How Fatal Ambiguity Undermines Effective Insider Trading Reform

Kevin R. Douglas*

Lawmakers are building momentum towards codifying our insider trading laws to clarify which kind of trading is illegal. In May 2021, the United States House of Representatives passed the Insider Trading Prohibition Act for the second time in two years. In January 2020, a Securities and Exchange Commission-sponsored Task Force on insider trading released a report containing proposed legislation. Both the House Bill and the Task Force proposal would prohibit trading while in possession of "wrongfully obtained" information and prohibit trades that involve a "wrongful use" of information. This Article explains why the concept of "wrongful" trading is too ambiguous to improve insider trading law and explores the requirements of effective legislative reform. Further, this Article demonstrates that the confusion in insider trading law is neither caused by a tension between fairness and efficiency nor by a tension between investor protection and the public interest.

This Article is the first to identify the confusion in insider trading doctrine as a symptom of fatal ambiguity. The doctrine is fatally ambiguous because officials consistently attempt to simultaneously invoke two conflicting concepts of "fairness." One is a property-based fairness that protects exclusive-use rights in inside information. The other is an equal-information-based fairness that fosters equal access to all material information for all market participants. Conflating these incompatible moral concepts causes officials to oscillate sporadically between protecting private rights and fostering specific forms of economic equality. Moreover, the problems caused by fatally ambiguous moral concepts are systemic and concomitant with similar confusion about the definitions of "economic efficiency," "investor protection," and the "public interest."

This Article recommends clarifying insider trading law by specifying whether consent is a defense against liability. Making consent a defense against liability is in harmony with a property-based fairness doctrine, and barring consent is in harmony with an equal-information-based fairness doctrine. Enforcing only one fairness doctrine

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allows everyone to attempt to privately adhere to both principles while successfully applying one of the principles through law.

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I. INTRODUCTION

For decades, many scholars have described U.S. insider trading law as "irrational,"[1] "uncertain,"[2] and a "theoretical mess."[3] Even prominent enforcement officials have declared the current doctrine so ambiguous that it results in "a legal haziness that leaves both investors and defendants unclear about what sorts of information-sharing or other

1. *See, e.g.*, JOHN P. ANDERSON, INSIDER TRADING: LAW, ETHICS, AND REFORM 98–117 (2018) (arguing that U.S. insider trading law is ineffective due to a dysfunctional enforcement regime).

2. Richard J. Morgan, *Insider Trading and the Infringement of Property Rights*, 48 OHIO ST. L.J. 79, 90 (1987).

3. Alan Strudler & Eric W. Orts, *Moral Principle in the Law of Insider Trading*, 78 TEX. L. REV. 375, 379 (1999).

activities by investors would be considered insider trading."[4] The House of Representatives has twice responded to these criticisms and calls for reform by passing the Insider Trading Prohibition Act. This pending legislation would make it illegal to trade while aware of information that a person knows "has been obtained wrongfully, or [when trading] would constitute a wrongful use of such information."[5] The Bharara Task Force on Insider Trading (Bharara Task Force or Task Force)—sponsored by the Securities and Exchange Commission (SEC)—has also proposed model legislation to clarify the law.[6] The Task Force has proposed defining insider trading as (a) trading with information "knowing that such information had been obtained or communicated wrongfully, or (b) to wrongfully communicate or communicate wrongfully-obtained material, nonpublic information knowing that such information will be used in the purchase or sale of any security."[7]

Several scholars describe the confusion in the law as caused by conflicting approaches pursued by different officials or different branches of government. Professor John Anderson attributes the uncertainty to courts pursuing a breach of fiduciary duty or property rationale while enforcement officials pursue a competing equal access rationale.[8] This perspective makes sense, given how the SEC usually responds to the courts' efforts to limit insider trading liability. In *Chiarella v. United States*, for example, the U.S. Supreme Court identified a breach of fiduciary duty as a requirement for insider trading liability.[9] It asserted that expanding the scope of liability required an explicit act of Congress.[10] Eventually, the SEC lost several insider trading cases because federal courts followed the common law rule that neither marriages nor nondisclosure agreements constitute fiduciary relationships.[11] In response, the SEC passed Rule 10b5-

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4. Preet Bharara & Robert J. Jackson, Jr., Opinion, *Insider Trading Laws Haven't Kept Up with the Crooks*, N.Y. TIMES (Oct. 9, 2018), https://www.nytimes.com/2018/10/09/opinion/sec-insider-trading-united-states.html [https://perma.cc/9CSN-K7VW].

5. H.R. 2534, 116th Cong. (2019) (as passed by House, Dec. 5, 2019); H.R. 2655, 117th Cong. (as passed by House, May 18, 2021).

6. PREET BHARARA ET AL., REPORT OF THE BHARARA TASK FORCE ON INSIDER TRADING (Jan. 2020), https://www.bhararataskforce.com/s/Report-of-the-Bharara-Task-Force-on-Insider-Trading.pdf [https://perma.cc/FFU9-4HG4] [hereinafter BHARARA REPORT].

7. *Id.* at 18.

8. ANDERSON, *supra* note 1, at 93.

9. *Id.* at 230 (discussing how such liability is premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction).

10. *See* Chiarella v. United States, 445 U.S. 222, 233 (1980) (rejecting "recognizing a general duty between all participants in market transactions to forgo actions based on material, nonpublic information," because "[f]ormulation of such a broad duty, which departs radically from the established doctrine . . . should not be undertaken absent some explicit evidence of congressional intent"); *see also* Adam C. Pritchard, *Justice Lewis F. Powell, Jr. and the Counterrevolution in the Federal Securities Laws*, 52 DUKE L.J. 841, 865 (2003) (describing Justice Powell as supporting the view that Rule 10b-5 gave court flexibility on shaping remedies for violations of the law, but also as "suspicious of judicially created private causes of action not specifically authorized by Congress").

11. *See* United States v. Chestman, 947 F.2d 551, 568–69 (2d Cir. 1991) (stating that a marital relationship does not share key characteristics necessary to establish misappropriation liability); RESTATEMENT (SECOND) OF AGENCY: HUSBAND AND WIFE AS PRINCIPAL AND AGENT § 22 cmt. b (AM. L. INST. 1958) ("Neither husband nor wife [solely] by virtue of the relation has power to act as agent for the other."); *see also* United States v. Kim, 184 F. Supp. 2d 1006, 1010 (N.D. Cal. 2002) (stating that sharing confidential

2, which defines marriages, parent-child relationships, and sibling relationships as relationships of trust and confidence under Rule 10b-5.[12] Professor Donna Nagy describes the conflict as more than a result of federal courts and enforcement officials taking competing approaches.[13] Nagy argues that in addition to enforcement officials, several lower courts take an approach to insider trading that conflicts with the fiduciary principles identified by the U.S. Supreme Court.[14]

This Article builds on the prior scholarship by demonstrating that conflicting motivations also plague the statements and actions of individual officials and individual branches of government. This Article also makes a unique contribution by identifying the source of the confusion as the fatal ambiguity of the moral concepts in insider trading law. Doctrinally, each legal test for insider trading liability implies mutually exclusive fairness doctrines. Officials consistently premise liability on defendants violating an owner's property or exclusive-use rights in inside information. Like common law fraudulent nondisclosure doctrines, this first justification implies that fairness requires obtaining the informed consent of some principal before trading on the information (property-based fairness).[15] Simultaneously, officials describe liability as justified by defendants trading in securities markets with a material information advantage. This second justification suggests that fairness requires each market participant to have equal access to all material information (equal-information-based fairness).[16] Attempting to *simultaneously* foster these mutually exclusive fairness doctrines in relation to *the same information* causes the current law to opaquely and arbitrarily oscillate between these independent goals.[17] As explained below, the long history of courts and enforcement officials imposing liability for insider trading does not disprove the impracticability of the legal test presented in the case law. Instead, this history supports the conclusion that officials inconsistently select one of the conceptions of fairness when deciding any specific issue.

The conceptual conflict in the law is not simply a breach of formal logic and should not be dismissed as a semantic issue. Some defendants have spent years in prison for

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information alone "does not give rise to fiduciary-like relationship").

12. 17 C.F.R § 240.10b5-2(b)(3) (2021).

13. *See generally* Donna M. Nagy, *Insider Trading and the Gradual Demise of Fiduciary Principles*, 94 IOWA L. REV. 1315 (2009).

14. *Id.* at 1319 ("Despite the Supreme Court's explicit dictate that fiduciary principles underlie the offense of insider trading, there have been recent repeated instances in which lower federal courts and the [SEC] have disregarded these principles.").

15. *See* Kevin R. Douglas, *Missing the Role of Property in the Regulation of Insider Trading*, 69 CATH. U. L. REV. 209, 225 (2020) ("Because some treatises describe these disclosure obligations as required to ensure a "fair" transaction, it suggests that some legal doctrines rely on property or consent-based notions of fairness.").

16. *See* Donald C. Langevoort, *Setting the Agenda for Legislative Reform: Some Fallacies, Anomalies, and Other Curiosities in the Prevailing Law of Insider Trading*, 39 ALA. L. REV. 399, 400–01 (1988) (describing the equitable principles animating insider trading law as sharing the "same ideological roots underlying other legal rules that purport to neutralize some of the excessive advantages of economic power, size, and status"); Kimberly D. Krawiec, *Fairness, Efficiency, and Insider Trading: Deconstructing the Coin of the Realm in the Information Age*, 95 NW. U. L. REV. 443, 477 (2001) (implying that "fairness" always requires some form of economic equality by describing "inequalities in wealth, intelligence, and access to human capital in society at large" as "inconsistent with any notion of fairness").

17. *See infra* Part V.

violating insider trading law,[18] while others have lost hundreds of millions of dollars in penalties and disgorgement actions.[19] If American voters are committed to rule-of-law principles—especially notice—then those principles must apply with equal vigor to securities market participants and transactions. To the extent that the legal test for insider trading embodies an impossible contradiction, no legal institution can identify reasonable limits to the scope of the law. This impossibility undermines the legitimacy of insider trading law and the penalties imposed on targets of the prohibition. Given the stakes, lawmakers should clarify whether insider trading penalties target the violation of some party's private rights or the violation of some form of vice law.[20]

To identify the requirements for effective reform, this Article is organized as follows. Part II describes federal insider trading law and emphasizes the law's reliance on property principles; this includes when officials premise insider trading liability on a breach of fiduciary duty.[21] Part III outlines this author's theory of the problem by distinguishing fatally ambiguous statements from statements that are simply broad or vague. Part III also provides an abstract account of how fatal ambiguity operates in our current insider trading regime. Officials consistently use statutes and common law doctrines aimed at protecting property rights to penalize investors who benefit from certain kinds of economic inequality; specifically, officials penalize investors who trade with advanced information about securities price movement. This practice results in officials trying to protect one party's exclusive-use rights in confidential business information while simultaneously trying to foster equal access to the same information for all market participants.

Part IV explains why the form of ambiguity plaguing insider trading law is neither inevitable nor benign. While limited resources and the limits of language may make complete clarity impossible, the conclusion drawn in this Article is that the failure to

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18. One defendant, Raj Rajaratnam, comes to mind here. In 2011, Raj, formerly the head of the Galleon Group hedge fund, was found guilty of insider trading. Anna Driggers, Note, *Raj Rajaratnam's Historic Insider Trading Sentence*, 49 AM. CRIM. L. REV. 2021, 2021 (2012). Along with a court-ordered fine of $10 million and forfeiture of nearly $54 million, Raj was sentenced to 11 years in prison—the longest sentence ever imposed for insider trading. *Id.* This is aside from the over $90 million award the SEC obtained against Raj in a civil suit. *Id.* (describing the prison sentences for individuals convicted of insider trading).

19. *See* U.S. SEC. & EXCH. COMM'N, SELECTED DIV. OF ENF'T ACCOMPLISHMENTS: DEC. 2016–DEC. 2020 (Dec. 30, 2020), https://www.sec.gov/enforce/selected-division-enforcement-accomplishments-december-2016-december-2020 [https://perma.cc/6N5C-KUTN] (noting that between December 2016 to December 2020, the SEC reported bringing over 3,000 enforcement actions and obtaining judgments totaling over $17 billion).

20. Despite referencing private rights related to property and breaches of fiduciary duty, the U.S. insider trading regime often seems based on what some would call inalienability rules or vice law. *See* Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1092–93; *see also* John P. Anderson, *Greed, Envy, and the Criminalization of Insider Trading*, UTAH L. REV. 1, 1 (2014) (describing the prohibition of some forms of insider trading as only justifiable as a means of combating the vice of greed). Coincidentally, some defendants in insider trading cases may have faced harsher treatment if there was evidence that they were engaged in other stigmatized behavior. *See generally* Ellen S. Podgor, *Carpenter v. United States: Did Being Gay Matter?*, 15 TENN. J.L. & POL'Y 116 (2020) (exploring "whether the sexuality of two of the defendants made a difference in how the case was handled").

21. *See* Douglas, *supra* note 15, at 233 (arguing that "treating fraud, fiduciary duty, fairness, or disclosure doctrines as mutually exclusive from property doctrine is a mistake")

define the moral concepts animating insider trading law has been unnecessary and detrimental to the stated policy goals of protecting investors and promoting the public interest. Part V describes how the fatal ambiguity of moral concepts motivates insider trading law in practice. Courts do butt heads with enforcement officials over which fairness principle should control the regulation of insider trading. However, individual officials from each branch of government regularly make statements that express the attempt to simultaneously foster competing notions of fairness. The result is that officials inconsistently and unpredictably oscillate between either protecting property rights or penalizing economic advantages.

Part VI explores several implications of the fatally ambiguous moral language animating insider trading law. First, fatal ambiguity is a systemic problem; because we use words to define other words, redefining fundamental concepts has a cascade effect on related areas of law or analysis. As a result, the symptoms of fatal ambiguity are present in other concepts central to discussions about insider trading, including "economic efficiency," "investor protection," and the "public interest." Part VII offers recommendations for effective reform. Passing a statute that maintains the tradition of only using opaque terms, such as "unfair" or "wrongful," will not solve the problem.[22] The definition of these terms must indicate whether consent is a defense against liability. Prioritizing one conception of fairness will promote the rule of law by giving both civilians and government officials reasonable notice about which kind of trading is legal. In addition, this solution will leave civilians free to pursue the other kind of fairness through private activities and institutions.

This Article's conclusion briefly explores why the author would prioritize property-based fairness in insider trading law and the implications of that choice. Given the capabilities and limits of courts and enforcement officials, moral commitments to recognizing equal dignity and promoting the individual welfare of each market participant are best achieved by protecting each participant's economic liberty. Of course, a thorough treatment of these issues requires an independent article.

II. THE LAW: STATUTES, CASE LAW, AND GAP-FILLING RULES

Insider trading doctrine is best understood as a genetically modified version of the intentional tort fraudulent nondisclosure in breach of a fiduciary duty of loyalty. Insider trading cases generally apply the antifraud provisions of federal securities statutes and rules, including Exchange Act section 10(b), Rule 10b-5, and Securities Act section 17(a).[23] The cases sometimes apply the broader antifraud provisions codified in federal

22. *See* John P. Anderson, *The Final Step to Insider Trading Reform: Answering the "It's Just Not Right!" Objection*, 12 J.L. ECON. & POL'Y 279, 286 (2016) ("[S]imply codifying the current working definition of insider trading would not solve the problem."); Miriam H. Baer, *Insider Trading's Legality Problem*, 127 YALE L.J.F. 129, 129 (2017) ("Under the best circumstances, [statutes] can improve the content of criminal law precisely because they permit the legislature to differentiate similar yet morally distinct conduct.").

23. Among other things, Rule 10b-5 makes it unlawful to make material misrepresentations or omit material facts "in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5 (2019). Rule 10b-5 was authorized under section 10(b) of the Exchange Act and was modeled on section 17 of the Securities Act. One important difference between Rule 10b-5 and section 17(a) is that the language of the Securities Act

mail and wire fraud statutes.[24] Under common law, fiduciaries commit fraudulent nondisclosure when receiving a personal benefit from their principal's assets without first receiving their principal's informed consent.[25] This is in contrast to "the morals of the marketplace," where simply not lying is sufficient to obtain effective consent.[26] But a fiduciary must first disclose all material facts about the contemplated use of assets to receive the right kind of consent. Trade secrets and business opportunities are assets covered by a fiduciary's duty of loyalty.[27] When fiduciaries fail to obtain informed consent before acquiring a personal benefit from their principal's assets, courts recognize the gain as unjust enrichment.[28] Insider cases sometimes follow a similar pattern. It is the role that fiduciary duty law plays in protecting a principal's property rights in business assets that this Article emphasizes as the source of property-based fairness animating insider trading law. By contrast, many securities law scholars explain the official recognition of property rights as only motivated by the goal of economic efficiency and as generally at odds with a commitment to fairness.[29]

Insider trading cases are primarily categorized under three theories of liability: classical, misappropriation, and tipper-tippee liability. The classical theory of liability makes it unlawful for employees and other fiduciaries to use information obtained in their position to trade in the stock of their employers.[30] The U.S. Supreme Court first stated the classical theory test in *Chiarella*.[31] The Court approvingly cited the SEC's view that an insider's duty to disclose or abstain from trading "arose from (i) the

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explicitly makes it unlawful "to obtain money or property" by means of any material misrepresentation or omission. 15 U.S.C. § 77q.

