactic function, such disclosure ideally would be mandated *in advance of*[201] or, at a minimum, simultaneously with, the "subject transaction." This is the precise, concrete proposal of this essay: If this *ex ante* disclosure rule[202] were adopted, information relevant to third party investors' decisions would be available and price would adjust in response to the information. Indeed, high-frequency traders could act on the news in a matter of microseconds.[203] Resulting price movement would both alert other investors to potential material news about the company and, because the change in price would occur so quickly, the insider would enjoy less or no advantage from engaging in the transaction in the first place. And both the deterrent effect and the leveling of the playing field would be achieved without disclosure of the substantive inside information, that is, without striving for "parity of information."

Advance or contemporaneous disclosure that an insider is trading would need to include an additional data point, to enable proper evaluation by outsider investors: whether the trade was effected pursuant to a pre-arranged plan. Rule 10b-5-1 affords an investor an affirmative defense to a charge of insider trading, if the transaction occurred pursuant to a prearranged plan developed before the insider received inside information.[204]

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[199] Ronald J. Colombo, *Tipping the Scales Against Insider Trading: Adopting a Presumption of Personal Benefit to Clarify* Dirks, 45 HOFSTRA L. REV. 117, 122 (2016).

[200] *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 403(a)(2)(C), 116 Stat. 745, 788 (codified as amended at 15 U.S.C. § 78p (2012)).

[201] In the context of repurchase tender offers, in which a corporation offers to buy back its own stock, one scholar has proposed that insiders must disclose the quantity of shares they have tendered at least five days before the close of the offer period. *See* Jesse M. Fried, *Insider Signaling and Insider Trading with Repurchase Tender Offers*, 67 U. CHI. L. REV. 421, 471 (2000).

[202] It is possible that even an *ex post* disclosure rule would suffice to inform markets, but this would not preclude profiteering by the insider, whose transaction by definition would be complete before disclosure.

[203] *See* Yadav, *supra* note 14, at 992.

[204] *See* 17 C.F.R. § 240.10b5-1 (2017). To take advantage of this affirmative defense, the transaction plan must: specify the amount of securities to be bought or sold, the price, and the date; or provide a formula or algorithm for determining the quantity, price, and date of the purchase or sale; or demonstrate that the insider did not "exercise any subsequent influence over how, when, or whether to effect purchases or sales; provided, in addition, that any other person who, pursuant to the contract, instruction, or plan, did exercise such influence must not have been aware of the material nonpublic

If an insider's trade were effected as part of a prearranged plan that satisfied the rule, that fact would affect an outsider's evaluation of the trade: the outside analyst would likely conclude that the trade was not driven by the insider's receipt of new, material, inside information, and so need not prompt reconsideration of a preexisting assessment of the securities purchased or sold.[205]

Others have proposed accelerating the requirement that insiders file Form 4. In 1987, a task force on reform considered recommending adoption of a same-day reporting requirement, an idea previously proposed in the Senate, but rejected it as "unnecessarily burdensome" given the difficulty of submitting the form quickly to the SEC.[206] But the task force also noted that "[i]n the future, development of the EDGAR system[207] or facsimile delivery services might eliminate present difficulties in compliance."[208] Today, technology permits extremely rapid transmission of the form to the Commission. Scholars have also noted the potential impact of drastically shortening the reporting time or requiring disclosure in advance of trading.[209] But the reforms described in these proposals, made in the 1980s, likely would have greater impact in the current environment, given the technology-enhanced quickness of investor responses to new information.[210]

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information when doing so." *Id.* The purchase or sale must be conducted pursuant to the plan, and the plan must not have been entered into in an effort to evade the insider trading prohibition. *Id.* Significantly, the rule does not impose a schedule on the insider using a plan, and consequently an insider could set up a plan to execute a purchase or sale in short order, provided that the insider did not at the time have material, inside information. But such short-notice planning might give a whiff of impropriety. *See* Stuart Gelfond & Arielle L. Katzman, *A Guide to Rule 10b5-1 Plans*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Mar. 24, 2016), https://corpgov.law.harvard.edu/2016/03/24/a-guide-to-rule-10b5-1-plans/ [https://perma.cc/8R4K-EYZL].

[205] The rule does not specify how far in advance a transaction must be planned; that would also be important information that third-party outsiders would want to know on this proposed, enhanced Form 4.

[206] Comm. on Fed. Reg. of Sec., *Report of the Task Force on Regulation of Insider Trading*, 42 BUS. L. 1087, 1102 (1987) [hereinafter Task Force Report].

[207] EDGAR is the electronic filing system that companies use to submit forms to the Commission. *Filings & Forms*, SEC. & EXCH. COMM'N, https://www.sec.gov/edgar.shtml [https://perma.cc/H846-SHBA]. The filings are available online free of charge. *Id.*

[208] Task Force Report, *supra* note 206, at 1102.

[209] *See, e.g.*, Ellen Taylor, *Teaching an Old Law New Tricks: Rethinking Section 16*, 39 ARIZ. L. REV. 1315, 1356–57 (1997) (discussing the possibility of pre-trade disclosure by insiders and the disincentive effect of such disclosure on insiders); Marleen A. O'Connor, *Toward a More Efficient Deterrence of Insider Trading: The Repeal of Section 16(b)*, 58 FORDHAM L. REV. 309, 354–55 (1989) (noting the likelihood that insiders would consider the effect of disclosure on outsider investor behavior before buying or selling based on inside information).