24. *See* Karen E. Woody, *The New Insider Trading*, 52 ARIZ. ST. L.J. 594, 599 n.19 (2020) (detailing that 18 U.S.C. § 1348 was "enacted as part of Sarbanes-Oxley, was modeled after the mail and wire fraud statutes, 18 U.S.C. § 1341 and § 1343, and mirrors much of the language of Rule 10b-5"); *see also* Carpenter v. United States, 484 U.S. 19, 21–22 (1987) (invoking the same antifraud provisions).

25. *See* RESTATEMENT (SECOND) OF AGENCY: ACTING AS ADVERSE PARTY WITH PRINCIPAL'S CONSENT § 390 (AM. L. INST. 1958); RESTATEMENT (SECOND) OF AGENCY: USING OR DISCLOSING CONFIDENTIAL INFORMATION § 395 (AM. L. INST. 1958); RESTATEMENT (SECOND) OF TORTS: LIABILITY FOR NONDISCLOSURE § 551(2)(a) (AM. L. INST. 1976); RESTATEMENT (THIRD) OF TRS.: EFFECT OF BENEFICIARY CONSENT, RATIFICATION, OR RELEASE § 97 (AM. L. INST. 2012).

26. Meinhard v. Salmon, 164 N.E. 545, 547 (N.Y. 1928); Laidlaw v. Organ, 15 U.S. 178, 194 (1817).

27. *See* Town & Country House & Home Serv., Inc. v. Newbery, 147 N.E.2d 724, 726 (N.Y. 1958) (declaring that former employees may not solicit their former employer's "customers who are not openly engaged in business in advertised locations or whose availability as patrons cannot readily be ascertained"); *see also Meinhard*, 164 N.E. at 547 (describing a corporate opportunity as "an incident of the enterprise").

28. *Unjust Enrichment*, BLACK'S LAW DICTIONARY (11th ed. 2019) ("A benefit obtained from another, not intended as a gift and not legally justifiable, for which the beneficiary must make restitution or recompense.").

29. *See, e.g.*, Jonathan R. Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9, 10–11 (1984) (describing pre-*Chiarella* insider trading decisions as grounded on vague notions of fairness and equity; and further describing the post-*Chiarella* focus on property rights in information as more concerned with "the optimal allocation of information among parties"); *see also* Krawiec, *supra* note 16, at 450 (taking for granted that within insider trading scholarship, "fairness concerns [are] expressed by informational-egalitarians" and "efficiency concerns [are] expressed by informational-propertarians").

30. For example, imagine the CEO of a company like McDonald's buying McDonald's Corp. stock based on nonpublic information obtained in his position as CEO.

31. Chiarella v. United States, 445 U.S. 222, 228 (1980).

existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure."[32] The Court gave the classical theory its current form in the case of *United States v. O'Hagan*, and again attributed liability to the existence of a fiduciary relationship "between the corporation's shareholders and the insider that gives rise to a duty to disclose or abstain from trading."[33]

The misappropriation theory of liability makes it unlawful for employees and other fiduciaries of one company to use information obtained in their position to trade in the stock of a second company to which the fiduciary owes no obligations. The Supreme Court also gave the misappropriation theory its stamp of approval in *O'Hagan*. The Court stated that fiduciaries face liability for trading in the stock of a second company for personal gain because doing so without first informing their employer of their intent is considered an act of deception and a "breach of a duty of loyalty and confidentiality" that "defrauds the principal of *the exclusive use* of that information."[34]

The tipper-tippee theory of liability was first discussed by the Supreme Court in *Dirks v. SEC*[35] and reaffirmed in *Salman v. United States*.[36] When a fiduciary covered under the classical or misappropriation theory (a tipper) discloses information to someone not covered under either theory (a tippee), liability is imposed on the tipper and tippee if the disclosure constitutes a breach of duty.[37] In *Dirks*, the Court stated that to establish if there has been a breach of duty requires determining "whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings."[38]

The disconnect between disclosure and consent creates the distance between insider trading law and common law fraudulent nondisclosure or unjust enrichment cases. Both the classical and the misappropriation theories identify only disclosure before trading as required to make the transactions fair and as necessary to avoid liability. By contrast, common law generally requires disclosure to obtain the right kind of consent. Moreover, the classical theory requires disclosure to the general public, not simply disclosure to the principals in the fiduciary relationship.[39] As explained in the next three Parts, the disconnect between disclosure and consent provides important evidence of the competing fairness doctrines animating the law.

Finally, the SEC has created several administrative rules to fill perceived gaps in insider trading case law,[40] and Congress has passed at least two statutes in response to

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32. *Id.* at 227.

33. United States v. O'Hagan, 521 U.S. 642, 643 (1997).

34. *Id.* at 652 (emphasis added).

35. Dirks v. SEC, 463 U.S. 646 (1983).

36. Salman v. United States, 580 U.S. 39 (2016).

37. *See Dirks*, 463 U.S. at 647 ("In determining whether a tippee is under an obligation to disclose or abstain, it is necessary to determine whether the insider's 'tip' constituted a breach of the insider's fiduciary duty.").

38. *Id.* at 663.

39. Cady, Roberts & Co., Exchange Act Release No. 34-6668, 1961 WL 60638, at *3 (Nov. 8, 1961); United States v. O'Hagan, 521 U.S. 642, 652–53 (1997); Chiarella v. United States, 445 U.S. 222, 227–28.

40. *See generally* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716 (Aug. 24, 2000) (to be

previous calls for reform.[41] Part V will explore how these administrative rules and statutory provisions add to the confusion.

III. Fatal Ambiguity and Doctrinal Confusion

This Part explains how failing to provide clear definitions of the moral principles animating insider trading law results in an arbitrary doctrine.[42] The analysis below does not attempt to find a subtle principle that helps to rationalize insider trading decisions that are only superficially intractable. Instead, after defining fatal ambiguity in Part III.A, Part III.B identifies an irresolvable contradiction as the source of the confusion in the law.

A. Fatal Ambiguity

Many scholars have explored the relationship between ambiguous, vague, and broad legal provisions. Ambiguity—broadly—refers to statements that someone can reasonably interpret as having more than one meaning. This includes statements that are broad or vague. Broad provisions are defined as simply being open-ended and include laws that are written as standards instead of as rules. A vague provision, on the other hand, may imply an unclear legal mandate, not just an open-ended legal mandate. To distinguish between vague and broad statements, imagine a hypothetical statute that states, "this provision sanctions the use of proxies by shareholders for any required shareholder vote." Identifying the law as applying to "any required shareholder vote" is an example of a broad statement, making the statute's application open-ended. It would be more than reasonable to interpret this provision as applying to votes on the election of directors, a merger proposal, and any other corporate action requiring a shareholder vote. Now imagine that the hypothetical provision instead states that "when reasonable, this provision sanctions the use of proxies by shareholders for any required shareholder vote." Without further explanation, this modified provision becomes a bit vague. For which required shareholder votes are the use of proxies unreasonable?

Ambiguity is sometimes benign and sometimes problematic. Consider the term "sanction" from our original hypothetical statute. Sanction can either be defined as (1) official "approval or authorization" or (2) a "penalty for some legal infraction."[43] Without clarification, someone could interpret our hypothetical provision as either authorizing or penalizing the use of proxies for shareholder voting. The term "proxy" is also ambiguous, but confusion over which of the many meanings apply does little to undermine clarity in the law. The drafters of our hypothetical statute could have meant to convey (1) proxy, meaning "a person who is authorized to vote another's stock shares,"

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codified at 17 C.F.R. pts. 240, 243, 239) (promulgating supplemental rules governing insider trading).

41. Securities Exchange Act of 1934 § 21A, 15 U.S.C. § 78u-1 (West); Securities Exchange Act of 1934 § 20A, 15 U.S.C. § 78t-1.

42. This Article treats positive and negative moral concepts, respectively, as effectively synonymous. Some philosophers attempt to precisely distinguish between concepts like fairness, equity, justice, virtue, etc. *See generally* JOHN RAWLS, JUSTICE AS FAIRNESS: A RESTATEMENT (Harv. Univ. Press, 2001).

43. *Sanction*, BLACK'S LAW DICTIONARY (11th ed. 2019).

or (2) proxy, meaning the "document granting this authority."[44] A lack of clarity about which definition of "proxy" the legislature intended to convey should not cause any problems in applying the law. Whichever meaning of "proxy" is applied, civilians are effectively authorized or prohibited from taking the same set of actions. A lack of clarity about which definition of "sanction" the legislature intended puts courts and enforcement officials in a position to take conflicting actions in response to the same behavior—penalize or protect.

What if our hypothetical legislature openly called for *both* definitions of "sanction" to *simultaneously* apply in this provision? Applying such an absurd statute would be more than ambiguous—it would be fatal. A statute calling for the simultaneous application of conflicting definitions of sanction would be fatally ambiguous in at least two ways. First, it is impossible to effectively enforce a statute calling for the simultaneous adoption of contrary actions; therefore, this statute would be dead on arrival. Second, if officials decided that *something* must be enforced based on this statute without correcting for the impossibility of it simultaneously demanding incompatible actions, then officials would have to arbitrarily enforce one set of actions at any point in time. They would sometimes act as if the law penalized the use of proxy voting and sometimes act as if the law protected the use of proxy voting. This kind of ambiguity makes the law fatal by undermining the rule of law, which is required for individual welfare.[45] Finally, laws that undermine individual welfare generally inspire capital flight.[46] Therefore, fatal ambiguity is detrimental to both individual flourishing and social welfare.

Next, Part III.B explains how current insider trading law employs fatally ambiguous moral concepts, including "fairness" and "justice."

B. How Fatal Ambiguity Explains the Doctrinal Confusion

Officials consistently use statutes and common law doctrines aimed at protecting private rights to penalize investors who benefit from certain kinds of economic inequality; specifically, officials use statutes and doctrines aimed at protecting property rights in information to penalize investors who trade with advanced information about securities price movement. Relying on laws meant to protect private rights to penalize information inequality causes insider trading law to invoke at least two conceptions of fairness—property-based fairness and equal-information fairness.[47]

Analogous to "sanction," the terms "fairness" and "justice" are polysemous concepts with related yet mutually exclusive definitions. The incompatibility of property-based

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44. *Proxy*, BLACK'S LAW DICTIONARY (11th ed. 2019).

45. *See generally* TARA SMITH, JUDICIAL REVIEW IN AN OBJECTIVE LEGAL SYSTEM (2015) (discussing key components of a functional and effective legal system).

46. *See, e.g.*, Thomas B. Pepinsky, *The Politics of Capital Flight in the Global Economic Crisis*, 26 ECON. & POL. 431 (finding countries with a strong system of laws and governance experienced less capital flight during the 2008–2009 economic crisis); Eric Osei-Assibey, Kingsley Osei Domfeh & Michael Danquah, *Corruption, Institutions and Capital Flight: Evidence from Sub-Saharan Africa*, 45 J. ECON. STUD. 59 (2018) (study showing that weak public institutions and corruption inspire capital flight).

47. *See supra* notes 15–16 and accompanying text.

fairness and equal-information fairness becomes obvious when property rights are viewed holistically as *exclusive-use* rights.[48] As used in unjust enrichment cases involving a breach of the duty of loyalty, "justice" requires fiduciaries to obtain the right kind of consent before making personal use of a principal's business property. Recall that this conception of justice applies to intangible objects, including trade secrets and business opportunities.[49] Under property-based fairness, "use" includes a principal directly benefiting from an object and a principal gaining benefits from transferring or licensing the object to others.[50] For example, one publicly-traded company might use information about the viability of acquiring a second publicly-traded company to (1) effectively acquire that second company or (2) generate profits by selling its plans to a third party. It is the potential for the principal to transfer or license a business asset for a fiduciary's benefit that makes informed consent a method for achieving a particular kind of fairness.

Now consider the conception of "fairness" embodied in the disclose or abstain rule found in insider trading cases. A fiduciary disclosing confidential business information to the general public is antagonistic to the exclusiveness required to protect the principal's property rights in information—especially if that information is valuable in part because it is secret. In addition, the expectation that the alternative to disclosure is abstaining undermines the use element of the principal's exclusive-use rights. The conflict is clearer when we consider that Regulation Fair Disclosure (Regulation FD) explicitly prohibits some owners of inside information from engaging in selective disclosure—a prerequisite of licensing third-party trading on that information.[51]

There are good reasons to recognize the mutually exclusive conceptions of fairness discussed above as embedded in American law and culture.[52] The protection of property

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48. Adam Mossoff, *What Is Property? Putting the Pieces Back Together*, 45 ARIZ. L. REV. 371, 376 (2003) (arguing that rights to "acquisition, use, and disposal—are necessary for a *sufficient*" conception of property); *see also* Adam Mossoff, *Exclusion and Exclusive Use in Patent Law*, 22 HARV. J.L. & TECH. 321, 347–70 (2009) (describing "how the legal realists used patents in arguing for an exclusion concept of property in land, and [arguing that] this revolution in property theory in the early twentieth century led patent lawyers to later mistakenly accept the legal realists' characterization of property as securing only the right to exclude"); RICHARD EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN 59–62 (1985) (describing property as a "unified" concept which always includes the rights to possess, use and dispose); Eric R. Claeys, *Takings, Regulations, and Natural Property Rights*, 88 CORNELL L. REV. 1549, 1568 (2003) (Instead of exclusion alone, describing property rights as including "the trinity of disposition, use, and control"); Larissa Katz, *Exclusion and Exclusivity in Property Law*, 58 U. TORONTO L.J. 275, 283 (2008) ("[T]he ability of the owner to use and dispose of her [property] is simply the *effect* of her right to exclude others generally. It does not . . . require any separate justification.").

49. *See supra* note 27 and accompanying text.

50. *See* RESTATEMENT (THIRD) OF UNFAIR COMPETITION: DEFINITION OF TRADE SECRET § 39 cmt. a (AM. L. INST. 1995) ("The rules protecting trade secrets also promote the efficient exploitation of knowledge by . . . facilitating disclosure to employees, agents, licensees, and others who can assist in its productive use."); *see also* RESTATEMENT (FIRST) OF PROP.: ALIENABILITY OF COMMERCIAL EASEMENTS IN GROSS § 489 cmt. a (AM. L. INST. 1944) ("Property interests are, in general, alienable. If a particular property interest is not alienable, this result must be due to some policy against the alienability of such an interest."); *but see* JAMES E. PENNER, THE IDEA OF PROPERTY IN LAW 93–96 (2000) (concluding that exclusive use rights include the right to give gifts or make gratuitous loans, but not the right to transfer or license for consideration).

51. 17 C.F.R. § 243.100 (2021).

52. *See generally* Kevin R. Douglas, *Michael Milken: A Case Study in America's Moral Schism*, 15 TENN. J.L. & POL'Y 128 (2020); John P. Anderson, Jeremy L. Kidd & George A. Mocsary, *Public Perceptions*

rights is broadly accepted as a moral imperative among Americans. This is true whether we view the protection of property rights as primarily motivated by the commitment to fostering social welfare[53] or primarily motivated by the goal of fostering individual welfare.[54] The latter is sometimes expressed in trade secret cases when courts declare that it seems "fair that one should be able to keep and enjoy the fruits of his labor."[55] The same notion is expressed by the term "sweat equity," which is used to describe the ownership rights a specific person creates in something through her productive efforts.[56] Although less obvious, moral commitments to economic equality are also embedded in American law and culture. While the idea originated with German political philosophers during the 1800s, Americans were early and enthusiastic adopters of benevolent societies. These societies were aimed at achieving socialist goals through voluntary action.[57] The United States also has a long history of outpacing equally wealthy European nations in charitable contributions.[58] Using the law to foster moral commitments to economic equality is uncommon in the United States, but the practice is not completely foreign. Tax codes are described as progressive when used as a means of achieving greater levels of economic equality.[59] Laws against price gouging can be thought of as making it unlawful to benefit from a specific kind of economic advantage—business opportunities that result from public emergencies.[60] Moreover, if the popularity of Thomas Pickett's *Capital in the Twenty-First Century* is any indication of cultural norms, the opposition to economic inequality in the United States may have increased dramatically between 2008 and 2021.[61]

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of Insider Trading, 51 SETON HALL L. REV. 1035, 1089–1103 (2021) (relying on a national survey of public attitudes regarding insider trading, the authors conclude that "[p]ublic opinions about the morality of and appropriate punishment for insider trading appear unstable").

53. *See* sources cited *infra* note 62 and accompanying text.

54. *See* sources cited *infra* note 63 and accompanying text; *see also* THE FEDERALIST NO. 10 (James Madison) ("The diversity in the faculties of men, from which the rights of property originate, is not less an insuperable obstacle to a uniformity of interests. The protection of these faculties is the first object of government. From the protection of different and unequal faculties of acquiring property, the possession of different degrees and kinds of property immediately results . . . .

55. Metallurgical Indus. Inc. v. Fourtek, Inc., 790 F.2d 1195, 1201 (5th Cir. 1986).

56. *Sweat Equity*, BLACK'S LAW DICTIONARY (11th ed. 2019) ("Financial equity created in property by the owner's labor in improving the property.").

57. DAVID T. BEITO, FROM MUTUAL AID TO THE WELFARE STATE: FRATERNAL SOCIETIES AND SOCIAL SERVICES, 1890–1967 204 (2000).

58. CHARITIES AID FOUND., CAF WORLD GIVING INDEX 7 (10th ed. 2019).

59. *See* ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS 8 (6th ed. 2012) (stating that "the income tax precisely targets inequality, whereas redistribution by private legal rights relies on crude averages").

60. CAL. PENAL CODE § 396 (West 2022) criminal provision barring price increases of more than ten percent on certain goods during a state-declared emergency). ("A violation of this section is a misdemeanor punishable by imprisonment in a county jail for a period not exceeding one year, or by a fine of not more than ten thousand dollars ($10,000), or by both that fine and imprisonment."); *see also* ME. REV. STAT. ANN. tit. 10, § 1105 (West 2022) ("After the Governor has declared an abnormal market disruption and before the declaration of the abnormal market disruption expires, a person may not sell or offer for sale necessities at an unconscionable price.").

61. *See, e.g.*, Sam Tanenhaus, *Hey, Big Thinker*, N.Y. Times (Apr. 25, 2014), https://www.nytimes.com/2014/04/27/fashion/Thomas-Piketty-the-Economist-Behind-Capital-in-the-Twenty-First-Century-sensation.html [https://perma.cc/M3ZF-YAWG (acknowledging the popularity of Thomas Pickett's 2014 *New York Times* best-seller, CAPITAL IN THE TWENTY-FIRST CENTURY).

Scholars and court opinions express many other disagreements about which moral principles are valid and should be enforced by law. Many scholars conclude that the overarching goal of moral doctrines is to foster collective happiness, as described by J.S. Mill and other philosophers.[62] Some cases suggest that the overarching goal is fostering individual happiness, as John Locke and others described.[63] Some apply the "morals of the marketplace" doctrine, which identifies transactions between arm's-length third parties as "just" as long as the transactions are consensual.[64] Other cases suggest that even consensual transactions can be morally "unconscionable" if certain economic disparities exist between the transacting parties.[65] Some cases involving transactions between a fiduciary and a principal describe informed consent as sufficient to avoid the problem of unjust enrichment.[66] Other cases involving transactions between fiduciaries and principals describe informed consent as insufficient if prices significantly deviate from the norm.[67] Additional frustration comes from determining which rules of evidence

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62. *See* JOHN STUART MILL, ESSAYS ON ETHICS, RELIGION AND SOCIETY 214 (J.M. Robson ed., 1969) (Mill described the goal of human life and the standard of morality as achieving happiness "to the greatest extent possible, secured to all mankind; and not to them only, but, so far as the nature of things admits, to the whole sentient creation"); *cf.* JONATHAN R. MACEY, INSIDER TRADING: ECONOMICS, POLITICS, AND POLICY 2 (1991) (describing common law principles of fairness as aimed at supporting "a system of economic incentives that enhance social welfare and create incentives for the efficient allocation of resources"); *see also* ROBERT C. CLARK, CORPORATE LAW 155 (1986) (describing laws punishing unfair actions as aimed at promoting alternatives that are "socially more efficient"). *But see* Michael D. Guttentag, *Law and Surplus: Opportunities Missed*, 2019 UTAH L. REV. 607, 649 (2019) (treating fairness as synonymous with economic equality, the author criticizes scholars who "reject the notion that considerations of fairness or distributive justice should also be included in [policy] analysis"); *contra* Richard A. Posner, *Utilitarianism, Economics, and Legal Theory*, 8 J. LEGAL STUD. 103 (1979) (distinguishing allocational efficiency and utilitarianism's greatest happiness for the greatest number).

63. *See* JOHN LOCKE, SECOND TREATISE OF CIVIL GOVERNMENT § 26 (1690) ("God gave the world to men in common; but since he gave it [to] them *for their benefit, and the greatest conveniencies of life* they were capable to draw from it, it cannot be supposed he meant it should always remain common and uncultivated . . . So that God, by commanding to subdue, gave authority so far to appropriate: *and the condition of human life*, which requires labour and materials to work on, necessarily introduces private possessions.") (emphasis added); *cf.* Metallurgical Indus. Inc. v. Fourtek, Inc., 790 F.2d 1195, 1201 (5th Cir. 1986) ("That the cost of devising the secret and the value the secret provides are criteria in the legal formulation of a trade secret shows the equitable underpinnings of this area of the law. It seems only fair that one should be able to keep and enjoy the fruits of his labor. If a businessman has worked hard, has used his imagination, and has taken bold steps to gain an advantage over his competitors, he should be able to profit from his efforts. Because a commercial advantage can vanish once the competition learns of it, the law should protect the businessman's efforts to keep his achievements secret. As is discussed below, this is an area of law in which simple fairness still plays a large role.").

64. Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928) (contrasting transactions between arm's-length third parties and transactions between strangers: "Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place").

65. RESTATEMENT (SECOND) OF CONTRACTS: UNCONSCIONABLE CONTRACT OR TERM § 208 (AM. L. INST. 1981).

66. United Tchrs. Assocs. Ins. v. MacKeen & Bailey Inc., 99 F.3d 645, 650 (5th Cir. 1996) (holding that an agent's fiduciaries duties include "the general duty of full disclosure respecting matters affecting the principal's interests and a general prohibition against the fiduciary's using the relationship to benefit his personal interest, except with the full knowledge and consent of the principal").

67. Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) ("[I]n a non-fraudulent transaction we recognize that price may be the preponderant consideration outweighing other features of the merger.").

apply and which kinds of remedies are available depending on which underlying moral principles are operating.[68]

Given these disagreements, many scholars question the usefulness of moral concepts in understanding legal cases.[69] Fortunately, instead of abandoning moral concepts in legal opinions, a long line of business law cases recognize a distinction between the moral principles that are prevalent within society and those moral principles that are enforced by law.[70] For example, not all forms of lying are illegal.[71] Unfortunately, many of these cases fail to clarify which moral principles will be enforced through law. Moreover, many have either championed or resigned themselves to the ambiguity and vagueness generally found in the law.[72] While limited resources and the limits of language may make complete clarity impossible, the failure to define the moral concepts animating insider trading law has been unnecessary and detrimental to the stated policy goals of protecting investors and promoting the public interest.

In Part V, this Article demonstrates that the confusion in insider trading law is not simply the result of warring branches of government adopting competing moral commitments. Instead, *individual officials and independent institutions* consistently attempt to simultaneously adhere to conflicting fairness doctrines. First, Part IV explains why the form of ambiguity plaguing insider trading law is neither inevitable nor benign.

IV. THE VIRTUE AND VICE OF AMBIGUOUS LAW

A. The Virtues of Ambiguity

Most scholars correctly recognize that sophisticated legal analysis requires an appreciation of both inevitable and beneficial forms of ambiguity. Many scholars describe ambiguity as a seemingly permanent feature of language. For these scholars,

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68. *See* Metallurgical Indus. Inc. v. Fourtek, Inc., 790 F.2d 1195, 1206 (5th Cir. 1986) (distinguishing between cases involving a breach of contract from those involving a violation of property rights, the court explained that if "Metallurgical were suing only on the contract, then the parol evidence rule unquestionably would bar evidence of prior agreements. This is not the case, however; the cause of action we are addressing on appeal [sounds in tort and] is independent of any contract").

69. Mark A. Lemley, *The Surprising Virtues of Treating Trade Secrets as IP Rights*, 61 STAN. L. REV. 311, 327 (2008) ("'Commercial morality' has no more substantive content than 'unfair competition' or 'unjust enrichment'—it still requires some external source to determine what behavior is and is not moral."); *see also* Robert G. Bone, *A New Look at Trade Secret Law: Doctrine in Search of Justification*, 86 CALIF. L. REV. 241, 246 (1998) ("Those who argue from rights and fairness are unable to identify a right or a coherent conception of fairness that fits trade secret law."); *cf.* Eric R. Claeys, *Private Law Theory and Corrective Justice in Trade Secrecy*, 4 J. TORT L. 1, 3 (2011) ("Property principles seem to explain important variations in trade secrecy's tort, contract, and remedy doctrines—and also corresponding variations in the parts of trade secrecy that implicate unfair competition and confidentiality principles.").

70. *See* Laidlaw v. Organ, 15 U.S. 178, 193 (1817) ("Human laws are imperfect in this respect, and the sphere of morality is more extensive than the limits of civil jurisdiction."); *see also* Goodwin v. Agassiz, 283 Mass. 358, 363 (1933) ("Law in its sanctions is not coextensive with morality."); Chiarella v. United States, 445 U.S. 222, 232 (1980) ("First not every instance of financial unfairness constitutes fraudulent activity under § l0(b).").

71. RESTATEMENT (SECOND) OF TORTS: CONDITIONS UNDER WHICH MISREPRESENTATION IS FRAUDULENT (SCIENTER) § 526 (AM. L. INST. 1977); *see also* United States v. Alvarez, 567 U.S. 709, 729–30 (2012) (holding that the Stolen Valor Act of 2005 infringes on First Amendment rights).

72. *See infra* Part IV.

lawmakers must embrace that inescapability of ambiguity and—from the options available—select the course that yields the highest net benefits or lowest net costs.[73] Moreover, learning how to grapple with this ambiguity is a prerequisite for becoming a skilled lawyer. It would therefore be tragic for a law professor to misidentify inevitable ambiguity in a body of law as fatal. Professor Kaplow, for example, has argued that all laws are either under-inclusive or overinclusive.[74] From this perspective, lawmakers can only determine which of these alternatives is least costly when regulating a specific subject matter. Professor Kaplow also implies that lawmakers should err on the side of over-inclusiveness by adopting standards for the regulation of activities that occur infrequently.[75] Analogous to what Kaplow might call an overinclusive law, Professor Jill Fisch has described section 10(b) of the Exchange Act as an "open-textured statute" that "requires the courts to engage in the more expansive interpretive exercise associated with common law adjudication."[76] Professor Fisch describes the open-ended text of section 10(b) as particularly appropriate in the insider trading context because it is "'nearly impossible . . . to define a rule fitting all situations' in which corporate insiders may or may not trade in their companies' stock."[77] Other scholars have described ambiguous laws as benign—if not beneficial—when they exist as a consequence of our particular form of republican government.[78] Discussing another area of federal securities regulation, Professors Grundfest and Pritchard have argued that ambiguity "may have strong survival characteristics in our multi-branch legal regime that relies on political compromise within and among the branches in order to function."[79] This position treats ambiguity as a useful way for officials to achieve ambitious policy goals given the problem of political and other constraints.

However avoidable they may be, ambiguous legal doctrines might reflect American commitments to democratic government. One obvious way would be if the law reflected the values of the vast majority of voters. Conflicts between property-based fairness and economic-equality-based fairness found in insider trading law are likely an expression of conflicting values embodied in American culture. This author is convinced that the conflict in values is not simply a conflict between different voters. Instead, many Americans are internally conflicted about what they consider just or fair business activity.[80] Therefore, the confusion in insider trading law may be an effect of popular

73. *See, e.g.*, Charles B. Nutting, *The Ambiguity of Unambiguous Statutes*, 24 MINN. L. REV. 509, 509 (1940); Brian G. Slocum, *The Importance of Being Ambiguous: Substantive Canons, Stare Decisis, and the Central Role of Ambiguity Determinations in the Administrative State*, 69 MD. L. REV. 791, 794 (2010); Michael S. Greve & Ashley C. Parrish, *Administrative Law Without Congress*, 22 GEO. MASON L. REV. 501, 511 (2015).

74. Louis Kaplow, *Rules versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 565 (1992).

75. *Id.* at 579.

76. *See* Jill E. Fisch, *Constructive Ambiguity and Judicial Development of Insider Trading*, 71 SMU L. REV. 749, 757–58 (2018) (noting that Rule 10(b) benefits as an "open-textured statute" because it is "nearly impossible" to encompass all the possibilities by which "corporate insiders may or may not trade in their companies' stock").

77. *Id.*

78. *See generally* Joseph A. Grundfest & Adam C. Pritchard, *Statutes with Multiple Personality Disorders: The Value of Ambiguity in Statutory Design and Interpretation*, 54 STAN. L. REV. 627, 629–30 (2002).

79. *Id.* at 636.

80. Douglas, *supra* note 52, at 139.

contradictory commitments. Moreover, if the genuinely conflicted and confused values of individual voters would make the open pursuit of economic equality impractical, then it makes sense for Fisch, Grundfest, Pritchard, and others to describe insider trading law's incomplete commitment to economic equality as a virtue, not a vice.[81]

Even if we discount the value of laws that reflect genuinely democratic principles, the conflicts in insider trading law may reflect American commitments to republican government. Many acknowledge that our representative form of government is meant to limit some of the harmful effects of democracy. The ideal involves our congressmen and congresswomen avoiding the pressures of mob rule by taking the time to deliberate on new legislation. Now consider that Congress chose to leave insider trading undefined during their 1984 and 1989 reform efforts.[82] As outlined in Part V.C., Congress also added standing and remedy provisions to the Exchange Act that foster commitments to economic equality while fully aware that liability for insider trading is usually authorized under property-focused statutes.[83] These intentionally vague and conflict-fostering statutory provisions were signed into law by Ronald Reagan, a democratically elected president. The same statutes and conflicting case law were later reaffirmed by the U.S. Supreme Court in *O'Hagan*.[84] What more could a person committed to the American form of government ask for in the way of identifying a *legitimate* law?

Even if not clear expressions of the democratic and republican virtues embraced by Americans, the ambiguity in insider trading law may still be useful. In 1988, lawmakers explained their opposition to defining insider trading as a means of preventing crafty investors from coming up with contrivances aimed at skirting the law.[85] This concern makes sense in light of the countless cases brought by enforcement officials for trading activity later deemed by courts to be outside the scope of Rule 10b-5 and the other antifraud provisions of federal securities law.[86]

In Part IV.B, however, I will explain why the foregoing defenses of ambiguity fail to support keeping the status quo in U.S. insider trading law.

B. The Viciousness of Ambiguity

There are many reasons to reject the problems described in this Article as forms of benign ambiguity. First, in addition to being under- or overinclusive, it is important to recognize that laws can be written using arbitrarily inclusive statements. In addition to overinclusion, the potential for arbitrary inclusion is likely an important source of the chilling effect that scholars and courts attribute to vague laws.[87] Second, what many

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81. *See* Grundfest & Pritchard, *supra* note 78, at 636 ("Efforts to impose greater precision than the underlying political structure can bear may lead nowhere because the political equilibrium between the judicial and legislative branches may benefit from a base level of interpretive ambiguity."); *see also* Fisch, *supra* note 76, at 758 ("The definitional challenge is the product of several factors—the continued evolution of the market, shifting norms about the appropriate legal and moral response to information disparities, and the ability of traders to develop new products, practices, and strategies.").

82. *See infra* notes 211–212 and accompanying text.

83. *See infra* note 203 and accompanying text.

84. United States v. O'Hagan, 521 U.S. 642 (1997).

85. *See infra* notes 211–212 and accompanying text.

86. *See supra* note 11 and accompanying text; *infra* note 93.

87. *See* John P. Anderson, *Solving the Paradox of Insider Trading Compliance*, 88 TEMP. L. REV. 273,

scholars describe as broad statements of law may actually be vague or fatally ambiguous statements. Third, officials undermine an equal application of the law by using intentionally ambiguous laws to demand "full and fair disclosure" from civilians. This approach seems to replace the old-world recognition of a divine right of kings with an evolutionary right of lawmakers and other officials. Ultimately, even if ambiguity is sometimes useful or, in some ways, inevitable, there must be some limit on acceptable ambiguity. To paraphrase one scholar, "to be occupied with [ambiguity] is one thing, to be preoccupied with it another."[88]

First, as Part V demonstrates, fatal ambiguity results in officials arbitrarily moving between conflicting commitments. Such inconsistent enforcement of the law leaves civilians without proper notice of which activities are lawful and which will result in legal penalties. Recall the well-known disagreement discussed in Part III.B over how to define "fair" or "just" business activity. Given this disagreement, it seems more than negligent to communicate grants of police power using imprecisely defined moral concepts.[89] As discussed in Part II, these terms are polysemous in the same way as the term "sanction" and can therefore denote mutually exclusive meanings. Again, in practice, this means that civilians are subject to liability under a law that oscillates arbitrarily between incompatible standards. If we accept his account of his trial, then the criminal conviction of Raj Rajaratnam provides a tragic example of the danger discussed above. In 2011, Rajaratnam was sentenced to 11 years in prison for insider trading.[90] In an interview following his release from prison, Rajaratnam claimed that his defense attorneys assured him that there was no way that he could be convicted.[91] While all

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295 (2016) ("To take stock, vagueness in the law translates into uncertainty for issuers in the design and implementation of their insider trading compliance programs. This uncertainty, when combined with the threat of significant reputational and economic sanctions for "ineffective" compliance programs, typically leads firms to adopt a "play-it-safe" approach."); *see also* Walker v. City of Birmingham, 388 U.S. 307, 344–45 (1967) (Brennan, J., dissenting) ("We have molded both substantive rights and procedural remedies in the face of varied conflicting interests to conform to our overriding duty to insulate all individuals from the "chilling effect" upon exercise of First Amendment freedoms *generated by vagueness, overbreadth and unbridled discretion to limit their exercise*.") (emphasis added); *see also* Anderson, Kidd & Mocsary, *supra* note 52, at 1079–80 (after conducting a national survey of public attitudes on insider trading, the authors concluded that the "chilling effect of insider trading enforcement may thus have a greater impact on market participation than does the activity that it seeks to prevent"); *see also* Geeyoung Min, Strategic Compliance 34 (Dec. 2022) (unpublished manuscript) (on file with author) (over 70% of the companies surveyed "appear to make their insider trading policies stricter than external regulations").

88. H.L.A. Hart, *Positivism and the Separation of Law and Morals*, 71 HARV. L. REV. 593, 615 (1958). (discussing "penumbras").