[210] It is reliance on the speediness of particular investors that distinguishes this proposal from others; there is evidence that individual investors are "overwhelmed" by information and so are not likely to respond to disclosure of developments relevant to

To be effective, the SEC would need to expand the group of potential insiders who must report transactions on Form 4, to include all employees with access to information that could be material to a reasonable investor—a deliberately broad class.[211] Of course, an insider could attempt to circumvent the reporting requirement imposed by Form 4 by tipping someone else off. History well documents the possibility of indirect profiteering off of inside information. But existing law addresses the concern: It is "unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this chapter or any rule or regulation thereunder through or by means of any other person."[212] Thus while a family member of an insider might try to escape liability on the ground that no disclosure requirement applied, the interplay of rules would make the claim difficult. The trading by the family member or friend would be construed as trading by the insider, unless the source of information could establish that she had no idea that the tippee would act on it.

As has been suggested above, tippee liability in a doctrinal framework that explicitly recognizes a fair access norm would have to turn on the lawfulness of access to the information used, of course, and the mens rea of the tippee. If a tippee knew or believed that information received was not lawfully accessible and knew that trading on the basis of such information was prohibited, the tippee would be culpable. At least in the criminal context, the doctrine of willful blindness[213] would apply, to capture those who avoided investigating whether the information received was lawfully accessible or not. This analysis reduces the importance of retracing the path of information along a chain of tippers and tippees, and of trying to determine who knew what about the source and the nature of any duty potentially breached by that source. There is an objective question of the accessibility of the information, and a subjective question of the awareness of the tippee. Such analysis is not overwhelmingly difficult.

As a practical matter, the regulatory refinement proposed in this essay would not reach every instance of insider

their investment decisions. Colleen Honigsberg, Robert J. Jackson, Jr., & Yu-Ting Forester Wong, *Mandatory Disclosure and Individual Investors: Evidence from the JOBS Act*, 93 WASH. U. L. REV. 293, 303 (2015).

[211] The requirement already applies to family members of the insider.

[212] 15 U.S.C. § 78t(b) (2012).

[213] *See* Lee & Harris, *supra* note 89, at 221 ("Willful blindness requires a showing that the defendant (1) subjectively believed there was a high probability that a fact existed, and (2) took deliberate actions to avoid learning that fact.").

trading. But if high-frequency traders, who can react very quickly to new information, can respond to these disclosures in advance of the insider, their informed investment conduct should affect prices. Critics of the *ex post* disclosure regime noted this advantage of an *ex ante* requirement,[214] but the likely efficacy of such a rule is far greater today, in the era of high speed trading. The greater the amount of time between the required disclosure by the insider of the intention to trade and the consummation of that trade, the more likely it is that the price of the underlying security will have adjusted in the interim, reducing the profitability of acting on the inside information in the first place—though, of course, high-speed traders will be able to profit as a result of the relatively slow pace of price adjustment. An important benefit of this proposal is its increasing efficacy as market players are able to move more quickly and to react in more sophisticated ways in response to new information. Speed can serve, rather than frustrate, a regulatory end.

CONCLUSION

The Supreme Court's insider trading doctrine has drifted from concern over market integrity and correspondingly shifted away from trying to preserve fairness. As a result, the doctrine is no longer anchored by the principles articulated by the SEC more than fifty years ago.[215] The Court's decisions in this area represent a series of workarounds attempting to shoehorn insider trading into an agency paradigm while endeavoring to capture conduct that does not constitute a fiduciary breach but still is egregious. This essay has argued for renewal of a commitment to fairness, which in turn can be defined as equal access to information. Adoption of this fair access norm would shift the focus of the insider trading inquiry to the question of whether the information that conferred transactional advantage was lawfully accessible to any investor.

Beyond advocating explicit recognition of a fair access norm in general terms, this essay offers an illustration of a possible

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[214] *See, e.g.*, Taylor, *supra* note 209, at 1357("[I]f market prices adjust before insiders trade, then insiders cannot reap the benefits of their assessments of their companies' value . . . . If insiders must share their insights with the market by prereporting their trades, they will have less incentive to trade."); *see also* S.S. Samuelson, *The Prevention of Insider Trading: A Proposal for Revising Section 16 of the Securities Exchange Act of 1934*, 25 HARV. J. ON LEGIS. 511, 524 (1988) (proposing that insiders should be required to disclose plans to trade 90 days ahead of time and noting that the public disclosure "would signal the market, thereby reducing his [sic] expected profit").

[215] *See supra* notes 39-41 and accompanying text.

regulatory initiative to implement such a change in emphasis, mandating significantly accelerated disclosure of transactions by insiders. In advocating for more rapid disclosure of the identity of the insider engaged in trading, the proposal seeks to leverage the ever-increasing quickness and sophistication of financial market players. Rather than trying to restrain technologically advantaged trading to level the playing field, an accelerated disclosure regime would provide a financial reward to existing innovators whose near-instantaneous transactions could reduce or eliminate the potential rewards to insiders seeking to enrich themselves. Such an accelerated disclosure rule is explicitly allowed for by existing federal legislation and would require no enlargement of the Commission's authority. But adoption of a fair access norm would provide a polestar to reorient insider trading doctrine and would help significantly in the effort to make financial markets fair to all investors.