89. *See* TARA SMITH, JUDICIAL REVIEW IN AN OBJECTIVE LEGAL SYSTEM 1 (2015) (arguing that "the essential requirements of objectivity in judicial decision making derive from the fundamental character of objective law"); Tara Smith, *Neutrality Isn't Neutral: On the Value-Neutrality of the Rule of Law*, 4 WASH. U. JURIS. REV. 49, 59 (2011) ("The contrast with the Rule of Men also highlights another facet of the [the rule of law's] basic appeal: its objectivity.").

90. David S. Hilzenrath, *Raj Rajaratnam, Hedge Fund Billionaire, Gets 11-Year Sentence for Insider Trading*, WASH. POST (Oct. 13, 2011), https://www.washingtonpost.com/business/economy/hedge-fund-billionaire-gets-11-year-sentence-in-fraud-case/2011/10/13/gIQAa0PZhL_story.html [https://perma.cc/N78H-8PEE].

91. CNBC, *Watch CNBC's Full Interview with Galleon Group's Raj Rajaratnam*, YOUTUBE (Dec. 8, 2021), https://www.youtube.com/watch?v=bqrrOyQh38A [https://perma.cc/2BUE-95V2]. Mr. Rajartan also

lawyers are human and therefore fallible, it should be jarring that the legal team hired by a billionaire could get the law so wrong and with such painful consequences. Adding insult to injury, the prosecutor responsible for Rajaratnam's and dozens of other insider trading convictions later described insider trading law as too unclear to allow investors to know which kind of trading is legal.[92] In addition to defendants being surprised when they unexpectedly face liability for insider trading, many officials and scholars have been dismayed when certain defendants were able to avoid liability.[93]

Second, some laws described as broad are actually vague or fatally ambiguous. H.L.A. Hart's classic example about vehicles in the park is broad because it applies to a wide variety of objects, including duck boats, bicycles, and wheelchairs.[94] Even if Hart's hypothetical legislature did not intend to prohibit motorized wheelchairs, it likely did intend to prohibit more than just motorcycles, and so a broad concept is appropriate. A concept applying to a category that includes a wide variety of objects is not the same as the concept being vague—potentially applying to multiple distinct categories. Following the pattern from our hypothetical statute on shareholder voting from Part II.A, we can make Hart's statute vague by adding some version of the word "reasonable." So, instead of a statute that prohibits vehicles, imagine one that prohibits engaging in "unreasonably dangerous activities" in the park. Without clarity on what constitutes an unreasonable danger, the statute becomes vague. Law enforcement officials and judges are then burdened with the responsibility of defining the scope and limits of the law as they go along.

Many of the antifraud provisions cited to punish insider trading are better described as vague than as broad. Exchange Act § 10(b) is vague because of its catch-all provision. The statute could have simply made it unlawful to use "any manipulative or deceptive device" when buying or selling covered securities.[95] Instead, the same provision also makes it illegal for an investor to use a "contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."[96] This last phrase is almost more than vague because it contemplates the violation of rules which have not yet been created by the SEC. That said, one could argue that Rule 10b-5 and Securities Act 17(a) are ambiguous in the sense that it is unclear whether the three sub-provisions of the rule and statute are meant to be read as different ways of saying the same thing or as prohibiting three separate kinds of behavior.[97] As of 2019, the Supreme Court treats these sub-

wrote a book about his experience following his decision to go to trial on the insider trading charges brought against him. *See generally* RAJ RAJARATNAM, UNEVEN JUSTICE (2021).

92. *See* Bharara & Jackson, *supra* note 4 and accompanying text.

93. *See generally* Eric C. Chaffee, *Schrodinger's Hacker: Insider Trading and Data Breaches*, 15 TENN. J.L. & POL'Y 69 (2020) (discussing a recent controversy over whether to charge hackers with insider trading for trading based on stolen information).

94. H.L.A. Hart, *Positivism and the Separation of Law and Morals*, 71 HARV. L. REV. 593, 607–11 (1958).

95. Exchange Act § 10(b), 15 U.S.C. § 78j.

96. *Id.*

97. For example, in connection with a purchase or sale of covered securities, Rule 10b-5 makes it illegal:

> (a) To employ any device, scheme, or artifice to defraud,

provisions as prohibiting different kinds of behavior.[98] For decades, however, the SEC and lower courts described the sub-provisions as "mutually supporting rather than mutually exclusive," suggesting that "it makes no difference which subsection is used in a given case."[99] Using three different statements to prohibit fraudulent misrepresentation or fraudulent nondisclosure when transacting in covered securities is confusing.

These antifraud provisions, however, are not so confusing as to prohibit the exercise of private rights that they simultaneously claim to protect. Nothing in these provisions seems to restrict the use rights involved in corporate fiduciaries or constructive insiders buying and selling covered securities after receiving the informed consent of their principals. Similarly, nothing in these provisions seems to restrict the rights involved in arm's length third parties doing the same after obtaining simple consent from information owners. It is true that the mandatory disclosure provisions of U.S. securities statutes seem to aim for a kind of information equality. As explained in Part V.B. below, however, the antifraud provisions used to justify liability for insider trading are fundamentally different from the mandatory disclosure provisions in federal securities law. The mandatory disclosure provisions clearly limit property rights in information to pursue a competing government objective.[100] However, courts consistently cite common law tort and agency principles aimed at protecting property and other private rights in order to flesh out the application of the antifraud provisions.[101] As demonstrated in Part V.A., courts continue to cite treatises that expound on private rights under common law to justify the application of federal antifraud provisions in insider trading cases. Yet, the conclusions drawn in insider trading cases are jarringly out of sync with the principles found in common law fraud cases. In addition, while the SEC has exercised the open-ended authority under Exchange Act § 10(b) to create rules aimed at punishing the use of "contrivances," those rules are not the ones used to impose liability for insider trading.[102]

Third, whatever the benefits, intentionally ambiguous securities law can only come at the expense of commitments to recognize the equal dignity of all citizens—including government officials. Officials have identified full and fair disclosure from securities

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> (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 . . . .

98. Lorenzo v. SEC, 203 L. Ed. 2d 484, 139 S. Ct. 1094, 1096 (2019) ("Dissemination of false or misleading statements with intent to defraud can fall within the scope of Rules 10b-5(a) and (c), as well as the relevant statutory provisions, even if the disseminator did not "make" the statements and consequently falls outside Rule 10b-5(b).").

99. West Virginia v. Fairchild, 298 S.E.2d 110, 129 (W. Va. 1982); *see also* Speed v. Transamerica Corp., 99 F. Supp. 808, 829 (D. Del. 1951); Cady, Roberts & Co., 40 S.E.C. 907, 913 (Nov. 8, 1961).

100. *See* Douglas, *supra* note 15, at 239–42 (distinguishing exceptions to general rules that "are authorized by an overarching policy objective that also justifies the general rule," and exceptions that are "authorized by a competing government interest").

101. *See* Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341 (2005) (describing private claims brought under section 10(b) of the Exchange Act and Rule 10b-5 as resembling "but is not identical to, common-law tort actions for deceit and misrepresentation."); *see also* Basic Inc. v. Levinson, 485 U.S. 224, 243 (1988) (describing reliance as an element of a Rule l0b-5 cause of action after accepting that "reliance is and long has been an element of common-law fraud").

102. *See infra* Part V.B.

issuers as the best tool for protecting the ordinary investor.[103] The SEC will bar a business from selling securities until that business' disclosure materials meet the SEC's standard of completeness.[104] At the same time, lawmakers pass intentionally vague laws, and administrative officials adopt intentionally vague regulations. Consider the catch-all provision of section 10(b) of the Exchange Act, which makes it illegal to engage in a "contrivance" meant to skirt rules adopted by the SEC.[105] Section 14(e) of the Exchange Act compounds this problem by authorizing the SEC to adopt rules and regulations that define which "acts and practices [are] fraudulent, deceptive, or manipulative" in the context of tender offers.[106] With this almost boundless grant of rule-making authority, the SEC adopted Rule 14e-3. Rule 14e-3(d) makes it illegal for anyone involved in a tender offer to "communicate material, nonpublic information relating to a tender offer to any other person under circumstances in which it is reasonably foreseeable that such communication is likely to result in a violation of this section except that this paragraph shall not apply to a communication made in good faith."[107] What does that mean? At a minimum, by neglecting to discuss whether information used with the owner's consent violates this provision, Rule 14e-3 is vague as to what would result in a violation of that section. Moreover, what would it mean to communicate the information in good faith?

Lawmakers and enforcement officials using intentionally vague statements of law to mandate full and fair disclosure seems like the kind of political indignity that early Americans fought when they rejected the absolute despotism of the British Parliament.[108] It also seems like the kind of principle that was abandoned when earlier political thinkers rejected the concept of the divine right of kings.[109] Historically, some believed "that no divine-right king could be bound by existing laws and customs."[110] Others believed "that if the king could do no wrong neither could a faithful subject acting upon his orders."[111] Do any other principles better describe the values implied by the passage of section 14(e) or Rule 14e-3?

Mandating the use of plain English when important civilians communicate yet encouraging ambiguity when government officials communicate fosters a two-tiered system that seems grossly unjust. To be specific, I mean "unjust" in two ways. Primarily,

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103. *See* H.R. 5480, 73rd Cong. (1st Session 1933) (The Securities Act of 1933 is self-described as an act to "provide full and fair disclosure of the character of securities . . . .").

104. Securities Release Notice, Release No. 47 (Sept. 22, 1933) (In 1933 the SEC declared that unless amended in accordance with its orders, it might refuse to permit some registration statements from becoming effective).

105. *See infra* notes 95 and 96 and accompanying text.

106. 15 U.S.C. § 78n.

107. 17 C.F.R. § 240.14e-3.

108. *See generally* THE DECLARATION OF INDEPENDENCE (U.S. 1776); *see also* Michael W. McConnell, *Establishment and Disestablishment at the Founding, Part I: Establishment of Religion*, 44 WM. &MARY L. REV. 2105, 2184–85 (2003) (describing the push for American independence as stronger among religious denominations that did not accept the divine right of kings or similar principles).

109. *See* JOHN LOCKE, SECOND TREATISE OF CIVIL GOVERNMENT § 1 (1690) (summarizing the first treatise of government: "All these premises having, as I think, been clearly made out, it is impossible that the Rulers now on Earth, should make any benefit, or derive any the least shadow of Authority from that, which is held to be the Fountain of all Power, Adam's private Dominion and paternal Jurisdiction").

110. JAMES VI ET AL., DIVINE RIGHT AND DEMOCRACY : AN ANTHOLOGY OF POLITICAL WRITING IN STUART ENGLAND 31 (David Wootton ed., 1986).

111. *Id.*

this two-tiered system is unjust because it treats government officials as fundamentally different from the civilian population. The work of government officials is dramatically different because it involves the use of physical coercion and threats of physical coercion to achieve its goals.[112] Nothing about that fact, however, implies that it is therefore okay for officials to be less clear or less honest in their communication. Second, this system is unjust in the sense conveyed in the unjust enrichment doctrine. It is widely accepted that American law does not generally recognize lawmakers or other officials as fiduciaries of the civilian population.[113] Therefore, civilian–principals have no standing to sue officials for breaches of the duties of care, loyalty, or good faith. If officials were fiduciaries, however, then intentionally passing ambiguous laws to trick voters into keeping them in office would likely qualify as a breach of all three duties. Using misrepresentations to obtain voter consent for the personal benefit of staying in office lacks the kind of informed consent required for fiduciaries to avoid liability for unjust enrichment and a breach of the duty of loyalty. Further, by definition, using intentional misrepresentations qualifies as acting in bad faith.[114] Finally, given the widespread disagreement over the definition of moral concepts, it is patently imprudent to use undefined moral concepts in official statements.[115]

Ultimately, lawmakers must acknowledge that there is more than one way to fail to achieve sophisticated and effective insider trading reform. Relying on simplistic analysis and ignoring the real complexity in a body of law will likely yield sophomoric conclusions. In addition, engaging in sophistry—finding complexity where it does not exist and drawing conclusions that bear no connection to reality—also undermines the development of sophisticated conclusions. This Article attempts to avoid both potential errors in uncovering the fatal ambiguity undermining insider trading laws.[116] To that end,

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112. *See* TARA SMITH, JUDICIAL REVIEW IN AN OBJECTIVE LEGAL SYSTEM 2–3 (2015) ("The government of a given society enjoys the exclusive authority to compel people to behave in certain ways by physical means—by guns, shackles, prisons. It may coerce compliance with its edicts.").

113. *See generally* Seth Davis, *The False Promise of Fiduciary Government*, 89 NOTRE DAME L. REV. 1145 (2014) ("Federal courts do not have unfettered authority to enforce freestanding fiduciary constraints on Congress and the executive as a matter of federal common law."). *But see* Evan J. Criddle, *Fiduciary Foundations of Administrative Law*, 54 UCLA L. REV. 117 (2006) (reframing the problem of agency discretion around the concept of fiduciary duty); Gary Lawson et al., *The Fiduciary Foundations of Federal Equal Protection*, 94 B.U. L. REV. 415 (2014) (describing the Constitution as a fiduciary document requiring equal protection of all citizens); Ethan J. Leib et al., *Translating Fiduciary Principles into Public Law*, 126 HARV. L. REV. F. 91 (2013) (applying fiduciary political theory to redistricting); Ethan J. Leib & Stephen R. Galoob, *Fiduciary Political Theory: A Critique*, 125 YALE L.J. 1820 (2016) (assessing the utility and limitations of fiduciary political theory).

114. *See* RESTATEMENT (SECOND) OF TORTS: LIABILITY FOR FRAUDULENT MISREPRESENTATION § 525 (AM. L. INST. 1977).

115. If we analogize government officials to trustees, imprudence is enough to face liability for a breach of care. If we analogize to corporate directors, however, then government officials would only face liability for gross negligence. To avoid liability for gross negligence, corporate fiduciaries must be reasonably informed about all relevant facts before making official decisions; however, these cases are generally decided under the business judgment rule and do not require a specific course of action based on any given information.

116. However, I understand that where I have tried to avoid sophistry, my analysis will seem simplistic, and where I have tried to avoid being sophomoric, my analysis will seem like sophistry. If I am correct, I can only hope that the average reader finds my analysis persuasive. If I am incorrect, I hope that I have provided enough information to allow some generous reader to help me to understand the source of my error. Thank you

Part V moves from the abstract to the concrete by cataloging how the historical development of insider trading law embodies fatally ambiguous moral concepts at every turn.

V. Fatal Ambiguity Expressed by Every Branch of Government

Recall that many attribute the confusion in the law to courts and enforcement officials pursuing contradictory approaches to insider trading.[117] Professor Anderson explains the incoherence as resulting from "the SEC and federal prosecutors [pressing] for an equal access regime," while federal courts remain "committed to the fiduciary-cum-fraud-based model."[118] An early example of this conflict is the SEC's response to the U.S. Supreme Court's holding that "warehousing" was not illegal under prevailing securities law. In securities markets, warehousing involves one investor giving "advance notice of its intention to launch a tender offer to institutional investors who then are able to purchase stock in the target company before the tender offer is made public and the price of shares rises."[119] In *Chiarella*, the Court affirmed that warehousing is not a violation of Rule 10b-5.[120] This position on warehousing implied that defendants could avoid liability for insider trading by obtaining the information owner's consent before trading. The SEC responded by passing Rule 14e-3, which limits warehousing under separate rule-making authority.[121] The conflict between courts and enforcement officials is also demonstrated in the SEC's adoption of Regulation FD, which prohibits selective disclosure by issuers.[122] Regulation FD directly contradicts *Dirks v. SEC*, in which the Supreme Court declared that it is possible for an insider to "act consistently with his fiduciary duty to shareholders" while engaged in selective disclosure.[123] In *Dirks*, the Court defends its attempt to limit the scope of insider trading liability by arguing that Congress has recognized "that [market professionals] contribute to a fair and orderly marketplace at the same time they exploit the informational advantage that comes from their possession of [nonpublic information]."[124]

This regulatory ping-pong match between courts and enforcement officials has overshadowed the internal conflicts expressed by each institution and by individual

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to all of my previous readers and conversation partners.

117. *See supra* notes 8–12 and accompanying text (discussing the nature of duties related to disclosure and Material Non-Public Information).

118. ANDERSON, *supra* note 1, at 93.

119. Chiarella v. United States, 445 U.S. 222, 234 (1980).

120. *Id.*

121. *Id.* ("Significantly, however, the Commission has acted to bar warehousing under its authority to regulate tender offers after recognizing that action under § 10(b) would rest on a 'somewhat different theory' than that previously used to regulate insider trading as fraudulent activity.") (internal footnotes omitted); *see also* 17 C.F.R. § 240.14e-3 (2022) (Rule 14e-3).

122. 17 C.F.R. § 243.100–103 (2021).

123. *Compare* 17 C.F.R. § 243.100 (requiring issuers to publicly disclose information if they have disclosed such information to brokers, investors, and others in like professions), *with* Dirks v. S.E.C., 463 U.S. 646, 657 n.16, 662 (1983) (stating that, in many cases, the corporate insider may be unsure if information is material or already disclosed, and that determining whether the insider personally benefits is valuable in determining liability).

124. *Dirks*, 463 U.S. at 657 n.16 (alterations in original).

officials. A closer look at official statements on insider trading allows us to see that individual officials consistently invoke fatally ambiguous definitions of fairness. Useful inferences about the moral principles at work can be made by focusing on the actions required before a fiduciary can receive a personal benefit from using their principal's assets. In addition, we can draw valuable inferences by looking for which private parties have standing to sue and which private parties face liability for violating insider trading law.

A. Justices Powell and Ginsburg Demand Disclosure Without Consent

Justice Powell's majority opinion in *Chiarella* is the clearest example of an individual official's attempt to simultaneously apply conflicting definitions of fairness. Although the term "consent" is never used, the opinion makes powerful strides toward limiting the scope of insider trading liability to cases where defendants violate property-based fairness doctrines. He begins by declaring that "not every instance of financial unfairness constitutes fraudulent activity under § 10(b)."[125] He continues by rejecting the recognition of "a general duty between all participants in market transactions to forgo" trading when in possession of a material information advantage.[126] In addition, Justice Powell cites the *Restatement (Second) of Torts* as providing the guiding principles for the scope of the applicable fiduciary obligations.[127] Reference to the Restatement is significant because that treatise identifies consent as a universal defense against tort liability.[128] He concludes that any dramatic departure from established doctrine "should not be undertaken absent some explicit evidence of congressional intent."[129]

Recall that in this opinion, Justice Powell emphasized that warehousing is not unlawful under Rule 10b-5.[130] More than consenting to the use of their nonpublic information, warehousing involves the party staging a tender offer *asking* certain investors to purchase the target stock before the offer is announced to the public.[131] This defense of warehousing implies that owners of inside information—like owners of other trade secrets—are free to license third parties to trade on their confidential business information.

Justice Powell's reliance on tort doctrine and his defense of warehousing imply that fiduciaries can avoid insider trading liability by obtaining the information owner's

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125. Chiarella v. United States, 445 U.S. 222, 232 (1980).

126. *Id.* at 233.

127. *Id.* at 228 (citing RESTATEMENT (SECOND) OF TORTS: LIABILITY FOR NONDISCLOSURE §551(2)(a) (AM. L. INST. 1976); *see also* United States v. Chestman, 947 F.2d 551, 557–58 (2d Cir. 1991) (discussing enforcement cases that the SEC lost due to the courts' common law interpretations of fiduciary relationships).

128. *See* RESTATEMENT (SECOND) OF TORTS: EFFECT OF CONSENT § 892A (AM. L. INST. 1979) (describing consent as one of several defenses applicable to all tort claims); *see also* Jordan v. Duff and Phelps, Inc., 815 F.2d 429, 436 (7th Cir. 1987) ("Section 29(a) of the Securities Exchange Act of 1934 . . . forbids waivers of the provisions of the Act, and here the critical provision is [§ 10(b) and the SEC's Rule 10b-5]. . . . [However, the] obligation to break silence is itself based on state law, see *Dirks*, *Chiarella*, and *Barker*, and so may be redefined to the extent state law permits.")

129. *Chiarella*, 445 U.S. at 233.

130. *Id.*

131. *See supra* note 119 and accompanying text.

consent.[132] Further, this implies that Justice Powell considered this body of law animated by the property-based fairness doctrine found in unjust enrichment and business opportunity cases. Nevertheless, Justice Powell's description of the actions required by fiduciaries before trading on their principal's information becomes doctrinally "fair" is completely at odds with protecting property rights in confidential business information. He adopted the two-part test for insider trading liability published by the SEC in a 1961 administrative release.[133] It declares that an insider's obligation to disclose all material information or abstain from trading "arose from (i) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure."[134] The first part looks like a quintessential application of the unjust enrichment doctrine and seems aimed at protecting the corporation's property rights in information. The second part, however, does not call for informed consent to make the transaction fair. Instead, the second prong requires disclosure to the general public, which does nothing to protect the property rights of the principal. This disconnect between disclosure and consent is especially troubling in those cases where the information's value depends partly on its secrecy. Consider the common case of a mining company making a significant mineral discovery and taking steps to quietly buy up the mineral rights before their competitors can swoop in.[135] Having an insider disclose this discovery to the public before buying his company's stock would only undermine the successful acquisition of the mineral rights.

It is tempting to view Justice Powell's treatment of disclosure as an application of the doctrine that fiduciary-principals only need to disclose the existence of a business opportunity to their fellow fiduciaries before it becomes doctrinally "just" to take a business opportunity for themselves. In the classic *Meinhard v. Salmon*, Chief Judge Cardozo declared that the active partner need only disclose the existence of the partnership opportunity to his silent partner before he could take advantage of the opportunity to manage a larger office building that would overlap the original site of the partners' business.[136] According to the New York Court of Appeals, "only through disclosure could opportunity be equalized."[137] A similar approach is implied by the court in *Speed v. Transamerica Corp.*, which Justice Powell cites as authority for the conclusion that disclosure is required to prevent insiders from taking "unfair advantage

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132. This implication also applies to criminal cases of fraudulent nondisclosure, where consent is not a defense against liability. *See* RESTATEMENT (SECOND) OF TORTS: CONSENT TO CRIME § 892C (AM. L. INST. 1979) ("[T]he consent of the individual is ordinarily no bar to a criminal prosecution, except as it may be made one by a definition of the crime or by rules of the criminal law applicable to particular offenses."); *see also* Keith M. Harrison, *Law, Order, and the Consent Defense*, 12 ST. LOUIS U. PUB. L. REV. 477, 478 (1993) ("Generally the consent of an individual victim of a crime will not operate as a defense to a criminal prosecution unless the lack of the individual victim's willing, capable, and informed consent is an element of the charged offense, such as in the crimes of rape or larceny.").

133. Cady, Roberts & Co., Exchange Act Release No. 34-6668, 1961 WL 60638, at *4 (1961).

134. Chiarella v. United States, 445 U.S. 222, 227 (1980).

135. *See generally* SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968); Goodwin v. Agassiz, 186 N.E. 659 (Mass. 1933) (illustrating cases where mining companies quietly acquired mineral rights).

136. Meinhard v. Salmon, 164 N.E. 545, 547 (N.Y. 1928).

137. *Id.*

of the uninformed minority stockholders."[138] In *Speed*, the court described the disclosure requirement as "an attempt to provide some degree of equalization of bargaining position" between insiders and outsiders in transactions that involve a conflict of interest.[139] Because principals have a superior legal title to the assets covered by the fiduciary relationship, the goal of equalizing opportunities or bargaining power between insiders and outsiders may only make sense in cases where the insider is a fiduciary–principal. In these cases, courts may consider requiring disclosure alone (not informed consent) as sufficient to protect the property interests that co-owners have in business opportunities.

Justice Powell, however, did not stop at describing the duty to disclose as aimed at protecting minority shareholders. He also described the duty as applicable to a "sale of stock to persons who previously may not have been shareholders in the corporation."[140] Requiring disclosure to the public effectively promotes the commitment to the equal-information concept of fairness that Justice Powell claimed Congress had never adopted.[141] *Meinhard* and *Speed* limit their attempts to equalize the business opportunity to the co-owners of the business. However, Justice Powell's approach implicitly promotes a fairness doctrine that requires equal trading opportunities for all market participants.

Justice Ginsburg's majority opinion in *O'Hagan* continued the trend of attempting to make simultaneous commitments to these mutually exclusive fairness doctrines. Recall that the Court in *O'Hagan* adopted the misappropriation theory of insider trading liability.[142] The commitment to a property-based fairness doctrine does not end with the name of the theory. In *O'Hagan*, Justice Ginsburg declared that a "company's confidential information qualifies as property to which the company has a right of exclusive use; the undisclosed misappropriation of such information constitutes fraud akin to embezzlement."[143] Analogous to Justice Powell's reliance on common law tort doctrine to explain the scope of liability, Justice Ginsburg cited the Restatements and described the duty to disclose or abstain in misappropriation theory cases as an extension of common law agency doctrine.[144] Moreover, like Justice Powell, Justice Ginsburg attempted to limit the scope of liability by declaring that it was not always illegal to trade with an information advantage. She declared that the misappropriation theory only targets information advantages obtained "from contrivance, not luck; it is a disadvantage that cannot be overcome with research or skill."[145]

Under the misappropriation theory, disclosure may only indirectly promote equal-information fairness, but the departure from property doctrine is stark. To avoid liability

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138. *Chiarella*, 445 U.S. at 228–29 (1980) (citing Speed v. Transamerica Corp., 99 F. Supp. 808, 829 (D. Del. 1951)).

139. *Speed*, 99 F. Supp. at 829.

140. *Chiarella*, 445 U.S. at 227 n.8.

141. *Id.* at 233.

142. *See supra* Part II (explaining the misappropriation theory and *O'Hagan*'s role in developing the theory).

143. United States v. O'Hagan, 521 U.S. 642, 643 (1997).

144. *Id.* at 654–55, 655 n.6.

145. *Id.* at 659.

under the misappropriation theory, instead of consent, fiduciaries need only disclose to their employers that they intend to trade on the employer's information in securities markets.[146] Although the defense does not require disclosure to the public at large, eliminating the need for employer consent in all misappropriation theory cases—not just cases involving a fiduciary–principal—undermines the legal protections for the information owner. Making disclosure alone a defense against liability under the misappropriation theory effectively allows a defendant to avoid liability for stealing inside information by first disclosing his intent to steal the information. Moreover, combined with Exchange Act sections 20A and 21A,[147] which impose liability on employers who do not do enough to prevent their employees from engaging in insider trading, the current law effectively requires employers to act as deputies in enforcing a prohibition on its employees trading with information advantages.[148]

Justice Ginsburg declared that insider trading under the misappropriation theory "both deceives the source of the information and harms members of the investing public."[149] This dual perspective on who is injured by insider trading is in accord with the divided loyalty found in Justice Powell's two-part test for liability under the classical theory. In classical theory cases, Powell and the SEC rationalized recognizing insiders as having fiduciary duties to non-shareholders before a sale based on the fact that the sale itself would create a fiduciary relationship between the two parties.[150] In misappropriation theory cases, the defendants owe no fiduciary obligation to the counterparties before or after the transactions. Justice Ginsburg even acknowledged that, in misappropriation cases, "the person or entity defrauded is not the other party to the trade."[151] Describing all "members of the investing public" as harmed by the violation of a single business' property rights in confidential business information supports the conclusion that an equal-information fairness doctrine also animates Justice Ginsburg's articulation of the misappropriation theory of insider trading liability.[152]

Outside of insider trading cases, trading with an information advantage is generally protected by trade secret law. What is viewed as unfair outside of securities trading is misappropriating—not using—a trade secret.[153] Trade secrets law is even used to protect the property rights that Wall Street firms have in their high-frequency trading computer

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146. *Id.* at 654 ("To satisfy the common law rule that a trustee may not use the property that [has] been entrusted [to] him, there would have to be consent. To satisfy the requirement of the Securities Act that there be no deception, there would only have to be disclosure.") (alterations in original).

147. 15 U.S.C. § 78t-1 (see the discussion of controlling person liability in subsection 20A(b)(3)); 15 U.S.C. § 78u-1 (see the discussion of controlling person liability in subsection 21A(a)(3)).

148. Stephen Wilks, *Sheriffs, Shills, or Just Paying the Bills? Rethinking the Merits of Compelling Merchant Co-operation with Third-Party Policing in the Aftermath of George Floyd's Death*, 79 WASH. & LEE L. REV. (forthcoming 2023).

149. *Id.* at 643–44.

150. Chiarella v. United States, 445 U.S. 222, 227 n.8 (1980) (quoting Cady, Roberts & Co., Exchange Act Release No. 34-6668, 1961 WL 60638, at *3 (Nov. 8, 1961)).

151. *O'Hagan*, 521 U.S. at 656.

152. However, as explained *infra* Part III of this Article, the view that the general public is injured by informed trading may be derivative of the deeper, unexamined presumption that prices can be correct or incorrect.

153. RESTATEMENT (THIRD) OF UNFAIR COMPETITION: IMPROPER ACQUISITION OF TRADE SECRETS § 43 (AM. L. INST. 1995).

code.[154] In addition, the *Restatement (Second) of Torts* differentiates between injuries to a legally protected interest and harm in general, "which may not necessarily [involve] the invasion of a legally protected interest."[155] The *Restatement (Third) of Unfair Competition* makes a similar "distinction between 'good faith' competition, which would not subject the actor to liability even if motivated in part by ill-will toward the other, and 'simulated competition' that was undertaken merely as a means of inflicting harm."[156] Moreover, despite the classical theory of liability identifying inside information as intended for the corporation's benefit, a series of federal court decisions have identified these corporations as subject to the same legal obligations and liabilities under Rule 10b-5 as their employees.[157] So whether or not they make the formal disclosures required before buying or selling securities under other provisions of federal securities regulations, courts have determined that these companies are liable for insider trading if they trade in their own securities while in possession of material nonpublic information.

B. SEC Officials Attempt and Fail to Completely Redefine "Fairness"

Like the judiciary, enforcement officials consistently attempt to simultaneously rely on both property-based fairness doctrines and equal-information fairness doctrines in explaining liability for insider trading. The conflict becomes obvious by considering the kinds of statutes and agency rules available to the SEC and comparing them to the kinds of statutes and rules applied in insider trading cases. Federal securities statutes can be divided into two categories: (1) antifraud provisions and (2) mandatory disclosure provisions. Courts generally declare that interpreting the antifraud provisions requires some adherence to common law principles.[158] As explained in Part II of this Article, officials generally reference the antifraud provisions to justify the prohibition on insider trading. As a result, in Justice Powell's opinion restricting the prohibition, he explained how his approach was in harmony with the definition of fraudulent nondisclosure found in the *Restatement of Torts*.[159] When Justice Ginsburg allowed an expansion of the prohibition, she explained how her approach was in harmony with the definition of embezzlement found in the *Restatement (Second) of Agency*.[160] The mandatory disclosure provisions are understood by courts to explicitly modify or eliminate property and other private rights recognized under state law and common law. For example, as discussed above, the SEC adopted Rule 14e-3 to restrict warehousing in response to the

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154. *See generally* United States v. Agrawal, 726 F.3d 235 (2d Cir. 2013) (affirming conviction of defendant for violating the Economic Espionage Act when he stole and converted a confidential computer code/trade secret and placed it in interstate commerce).

155. RESTATEMENT (SECOND) OF TORTS: INJURY AND HARM § 7 cmt. a (AM. L. INST. 1965).

156. RESTATEMENT (THIRD) OF UNFAIR COMPETITION: GENERAL PRINCIPLES § 1 (AM. L. INST. 1995).

157. McCormick v. Fund Am. Cos., Inc., 26 F.3d 869, 876 (9th Cir. 1994) ("Numerous authorities have held or otherwise stated that the corporate issuer in possession of material nonpublic information, must, like other insiders in the same situation, disclose that information to its shareholders or refrain from trading with them.").

158. *See* Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341 (2005) ("The courts have implied from these statutes and Rule a private damages action, which resembles, but is not identical to, common-law tort actions for deceit and misrepresentation.").

159. *See supra* notes 127–129 and accompanying text.

160. United States v. O'Hagan, 521 U.S. 642, 654–55 (1997).

DOJ and Supreme Court concluding that the activity is not prohibited under Rule 10b-5.[161] The majority in *O'Hagan* described the restrictions imposed by Rule 14e-3 as "a proper exercise of the SEC's prophylactic power under § 14(e)."[162] Starting by recognizing that prophylactics properly restrict more than the core activity prohibited, the Court concluded that Rule 14e-3 is "'reasonably designed to prevent' fraudulent trading" on inside information.[163]

Given the conflict between common law fraudulent nondisclosure cases and the "disclose or abstain" rule found in insider trading cases, readers should not be surprised that grounding insider trading restrictions on Rule 10b-5 and other antifraud provisions may not have been the SEC's first choice. In *Insider Trading: Law, Ethics, and Reform*, Anderson shows that months before the SEC first declared insider trading a form of securities fraud in an administrative release, the agency made a failed attempt to restrict insider trading using section 16(b) of the Exchange Act—a mandatory disclosure provision.[164] Before 1984, section 16(b)'s regulation of short-swing profits was the closest thing to a statutory restriction on insider trading.[165] Section 16(b) allows the shareholders of publicly traded companies to bring derivative suits against a company's directors, officers, and principal investors to disgorge profits generated by sales of the company's stock made less than six months after purchases of the company's stock.[166]

In August 1961, the SEC filed an amicus brief in the case of *Blau v. Lehman*, asking the U.S. Supreme Court to expand the reach of section 16(b) disgorgement powers to reach outside affiliates of a company's directors or officers who realize short-swing profits when trading in the company's stock.[167] The facts resembled an insider trading case involving tipper-tippee liability. In December 1961, the Court rejected the commission's request for two reasons.[168] First, the Court recognized that language conveying the interpretation of section 16(b) advocated by the commission "was considered and rejected by Congress when it passed the Act."[169] Second, the Court concluded that "Congress is the proper agency to change an interpretation of the Act unbroken since its passage."[170]

In November 1961, before the Court in *Blau* published its rejection of the SEC's request to expand the application of section 16(b), the SEC published its oft-cited *Cady, Roberts* administrative release[171] and a separate order in the same case.[172] The analysis in

161. *See supra* notes 119–121 and accompanying text.

162. *O'Hagan*, 521 U.S. at 645 (1997).

163. *Id.* at 672.

164. ANDERSON, *supra* note 1, at 32–33.

165. Securities Exchange Act of 1934 § 16(b), 15 U.S.C. § 78p(b).

166. *Id.*

167. Brief for the SEC as Amicus Curiae at *8–22, Blau v. Lehman, 368 U.S. 403 (1962) (No. 66), 1961 WL 102336.

168. *Blau*, 368 U.S. at 411–12.

169. *Id.* at 412.

170. *Id.* at 413.

171. Cady, Roberts & Co., Exchange Act Release No. 34-6668, 1961 WL 60638, at *3 (Nov. 8, 1961).

172. *See generally* Cady, Roberts & Co., Exchange Act Release File No. 8–3925, 1961 WL 59902 (Nov. 8, 1961) [hereinafter Cady Roberts: Suspension Order] (order suspending Cady, Roberts & Co. from the National Securities Exchange).

the release may be the earliest example of officials citing statutes aimed at protecting property rights for the authority to mandate the distribution of confidential business information to the public. In 1961, the SEC imposed insider trading liability for the first time on the brokerage firm Cady, Roberts & Co. and one of its partners, Robert M. Gintel.[173] Although the defendants settled with the SEC, the agency published an administrative release explaining why it thought that federal antifraud provisions impose liability for an activity explicitly recognized as non-fraudulent under common law.[174] The SEC's explanation amounts to the conclusion that federal securities law dramatically expands the scope of which market participants are owed fiduciary obligations by the insiders of public companies.

Before *Cady, Roberts*, most state courts determined that corporate insiders (by default) only owe fiduciary obligations to the corporate entity, not shareholders.[175] Therefore, when insiders bought or sold securities from an outside investor while face-to-face, the insider had no duty to disclose any material information that would impact the outsider's decision. *Goodwin v. Agassiz* is likely the only state supreme court commentary on the issue of insider trading over an anonymous exchange published before *Cady, Roberts*.[176] In *Goodwin*, two directors of the Cliff Mining Company (the defendants) anonymously purchased stock from the plaintiff without first disclosing information about a potential mineral discovery. The plaintiff claims that this violated his rights. Massachusetts's highest court upheld an earlier decision concluding that "[e]very element of actual fraud or misdoing by the defendants is negatived by the findings."[177] The court also applied the majority rule, concluding that the directors were under no obligation to share any information before trading with shareholders.[178]

The decisions in *Blau* and *Chiarella* demonstrate a long-standing commitment by federal courts to reject departures from common law rules without Congress' explicit authorization.[179] The *Cady, Roberts* release demonstrates that the SEC understood its interpretation of the antifraud provisions as a departure from common law rules.[180] In an

173. *Id.*

174. *See* Cady, Roberts & Co., Exchange Act Release No. 34-6668, 1961 WL 60638, at *5.

175. Goodwin v. Agassiz, 186 N.E. 659, 660 (Mass. 1933) ("'The fact that the defendants were directors created no fiduciary relation between them and the plaintiff in the matter of the sale of his stock.' The principle thus established is supported by an imposing weight of authority in other jurisdictions. A rule holding that directors are trustees for individual stockholders with respect to their stock prevails in comparatively few states . . . .") (citations omitted).

176. *Goodwin v. Agassiz* was decided by the Massachusetts Supreme Court in 1933. *Id.* at 660.

177. *Id.* at 661.

178. *Id.* at 660 ("The contention that directors also occupy the position of trustee toward individual stockholders in the corporation is plainly contrary to repeated decisions of this court and cannot be supported.").

179. The commitment has been partial and contested. *See* Pritchard, *supra* note 10, at 927 (describing a 1963 Supreme Court holding that the antifraud provision in the Investment Advisers Act did not require the SEC to establish an intent to deceive, which would have been required under common law).

180. Cady, Roberts & Co., Exchange Act Release No. 34-6668, 1961 WL 60638, at *5 (Nov. 8, 1961) ("Whatever distinctions may have existed at common law based on the view that an officer or director may stand in a fiduciary relationship to existing stockholders from whom he purchases but not to members of the public to whom he sells, it is clearly not appropriate to introduce these into the broader anti-fraud concepts embodied in the securities acts.").

attempt to provide statutory support for this departure, the SEC cited an opinion written by Judge Learned Hand in which he praised federal securities law for correcting what he described as "a grave omission in our corporation law."[181] In that opinion, however, Judge Learned Hand was deciding a case that applied section 16(b) of the Exchange Act and was explicitly praising the effects of that provision on corporate law.[182] The SEC cited Judge Learned Hand's comments as statutory support for a dramatic departure from common law fraud doctrine in securities transactions generally. These comments, however, were only dicta expressing a prominent judge's personal approval of the effects of a specific federal statute that explicitly calls for mandatory disclosure in a limited set of circumstances. Moreover, the statute praised by Judge Learned Hand was not the statute that the SEC relied on to impose liability against Cady, Roberts & Co.[183]

In the absence of statutory support, readers should expect the SEC's explanation of its departure from the common law approach to insider trading to describe how it protects the legal or equitable property interests of the corporation or its shareholders. Instead, the SEC offers several assertions that clearly embody commitments to information equality. For example, the SEC states the obvious fact that non-shareholders would have traded differently if they had been told the information in question.[184] While true, taking this fact as evidence that the trades were "fraudulent" is at odds with the principle identified in cases like *Laidlaw v. Organ* and reaffirmed by the Supreme Court in *O'Hagan*—not all information asymmetries are illegal.[185]

That the *Cady, Roberts* administrative release cites property-based statutes and rules in an effort to promote information equality may make sense as an incomplete attempt by one enforcement official to quietly—but dramatically—shift the moral commitments at work in U.S. securities markets. The opinion was authored by William Cary, former Chairman of the SEC. The next year, Cary published a law review article declaring his firm belief "that a proper function of the Securities and Exchange Commission is to raise [ethical] standards in the industry."[186] He goes on to acknowledge and lament that state corporate law generally uses disclosure to obtain the right kind of consent.[187] He then praises federal law for emphasizing "the positive aspects of disclosure and compelling disclosure to the public generally, as compared to a limited group."[188] Finally, without acknowledging his role in the process, Cary celebrates that:

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181. *See id.* at *5 n.23 (citing Gratz v. Claughton, 187 F.2d 46, 49 (2d Cir. 1951), *cert. denied*, 341 U.S. 920 (1951)).

182. *Id.* (stated in the context of § 16(b) of the Exchange Act).

183. Cady, Roberts & Co., Exchange Act Release No. 34-6668, 1961 WL 60638, at *1 (Nov. 8, 1961) ("These proceedings were instituted to determine whether [the defendants] willfully violated the 'anti-fraud' provisions of Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act'), Rule 10b-5 issued under that Act, and Section 17(a) of the Securities Act of 1933 ('Securities Act') . . . .").

184. *Id.* at *5 ("If purchasers on an exchange had available material information known by a selling insider, we may assume that their investment judgment would be affected and their decision whether to buy might accordingly be modified.").

185. Laidlaw v. Organ, 15 U.S. 178, 193 (1817); United States v. O'Hagan, 521 U.S. 642, 659 (1997).

186. William L. Cary, *Corporate Standards and Legal Rules*, 50 CALIF. L. REV. 408, 408 (1962).

187. *Id.* at 410 ("If, however, there is disclosure of an adverse interest, plus condonation by an independent body (either the board of directors or shareholders), the prohibitions against dealing may dissolve.").

188. *Id.*

> [In] the recent case of *Cady, Roberts & Co.*, the [SEC], for the first time, said that the duty of insider disclosure or—in the alternative—of abstinence applied in an exchange market and that it was a fraudulent practice to sell a security while in possession of inside information in a faceless transaction as well as face-to-face.[189]

Why should readers think that Cary was using his *Cady, Roberts* release to quietly shift the definition of fraud under federal securities law? Suppose the Supreme Court in *Blau* was correct and "that Congress is the proper agency to change an interpretation of the Act unbroken since its passage."[190] Also, suppose that Justice Powell was correct to conclude that dramatic departures from established doctrine "should not be undertaken absent some explicit evidence of congressional intent."[191] If both opinions are correct, Cary's efforts to apply the antifraud provisions in a way that contradicted almost 30 years of case law look like a conscious attempt to sidestep Congressional approval.

The adoption of Rule 10b5-2 follows the process of citing property-focused statutes and rules for the authority to penalize material information advantages and unequal trading opportunities.[192] As described above, Justice Powell attempted to limit insider trading liability to cases that involve a breach of a fiduciary duty of loyalty.[193] As a consequence, enforcement officials lost several cases when courts determined that marriages and club memberships are not fiduciary relationships as understood by common law.[194] In response, the SEC adopted Rule 10b5-2 to redefine most family relationships and any business relationship that includes a nondisclosure agreement as creating "duties of trust or confidence" for the purposes of insider trading liability under Rule 10b-5. There are obviously property interests associated with every marriage and almost every long-term contract. Yet, these interests are far from the kind of legal title held by principals or equitable title held by beneficiaries in the agency and trust relationships recognized in common law as fiduciary relationships.[195] It is more than reasonable to conclude that the SEC passed Rule 10b5-2 and related regulations to move the law closer to an equal-information standard of fairness. The release explaining the rule describes it as required to protect "the market and investor confidence," not the property rights of legal or equitable owners of inside information.[196] What should be controversial is that the SEC relied on provisions aimed at protecting exclusive-use

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189. *Id.* at 415–16.

190. Blau v. Lehman, 368 U.S. 403, 413 (1962).

191. Chiarella v. United States, 445 U.S. 222, 233 (1980).

192. 17 C.F.R. § 240.10b5-2 (2009).

193. *See supra* notes 9–10 and accompanying text.

194. *See supra* note 11.

195. *See* RESTATEMENT (SECOND) OF AGENCY: HUSBAND AND WIFE AS PRINCIPAL AND AGENT § 22 cmt. b (AM. L. INST. 1958) ("Neither husband nor wife by virtue of the relation has power to act as agent for the other."). *But see* Joan MacLeod Heminway, *Women Should Not Need to Watch Their Husbands Like [a] Hawk: Misappropriation Insider Trading in Spousal Relationships*, 15 TENN. J.L. & POL'Y 162, 214 (2020) (providing support for "enforcement actions based on a strong threshold presumption of a relationship of trust and confidence in spousal relations, as recognized by the SEC through its adoption of Rule 10b5-2(b)(3)").

196. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51716-01, 51729 (Aug. 24, 2000) ("The family member's trading has the same impact on the market and investor confidence in the third example as it does in the first two examples.").

rights to foster a fairness doctrine that requires information and other forms of economic equality.

When enforcement officials lost several cases that tried to expand the scope of who qualifies as a fiduciary, the SEC could have responded with rules that referenced a given mandatory disclosure provision in the securities statutes for authority. The agency did this when it adopted Rule 14e-3 to restrict warehousing in response to the Supreme Court and DOJ recognizing that the activity is not prohibited under Rule 10b-5.[197] The SEC also took this approach by citing mandatory disclosure provisions for the authority to adopt Regulation FD, which prohibits the selective disclosure that Justice Powell defended in his *Dirks* opinion.[198] Moreover, it would be reasonable to view section 10(b) of the Exchange Act as authorizing the SEC to create something akin to Rule 10b5-2 if under a different name. That statute does more than prohibit the use of "manipulative or deceptive" devices in the purchase or sale of securities. Section 10(b) arguably provides the SEC with the open-ended authority to prohibit any "*contrivance in contravention* of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."[199] Therefore, maybe a hypothetical "Rule 10b-2" could have been adopted to expand the definition of "fiduciary" for the purpose of preventing the use of "contrivances" to skirt the restrictions recognized under Rule 10b-5.

The problem with Rule 10b5-2 is the nominal reference to Rule 10b-5, which was modeled on section 17 of the Securities Act—an antifraud provision. Both provisions are clearly aimed at protecting property rights—not fostering the redistribution of information and trading opportunities. Like its predecessor, Rule 10b-5 only prohibits the use of deception or fraud in connection with the purchase or sale of securities. And unlike its siblings, Rules 10b-1 and 10b-3, Rule 10b-5 does not mention "contrivances." Ultimately, it is the practice of referencing property-focused statutes and rules while simultaneously calling for actions that foster information equality that makes the SEC's approach to insider trading fatally ambiguous. As Congress expressed by passing the Stolen Valor Act of 2013, words and labels matter.[200] Even if unintentional, relying on the cultural cache that Americans place on property rights to punish forms of economic inequality seems almost as troubling as impersonating a war hero to swindle people out of money.[201]

197. *See supra* notes 120–121 and accompanying text.

198. *See supra* notes 122–124 and accompanying text.

199. Exchange Act § 10(b), 17 C.F.R. § 240.10b-5 (2020); *see also* Fisch, *supra* note 76, at 757 (stating that because § 10(b) is an "open-textured statute," its interpretation requires the courts to engage in the more expansive interpretive exercise associated with common law adjudication).

200. *See* Stolen Valor Act of 2013, 18 U.S.C. § 704 (imposing fines and imprisonment for fraudulently wearing a military medal "to obtain money, property or other tangible benefit").

201. It may be more troubling since insider trading defendants can face decades in prison. *See, e.g.*, David S. Hilzenrath, *Raj Rajaratnam, Hedge Fund Billionaire, Gets 11-Year Sentence for Insider Trading*, WASH. POST (Oct. 13, 2011), https://www.washingtonpost.com/business/economy/hedge-fund-billionaire-gets-11-year-sentence-in-fraud-case/2011/10/13/gIQAa0PZhL_story.html [https://perma.cc/FU8P-9V9Q] (citing a convicted trader who received an eleven-year prison sentence).

C. Congress Blames Victims and Provides Strangers with Standing

Congress' attempts at insider trading reform during the 1980s continued the pattern of citing property-focused law for the authority to impose liability on investors who benefit from certain kinds of economic advantages. Recall that the legal test for insider trading adopted by the SEC's *Cady*, *Roberts* release and Justice Powell's opinion in *Chiarella* begin by justifying insider trading liability as a response to a fiduciary's misuse of "information intended to be available only for a corporate purpose."[202] Since *Chiarella*, Congress has twice passed legislation to increase the penalties for insider trading and to broaden the scope of illegal behavior. The legislative history documents Congress' knowledge that insider trading cases were primarily brought under property-focused statutes.[203] Yet, both reform efforts added features that conflict with basic elements of property rights.

In 1984, lawmakers passed section 21A of the Exchange Act to impose vicarious liability on employers and other controlling persons who fail "to take appropriate steps to prevent" likely acts of insider trading.[204] If insider trading is illegal partly because it violates an employer's rights to inside information, why should employers be liable for their employee's illegal trading? If we take the view of information advantages expressed in trade secret law, then the liability imposed under section 21A is analogous to parents facing liability if their babysitter steals their jewelry and then sells the jewelry to a bona fide purchaser for value. For section 21A to make sense, we must consider insider trading more akin to the unlawful use of a stolen weapon and the parents as negligent in failing to secure that weapon. However accurate the view that informed trading can harm less-informed investors, section 21A has the effect of fostering commitments to equality of information while depending on the violation of some party's exclusive-use rights in confidential information. Moreover, even if few employers have faced liability for the illegal trading of their agents, the threat of liability likely deters many employers from experimenting with inside information as a form of consideration.[205]

In 1989, Congress passed section 20A of the Exchange Act, which creates standing for private parties who trade contemporaneously with, and in opposition to, someone who engages in insider trading.[206] The confusion created by section 20A is especially jarring in the context of misappropriation theory cases in which an insider of one company purchases the securities of a second company. Recall that insider trading is described as unlawful under misappropriation theory because employees are defrauding

202. Chiarella v. United States, 445 U.S. 222, 227 (1980).

203. H.R. Rep. No. 100-910, at 8 (1988) ("Although there is no statutory 'definition' of insider trading, this activity is prescribed by provisions of the securities laws, including Section 17(a) of the Securities Act, Sections 10(b) and 14(e) of the Securities Exchange Act of 1934, and Section 206 of the Investment Advisers Act, and the case law that has developed over time interpreting those provisions.").

204. Exchange Act § 21A, 15 U.S.C. § 78u-1.

205. *See supra* note 87 and accompanying text; *see also* Henry G. Manne, *Insider Trading and Property Rights in New Information*, 4 CATO J. 933, 935–36 (1985) (explaining that using insider trading as compensation could be expanded to all forms of consideration).

206. 15 U.S.C. § 78u-4.

their employer of the exclusive use of the employer's information.[207] So, why are parties other than the employer allowed to sue the employee? If insiders breach a separate duty to shareholders when buying stock ahead of the announcement of good news, then section 20A's standing provision is a reasonable extension of common law principles in cases brought under the classical theory of liability. However, given Justice Powell's interpretation of insider duties,[208] section 20A also creates standing for those parties who were not shareholders—and therefore owed no fiduciary obligations—prior to a prohibited sale of securities. This standing provision makes sense under Justice Ginsburg's view that defendants in insider trading cases deceive their employers "and simultaneously harms members of the investing public."[209] As discussed in Part V.A. above, the view that insider trading can harm anyone other than the information owner is at odds with the common law understanding of cognizable harm and has the effect of fostering various forms of economic equality.[210]

Congress passing sections 20A and 21A of the Exchange Act may be the most problematic examples of official efforts to simultaneously promote conflicting fairness doctrines because these examples seem the most intentional. Lawmakers understood that there was confusion about the scope of insider trading liability when they took the time to enhance the penalties for insider trading. Yet lawmakers left the concept of insider trading undefined in their statutes out of what they describe as a concern that defining the term would "facilitate schemes to evade the law."[211] One report explains this decision by stating that "the Committee did not believe that the lack of consensus over the proper delineation of an insider trading definition should impede progress on the needed enforcement reforms encompassed within this legislation."[212] What is especially confusing is the idea that you can prevent schemes to evade a poorly defined law. If officials refuse to specify what they are trying to prevent, then how can civilians stay within the bounds of the law?

The current insider trading bills are a valiant effort to clarify insider trading law. Unfortunately, as discussed in Part VII of this Article, both proposals would continue the trend of using fatally ambiguous moral language. Both proposals would simply replace the concept of "unfairness" with the concept of "wrongful."

D. Summary

The examples listed in this Part demonstrate that the confusion in insider trading law runs deeper than conflicts between the approach taken by enforcement officials and the approach taken by courts. Official statements from every branch of government demonstrate that Congress, the SEC, and the Supreme Court each simultaneously invoke mutually exclusive fairness doctrines. By citing Rule 10b-5 and other antifraud

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207. *See supra* note 34 and accompanying text.

208. *See supra* notes 140–141 and accompanying text.

209. United States v. O'Hagan, 521 U.S. 642, 656 (1997).

210. *See supra* notes 152–156 and accompanying text.

211. Insider Trading and Securities Fraud Enforcement Act of 1988, H.R. Rep. No. 100-910, *reprinted in* 1988 U.S.C.C.A.N. 6043.

212. *Id.*

provisions for the authority to impose insider trading liability, officials invoke a fairness doctrine that requires protecting someone's exclusive-use rights in inside information. Concurrently, the same official statements invoke a fairness doctrine that demands disclosure practices that foster equality of information and equality of trading opportunities. Because it is impossible to simultaneously enforce these contradictory fairness doctrines in practice, officials almost arbitrarily bounce back and forth between the two doctrines as they decide cases. The opinion in *Chiarella* provides the clearest evidence that this undirected oscillation between the fairness doctrines happens within the minds of individual officials. In that opinion, Justice Powell rejects recognizing *all market participants* as having the fiduciary obligation to disclose material nonpublic information or abstain from trading. In the same opinion, he embraces recognizing that those with fiduciary obligations under Rule 10b-5 must disclose inside information to *all market participants*—including non-shareholders—before their trades are deemed doctrinally fair. Justice Powell's partial and contradictory commitment to some form of information equality is in addition to the interbranch conflict created by the SEC's adoption of Rule 14e-3 in response to the Supreme Court's conclusion that Rule 10b-5 does not prohibit warehousing. Both Justice Powell's adoption of the disclose-or-abstain rule and the SEC's restrictions on warehousing under Rule 14e-3 undermine a principal's rights to exclusive use of its inside information.

VI. The Systemic Implications of Fatal Ambiguity

A. No Tension Between Fairness and Efficiency

Many scholars describe the messiness in insider trading law as resulting from the difficulty of promoting securities markets that are simultaneously fair and economically efficient rather than from the use of competing notions of fairness. Professor Donald Langevoort, for example, argues that the tensions in the insider trading regime are derived "from an unresolved conflict between the values of efficiency and equity."[213] He describes court decisions that push back against the prohibition of insider trading as embracing a specific view of what is required to promote allocational efficiency in securities markets.[214] Most economists treat "allocational efficiency" as synonymous with the goal of maximizing wealth. Professor Langevoort also describes advocates of the prohibition as trying to limit the unfairness of excessive economic advantages.[215] Moreover, most insider trading scholars and many officials describe the role of property in insider trading cases as generally divorced from any notion of fairness. Instead, many describe the focus on property rights that emerged in the early Supreme Court cases on insider trading as almost exclusively motivated by a commitment to some version of economic efficiency.[216] Many of these commentators conclude that allowing principals to decide whether to authorize insider trading is the best way to achieve an efficient

213. Donald C. Langevoort, *supra* note 16, at 399.

214. *Id.*

215. *Id.* at 400–01.

216. *See* Krawiec, *supra* note 16 (describing how economic efficiency, not fairness, is the motivation in focusing on property rights within insider trading cases).

allocation of resources in securities markets.[217]

This Article concludes that there is no necessary conflict between using property doctrine to promote fairness and using it to promote economic efficiency.[218] Still, considering the popular belief that practical issues are fundamentally distinct from moral issues, the view that confusion is a necessary result of attempting to make securities markets both fair and economically efficient makes sense.[219] In harmony with David Hume's theory of an is–ought gap, many scholars describe economic analysis as descriptive and fundamentally distinct from prescriptive or normative claims. Yet, some scholars argue that all viable claims about what people "ought" to do are inextricably intertwined with claims about human nature and the rest of existence—claims about what "is." According to Tara Smith, one view recognizes "induction coupled with the purpose of living" as providing a factual base for normative judgments.[220] Moreover, the connection between moral reasoning and practical political reasoning is difficult to refute if we consider seminal economics scholarship. Descriptively, Adam Smith developed his understanding of wealth creation using the same approach he used to develop his understanding of morality and language.[221] Normatively, John Stuart Mill relied on a utility concept to outline his moral theory of utilitarianism and his understanding of economics. In *Principles of Political Economy*, Mill concludes that both utility and scarcity are required for an object to have market value.[222] Mill's view implies that objects cannot have market value without the capacity to impact overall utility—the greatest happiness for the greatest number.

Given the inextricable connection between moral (normative) and practical (descriptive) reasoning, this Article does not reject the relevance of official commitments to economic efficiency for understanding the confusion in insider trading law. Instead, understanding the confusion in the legal doctrine caused by competing definitions of fairness may help us recognize that a similar form of conceptual conflict plagues the clarity of policy discussions that focus on "economic efficiency." Part II.B highlights legal doctrines that describe fair business transactions as requiring (1) prices that reflect the intrinsic value of a product, (2) the right form of consent, or (3) parties that begin with relatively equal bargaining power or other economic positions.[223] Unsurprisingly, there are economic models of "ideal markets" that assume that maximizing wealth—achieving allocational efficiency—requires transactions that fit one or all of these three

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217. *Id.*

218. *See* Douglas, *supra* note 15, at 227–33 (recommending the "Property And . . ." approach to legal analysis over the "Property Or . . ." approach).

219. Charles Pigden, *Hume on Is and Ought*, 83 PHIL. NOW, Mar.–Apr. 2011, at 18–20, https://philosophynow.org/issues/83/Hume_on_Is_and_Ought [https://perma.cc/Q82U-NH4B] (see the work on David Hume's is–ought gap).

220. *See* TARA SMITH, VIABLE VALUES 103 (2000).

221. *See* MATT RIDLEY, THE EVOLUTION OF EVERYTHING 23 (2d ed. 2015) (categorizing Smith's work as the study of "emergent, evolutionary phenomena," Ridley states that "Adam Smith spent his life exploring and explaining such emergent phenomena, beginning with language and morality, moving on to markets and the economy, ending with the law, though he never published his planned book on jurisprudence.")

222. JOHN STUART MILL, PRINCIPLES OF POLITICAL ECONOMY 544 (Longmans, Green & Co. eds., 17th ed. 1871).

223. *See supra* notes 64–67 and the accompanying text.

definitions of fair business activity.

For models that describe economic efficiency as requiring prices that reflect the intrinsic value of a product, consider the efficient capital market hypothesis (ECMH).[224] ECMH models describe "market efficiency" as an input to "allocational efficiency." These models assume that at any point in time in an efficient market, "the actual price of a security will be a good estimate of its intrinsic value."[225] Interestingly, scholars disagree about how prices come to reflect all available information in efficient capital markets. As a result, some models rely on something like the revealed-preference approach, which treats consensual transactions as necessary (if not sufficient) to maximize wealth. Under the revealed-preferences approach, the active trading of insiders and others with information advantages indirectly bakes new information into prices by signaling changes in the supply or demand for a security.[226] Other models rely on a market-failure approach, which rejects the efficacy of consensual transactions in a market with information asymmetries. Under the market-failure approach, governments must compel information disclosure from securities issuers and other "insiders" in order to allow all market participants to determine the implications of the new information for themselves.[227] The revealed-preference approach clearly places more weight on consensual transactions than the market-failure approach. Both approaches, however, treat information equality as a corollary of efficient markets and maximizing wealth. Under the revealed-preferences approach, information equality is an implied outcome in efficient markets; informed trading causes securities prices to move closer to their "intrinsic" value, which eventually allows all market participants to benefit indirectly from that information. In contrast, under the market-failure approach, information equality is an explicit input within efficient markets; universal disclosure is required to facilitate price "correction."

In addition to information equality, both approaches to allocational efficiency imply that maximizing wealth requires price equality. The assumption that all transactions are made at a price that reflects the intrinsic value of a security implies that all transactions are made at (or near) the same price. This understanding of the relationship between prices and information causes securities law to invert the principles behind lemon laws.[228] Instead of penalizing the intentional sale of products with undisclosed material defects, insider trading laws penalize intentionally buying or selling securities with materially *defective prices*.

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224. *See generally* Ronald J. Gilson, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984); Merritt B. Fox, *Measuring Share Price Accuracy*, 1 BERKELEY BUS. L.J. 113 (2004) (describing which analysis methodology to employ when describing economic efficiency in reflecting intrinsic value of a product).

225. Eugene F. Fama, *Random Walks in Stock Market Prices*, 21 J. FIN. ANALYSTS 55, 56 (1965).

226. *See* Henry G. Manne, *Insider Trading and the Law Professors*, 23 VAND. L. REV. 547, 565 (1970) ("The efficient functioning of the stock market is actually one of the strongest arguments for unfettered insider trading . . . .").

227. Kevin S. Haeberle & M. Todd Henderson, *Information-Dissemination Law: The Regulation of How Market-Moving Information Is Revealed*, 101 CORNELL L. REV. 1373, 1408 (2016) (identifying increases in the bid-ask spread as one of many "information asymmetry costs," and concluding that it is these costs that predominantly motivate regulator opposition to informed trading).

228. Lemon laws take the common law prohibition on selling products with an undisclosed material defect and creates an industry specific application for used cars. *See, e.g.*, MICH. COMP. LAWS ANN. § 2571401 *et seq.* (West 2021); *see also* RESTATEMENT (SECOND) TORTS § 551 (AM. L. INST. 1977).

Few scholars would describe the goal of fostering correct prices or the goal of eliminating information asymmetries as synonymous with popular calls for economic equality. Yet, the similarities between the mutually exclusive definitions of fairness discussed in this article and competing models of economic efficiency should not be surprising. Consider the long history of courts and scholars using the concept of "fairness" to mean either allocational efficiency or something like "correct price." The *Restatement (Third) of Unfair Competition* begins by declaring free trade its general principle and then explains that the freedom to compete is fundamental because it "fosters the general welfare by promoting the efficient allocation of economic resources."[229] The entire-fairness test, which requires fair dealing and fair prices, is used by Delaware courts to evaluate corporate transactions that involve a conflict of interests between the corporation and one or more of its fiduciaries—like a director. Implying that fairness requires informed consent, Delaware courts describe fair dealing as covering how the transaction was "disclosed to the directors, and how the approvals of the directors and the stockholders were obtained."[230] Under the same legal test, fair price "relates to the economic and financial considerations . . . and any other elements that affect the *intrinsic or inherent value* of a company's stock."[231] Finally, recall the "morality of the market place," which protects mere consensual transactions between arm's length third parties.[232]

Whatever their resemblance to theories of fair business transactions, it may be difficult to treat the foregoing assumptions in models of economic efficiency as embodying any kind of conflict, let alone a fatal one. The fact that the assumptions in prominent models of market efficiency amount to several forms of economic equality does not mean that the scholars who developed or worked with these models intentionally defined market efficiency as requiring economic equality. Moreover, most policy debates are about how insider trading impacts "allocational efficiency," and almost everyone agrees that allocational efficiency is defined as maximizing wealth. Therefore, some would argue that competing definitions of "market efficiency" do not muddy the policy debate like competing definitions of fairness or justice muddy the doctrinal debate. For many, failing to recognize these distinctions will, at best, seem sophomoric. Readers should remember, however, that producing sophomoric analysis is not the only way to fail to achieve sophistication.[233]

Rigorously evaluating the proposition that the assumptions in prominent economic models contain a fatal conflict presents an arduous task for most readers. The undaunted should start by recalling that "market efficiency" is widely accepted as an input to "allocational efficiency" in ECMH models. This means that the competing assumptions and models described above support the conclusion that social scientists are debating the definition of an input to their ultimate goal and not the definition of the ultimate goal itself. If true, this only moves the location of the confusion in the policy debate one level

229. RESTATEMENT (THIRD) UNFAIR COMPETITION: GENERAL PRINCIPLES § 1 cmt. a (AM. L. INST. 1995).

230. Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983).

231. *Id.* (emphasis added).

232. *See supra* note 64 and accompanying text.

233. *See supra* note 116 and the accompanying discussion of sophistry.

up or down in their chain of reasoning; the confusion and the conflicts remain. In addition, the intentionality of building models where the only inputs to maximizing wealth amount to various forms of wealth equality is almost impossible to prove definitively and is therefore irrelevant.

Moreover, there is a much simpler explanation than the idea that ECMH models are the work of a Machiavellian conspiracy carried out over several decades to intentionally confuse policy discussions. The law of noncontradiction makes some conceptual errors systemic.[234] One critical conceptual mistake can lead to a cascade of different but related follow-on errors. There is no immediate need to determine which field of inquiry is the chicken and which is the egg—ethics or economics. Still, competing theories on morally acceptable business activity existed for thousands of years before the development of economics as a social science.[235] Therefore, a reasonable inference is that conflicts in the moral theories led to conflicts in the economic models. Ultimately, the resemblance between the competing definitions of "fairness" in our legal doctrines and the competing models of "economic efficiency" used in our policy debates supports the view that fatal ambiguity is systemic.

There are two more reasons to view models of economic efficiency as containing a fatal conceptual error. Let us put aside the fact that the revealed-preferences approach to market efficiency conflicts with the market-failure approach to market efficiency. The fact that both schools of thought treat information and price equality as corollaries to maximizing wealth is both theoretically and practically unsound. First, scholars consistently differentiate models focused on wealth creation from those focused on wealth distribution, which undermines the reasonableness of models that require specific forms of economic equality to maximize wealth.[236] This is not a criticism of economic models for failing to be realistic.[237] Analogizing Galileo Galilei's assumptions about

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234. Paula Gottlieb, *Aristotle on Non-Contradiction*, STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Mar. 21, 2019), https://plato.stanford.edu/entries/aristotle-noncontradiction/ [https://perma.cc/7ZM7-HA2L] ("It is impossible for the same thing to belong and not to belong at the same time to the same thing and in the same respect.").

235. For a general survey, see ERIC ALLISON & HENRY C. CLARK, ECONOMIC MORALITY: ANCIENT TO MODERN READINGS (Edward W. Younkins ed., 2014).

236. *See* ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS 7 (Donna Battista ed., 6th ed. 2016) (declaring "that economists are experts on two policy values—efficiency and distribution" and "we will focus on efficiency rather than distribution"); *see also* Calabresi & Melamed, *supra* note 20, at 1104 ("The reason that we have so far explained entitlements simply in terms of efficiency and distribution is ultimately tautological. We defined distribution as covering all the reasons, other than efficiency . . . ."); ROBERT BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 111 (1978) ("[I]t seems clear the income distribution effects of economic activity should be completely excluded from the determination of the antitrust legality of the activity. It may be sufficient to note that the shift in income distribution does not lessen total wealth, and a decision about it requires a choice between two groups of consumers that should be made by the legislature rather than by the judiciary.").

237. *See* Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383, 416 (1970) ("Though we shall argue that the model stands up rather well to the data, it is obviously an extreme null hypothesis. And, like any other extreme null hypothesis, we do not expect it to be literally true."); *see also* Joan Robinson, *What is Perfect Competition?*, 49 Q.J. ECON. 104, 113 (1934) ("The definition of a commodity is completely arbitrary, and the definition of a market depends upon the definition of a commodity."); *also see* FRANK H. KNIGHT, RISK, UNCERTAINTY AND PROFIT 10–11 (Cosimo ed., 2006) ("The evil results of the failure to emphasize the theoretical character of economic speculation are apparent in every field of practical economics. The theorist not having definite assumptions clearly in mind in working out the "principles," it is but natural that he, and still more the practical workers building upon foundations, should

objects moving through a frictionless void, many economists describe the assumptions in their models as simply useful for thinking about the real world.[238] The concern is that these economic models have been misidentified by their makers and users as eschewing distribution concerns, but the models simultaneously assume that various kinds of equal economic distribution are necessary inputs to or concomitants with maximizing wealth. Second, the long history of wealth redistribution causing capital flight undermines the reasonableness of models that assume that any form of economic equality is a practical input to economic growth.[239] Many scholars acknowledge the unrealistic features in prominent models and warn policymakers not to apply them without the adjustments required to make them account for real-world constraints.[240] However, other scholars take for granted that the elimination of information inequality will improve the efficacy and profitability of real securities markets.[241]

The competing approaches to building models of wealth maximizing activity[242] combined with the internal contractions built into all ECMH models[243] and the disagreement among scholars about the real-world applicability of the assumptions in these models[244] makes the policy analysis of insider trading just as confused as the doctrinal analysis. As explained in Part VII, clarifying insider trading law requires choosing between incompatible policy goals by specifying whether the consent of the information owner is a defense against insider trading charges. First, Part VI.B. demonstrates that the systemic effects of fatal ambiguity in insider trading law have spread beyond the mutually exclusive notions of "fairness" or the internally conflicted models of "economic efficiency."

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forget that unreal assumptions were made, and should take the principles over bodily, apply to concrete cases, and draw sweeping and wholly unwarranted conclusions from them.").

238. Calabresi & Melamed, *supra* note 20, at 1096 ("But no one makes an assumption of no transaction costs in practice. Like the physicist's assumption of no friction . . . .").

239. *See* ILYA SOMIN, FREE TO MOVE: FOOT VOTING, MIGRATION, AND POLITICAL FREEDOM 69 (2020) (describing studies that show migrants "tend to choose nations with greater economic freedom because relatively lower levels of economic regulation offer greater employment opportunities for immigrants"); *see also* Caleb Christensen, *Decline of the IPO and the Implications for Your Company*, IPOHUB (Oct. 10, 2018), https://www.ipohub.org/decline-of-the-ipo-and-the-implications-for-your-company/ [https://perma.cc/9RZH-XKTU] (theorizing that one potential explanation for the decline in initial public offerings between 1995 and 2015 is because "*the required disclosures* and other regulatory requirements are so burdensome that companies prefer to remain privately held, despite the potential growth opportunities they may be missing out on") (emphasis added).

240. Fama and Knight, for example, warned of the models' shortcomings. *See supra* note 237.

241. *See* Edward G. Fox, Merritt B. Fox & Ronald J. Gilson, *Economic Crisis and the Integration of Law and Finance: The Impact of Volatility Spikes*, 116 COLUM. L. REV. 325, 328 (2016) ("Securities law can enhance price accuracy, for example, by mandating that corporations disclose certain [information]. The better corporate and securities law [performs this task], the more valuable the corporation's underlying business and correspondingly, the [securities] that the corporation issues.").

242. The market-failure approach versus the revealed-preferences approach.

243. Treating information and other forms of economic equality as necessary inputs to or corollaries of maximizing wealth.

244. Only useful for thought experiments vs. useful as policy goals.

B. No Tension Between Investor Protection and the Public Interest

In her aptly titled article, *Fairness, Efficiency, and Insider Trading*, Professor Kimberly D. Krawiec builds on the explanation that any perceived confusion in insider trading law is simply the result of the tension between these two policy goals. She argues that "the fairness/efficiency debate in insider trading is merely a reprise of the public/private debate that characterizes many other areas of mainstream political and legal discourse."[245] In one important way, *Fairness, Efficiency, and Insider Trading* anticipates the arguments in Part VI.A. by describing the public–private divide as confusing only because it is imaginary.[246] Her article goes as far as to categorize the fundamental debate as one between "informational-egalitarians" and "informational-propertarians."[247] Professor Kraweic's solution attempts to create a "balance between private incentives to information production and distribution on the one hand, and, on the other hand, public access to such information once produced."[248] How is the foregoing solution different from the traditional explanation that officials are attempting to balance fairness and efficiency? Like economists of prior generations, Professor Kraweic rejects "a reliance on amorphous notions of fairness or investor harm."[249] Instead, she seems to call for economic analysis that measures more than the cost and benefits of the law in relation to maximizing wealth. Her approach also demands a cost-benefit analysis of the law's impact on achieving information equality.[250]

In harmony with Professor Kraweic's starting assumptions, this author is convinced that there is no inevitable "tension" between the public and private goals of regulating insider trading. However, as described in Part VI.A., treating the problem as strictly economic does not eliminate the impossibility of fostering equal access to some information while simultaneously protecting property rights—exclusive-use rights—in the same information. Still, Professor Kraweic's analysis sheds light on the depth of the confusion caused by the use of fatally ambiguous moral concepts. Making insider trading law sensible requires officials to clarify the meaning of many other fatally ambiguous terms in the law. This issue applies to both normative and descriptive concepts, including "investor protection," "the public interest," "fraud," "investor confidence," "market integrity," and "honesty."

Just like the false tension between economic efficiency and fairness, the perceived tensions between investor protection and the public interest melt away if we specify whether consent is a defense against liability for insider trading. The details of this

245. Krawiec, *supra* note 16, at 448.

246. *Id.* ("Much contemporary legal thought, however, is critical of this attempt to distinguish public from private life, arguing that these divisions are social constructs that mask substantive decisions to tolerate inequalities in the allocation of wealth, power, justice, and information.").

247. *Id.* at 450.

248. *Id.* at 449.

249. *Id.* at 448; *cf.* Jonathan R. Macey, *Ethics, Economics and Insider Trading: Ayn Rand Meets the Theory of the Firm*, 11 HARV. J.L. & PUB. POL'Y 785, 798 (1988) ("But the flaw in the fairness-as-equality argument is not that it relies on altruism, but that it makes investors worse off than they would be under an alternative arrangement as a group and therefore cannot be justified on altruistic grounds.").

250. Krawiec, *supra* note 16, at 450 ("Instead, a more balanced approach that appropriately accounts for the need to weigh incentives for information production and dissemination against the public's right to access such information . . . . ").

solution are discussed in Part VII.

Allowing consent as a defense against insider trading charges means adopting property-based fairness and the revealed-preferences approach to insider trading law. Under the property approach, the concept of "investor protection" would be narrowed by the principles embodied in section 7 of the *Restatement (Second) of Torts*, which distinguishes between legally cognizable harms to third parties and non-cognizable third-party harms.[251] This means that the criminal law will respond to the intentional violation of a market participant's property, contract, and other private rights. Under this approach, investors would not be protected from transacting with counterparties who have information or other economic advantages. Concepts like "fraud" and cognizable "dishonesty" would have to be limited to the kinds of behaviors identified as fraudulent nondisclosure and fraudulent misrepresentation in the Restatements.[252] This probably calls for eliminating the SEC's open-ended authority to define fraud under sections 15(d) and 14(e) of the Exchange Act. Adopting a presumption of investor competence, any prophylactic crime prevention goals embodied in sections 15(d) and 14(e) would have to be abandoned or pursued through burden-shifting procedures.

Similarly, the definition of "public interest" applied to insider trading law under the property and revealed-preferences approach would be limited to maximizing wealth through consensual transactions. This definition of "public interest" would exclude any government efforts to achieve any form of economic equality through insider trading law. Officials would be prohibited from using the law to foster equal prices, information, or trading opportunities. In addition, officials would be barred from using the insider trading law to facilitate broader goals related to economic equality, such as income or wealth equality. The definition of public interest could, however, include commitments to political equality that are in harmony with the recognition and protection of the private rights discussed in the previous paragraph. Viable forms of political equality include recognizing the equal dignity of civilians and government officials. This would mean that lawmakers and other officials should always be subject to burdens that are (at least) equal to the legal burdens placed on civilians.[253] For example, consider laws mandating "full and fair disclosure" from securities issuers,[254] which authorize enforcement officials to prohibit civilians from selling securities when the related disclosure materials are deemed insufficient. A recognition of the equal dignity of civilians and government officials would prohibit lawmakers from passing fatally ambiguous legislation and would prohibit administrative officials from adopting fatally ambiguous rules and regulations. A commitment to this kind of equality might require allowing civilians to bring something analogous to a derivative suit for a breach of the duty of care. Many official documents reject the idea that government officials are fiduciaries to the general public.

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251. *See* RESTATEMENT (SECOND) OF TORTS: INJURY AND HARM § 7 (1965) (distinguishing between legally cognizable harms to third parties and non-cognizable third-party harm).

252. *See* RESTATEMENT (SECOND) OF TORTS: LIABILITY FOR NONDISCLOSURE § 551 (1976) (describing what kinds of behavior qualifies as fraudulent disclosure); RESTATEMENT (SECOND) OF TORTS: LIABILITY FOR FRAUDULENT MISREPRESENTATION § 525 (1977) (describing what kinds of behavior qualify as fraudulent misrepresentation).

253. Maybe greater burdens because official use firearms to achieve their goals.

254. H.R. 5480, 73rd Cong. (1st Sess. 1933) (The Securities Act of 1933 is self-described as an act to "provide full and fair disclosure of the character of securities").

However, accepting these proclamations may be at odds with doctrines that recognize the creation of fiduciary relationships among parties who have made explicit contractual agreements to the contrary.[255]

Even "market integrity" and "investor confidence" can be defined to fit the property approach. Market integrity would refer to the fact that the cultural and legal institutions required to protect investors and foster investor confidence actually exist and function. Investor confidence would be limited to the reciprocal expectation that each market participant's private rights would be respected by all other market participants. In addition, investors would have confidence that enforcement officials and courts will readily help to resolve a violation of their private rights. Investor confidence, however, would not include the expectation of a level economic playing field in which the average investor is expected to have the same opportunity to generate trading profits as Warren Buffett.

Barring consent as a defense against insider trading liability means adopting the information-equality-based fairness and market-failure approach to insider trading law. The concept of "investor protection," at least in the context of insider trading, would have to be explicitly expanded beyond the protection of common law private rights. Under this approach, investors would also be protected from transacting with counterparties who have material information advantages. Similarly, "investor confidence" should be defined to clearly include the expectation that each market participant has access to the same material information. In addition, investors will have confidence that enforcement officials work diligently to discover and punish informed trading. Under the information-equality approach, concepts like "fraud" and cognizable "dishonesty" would have to be expanded beyond the behaviors identified as fraudulent nondisclosure and fraudulent misrepresentation in the *Restatement (Second) of Torts*.[256] As discussed in the paragraph above, this requires amending section 16 of the Exchange Act and other provisions to explicitly sanction all informed trading. These amendments may include replacing the SEC's open-ended authority to define fraud under section 14(e) of the Exchange Act with the narrow and explicit authority to prohibit specific forms of informed trading.

Accordingly, the definition of "public interest" applied to insider trading law under the information-equality and market-failure approach would be limited to eliminating (or substantially reducing) transactions that involve material information asymmetries. The physical impossibility of broadly achieving economic equality should dissuade prudent officials from using the law to directly pursue that goal. However, as a road map to efficacy, officials can follow the methods used in tender offer laws to make a narrow pursuit of economic equality feasible. These methods include the use of time separation and population specificity discussed in Part VII.A.[257] These limits will be required to offset the process of capital flight that generally follows attempts to redistribute wealth or to foster specific kinds of economic equality. At a minimum, this method of fostering

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255. At least as applied in cases determining third-party liability. *See* RESTATEMENT (SECOND) OF AGENCY: AGENT AND PARTNER § 14A ("[T]he rights and liabilities of partners with respect to each other and to third persons are largely determined by agency principles.").

256. RESTATEMENT (SECOND) OF TORTS § 525 (AM. L. INST. 1977).

257. *See infra* Part VII.A.

economic equality serves the public interest by increasing our institutional commitments to many rule-of-law principles, including notice and the recognition of equal dignity. Eliminating any connection between insider trading liability from property-based statutes and common law doctrines would clarify the law for voters and investors. This increased commitment to clarity would bring government officials closer to meeting the burden of full and fair disclosure placed on civilian investors and issuers.

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The foregoing analysis demonstrates that there is no inherent conflict between fairness and efficiency, nor is there an inherent conflict between investor protection and the public interest. Part VII offers a detailed outline of what is required to clarify insider trading law and then uses that outline to evaluate the pending legislative proposals.

VII. EFFECTIVE INSIDER TRADING REFORM

Despite the prevalence of both principles in American law and culture, effective reform requires choosing between property-based fairness and economic-equality-based fairness. It is impossible to protect a principal's exclusive-use rights in confidential business information while simultaneously fostering equal access to the same information for all market participants—especially when the information's value partially depends upon its secrecy. Therefore, "simply codifying the current working definition of insider trading would not solve the problem."[258]

Because the contradiction in insider trading doctrine may represent a prevalent contradiction in the values of American voters, lawmakers may be unwilling to explicitly prioritize any form of economic equality over the protection of property rights or vice versa.[259] But there is hope.

There is a tradition in American law and culture of distinguishing between popular moral sentiments in general and popular moral sentiments enforced by law. This tradition was behind the Supreme Court in *Chiarella* declaring that "not every instance of financial unfairness constitutes fraudulent activity."[260] And if lying is generally immoral, this tradition also explains why only some forms of deception are illegal.[261] The ability to foster one form of fairness using legal institutions while other forms of fairness are fostered by private activities may make it politically feasible for lawmakers to prioritize one of the two principles. Moreover, neither voters nor lawmakers can

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258. *See* Anderson, *supra* note 22, at 286.

259. *See* Douglas, *supra* note 52, at 139; *see also* sources cited *supra* note 52.

260. Chiarella v. United States, 445 U.S. 222, 232 (1980); *see also* Goodwin v. Agassiz, 186 N.E. 659, 661 (Mass. 1933) ("Law in its sanctions is not coextensive with morality. It cannot undertake to put all parties to every contract on an equality as to knowledge, experience, skill and shrewdness."); Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928) ("A trustee is held to something stricter than the morals of the market place."); Laidlaw v. Organ, 15 U.S. 178, 193 (1817) ("Human laws are imperfect in this respect, and the sphere of morality is more extensive than the limits of civil jurisdiction.").

261. *See, e.g.*, United States v. Alvarez, 567 U.S. 709, 710 (2012) (striking down the Stolen Valor Act of 2005 as unconstitutional); RESTATEMENT (SECOND) OF TORTS: MISREPRESENTATION OF INTENTION § 525 (AM L. INST. 1977).

choose between alternatives they do not know exist. Since very few discussions of insider trading acknowledge that there are competing notions of fairness in American law and culture, simply identifying the alternatives may be the first step to overcoming any hurdles.

Lawmakers also have the option of relying on policy analysis that focuses on the revealed preferences of market participants instead of focusing on the existence of specific kinds of economic asymmetries between market participants—the market-failure approach. The revealed-preferences approach treats a transaction as maximizing wealth as long as the parties to the transaction agree to participate in the transaction. Identifying the agreement to trade is synonymous with determining when parties consent. The market-failure approach assumes that market participants will not transact (or at least will do so less often) if price volatility, information asymmetries, and other forms of economic inequality are prevalent within a market. In the form of a self-fulfilling prophecy, policymakers and scholars who adopt the market-failure approach often call for the adoption of laws that prohibit trading when parties to transactions have information and other economic advantages. Therefore, the market-failure approach frequently prevents market participants from consenting to specific kinds of transactions. As explained in Part VII.A., this allows lawmakers to create a harmonious legal regime by either pairing a property-based fairness doctrine with a revealed-preferences approach to policy analysis or pairing an equal-information fairness approach with a market-failure approach to policy analysis.

The recommendations below do not resolve every problem that makes the current doctrine unclear or incoherent, such as what qualifies as material information or what form of scienter to require.[262] However, because fatal ambiguity is systemic, there is good reason to believe that resolving the issue of consent will clarify how other controversies in insider trading law should be resolved.

A. Clarifying the Role of Consent to Clarify the Law

Property-Based Fairness and Maximizing Wealth

The harmony between property-based fairness and the revealed-preferences approach to policy analysis gives lawmakers the option of effectively prioritizing property doctrine and allocative efficiency as their policy goals. Under this property and revealed-preferences approach, the law would uphold any transactions authorized with the right kind of consent. In the context of insiders of publicly traded companies transacting with outside shareholders, this would likely require informed consent. Insiders would not generate special profits if they were required to disclose material

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262. For a more thorough discussion of these issues, see Joan MacLeod Heminway, *Just Do It – Specific Rulemaking on Materiality Guidance in Insider Training*, 72 LA. L. REV. 999, 1011 (2012) ("In general, enforcement agents believe it is in their best interest to preserve discretion by leaving materiality and other key concepts and terms vague."); *see also* Joan MacLeod Heminway, *Materiality Guidance in the Context of Insider Trading: A Call for Action*, 52 AM. U. L. REV. 1131, 1135 (2003) (proposing "materiality determinations . . . . through, among other things, the expanded use of *per se* rules, presumptions, and safe harbor provisions"); Anderson, *supra* note 22, at 290 ("[I]n promulgating Rule 10b5-l(b) in 2000, the SEC seems to have effectively dropped the requirement of scienter for insider trading liability.").

information to all outside shareholders before trading; instead, they would have to obtain informed consent using one of two alternatives. First, as proposed by John Anderson, insiders could obtain consent from the corporation itself via the board of directors or officers empowered by the board to license trading on the company's information.[263] Anderson proposes providing notice of this arrangement to outside shareholders by (1) including a provision in the company's articles of incorporation declaring that the board of directors may authorize insider trading and (2) making periodic disclosures of the level of insider trading that has occurred with board authorization. Second, publicly traded companies could rely on statutory provisions that allow shareholders to exclude a broad category of behavior from what may otherwise constitute a breach of the duty of loyalty. Section 8.70(a)(2) of the Model Business Corporation Act allows directors to limit or eliminate the requirement that insiders offer business opportunities to the corporation before taking advantage of the opportunity.[264] Section 122(17) of the Delaware General Corporation Law similarly allows a provision in the certificate of incorporation to renounce "specified classes or categories of business opportunities that are presented to the corporation or 1 or more of its officers, directors or stockholders."[265] By following the requirements of one of these provisions, publicly traded companies should be allowed to authorize insiders and select third parties to use the company's inside information for securities trading.

Modifying current securities law to facilitate this property and revealed-preferences approach would require several steps. First, Congress would have to eliminate all statutes and administrative rules that prevent information owners from consenting to the use of their information for trading in securities markets. This would entail adding safe harbors to sections 13 through 15 of the Exchange Act that identify the consent of shareholders or directors as a defense against liability for insider trading. It would also mean repealing Regulation FD and portions of Rule 14e-3. These safe harbors would leave the legal or equitable owners of the information free to authorize insider trading during issuer stock repurchases, self-tender offers, and third-party tender offers. These changes would also remove restrictions on selective disclosure by issuers.

Second, the information owner should never face liability for the unauthorized use of its information for securities trading. This means amending sections 20A(b)(3) and 21A(a)(3) of the Exchange Act to clarify that section 20(a) does not apply to information owners in insider trading cases.[266] Third, only the legal or equitable owners of the information would have standing to sue and recover for insider trading. This would mean more than repealing section 20A of the Exchange Act. Like private actions brought under section 16(b) of the Exchange Act, allowing only information owners to recover unauthorized profits would mean restricting the SEC from bringing disgorgement actions;[267] and like section 16(b) cases, shareholders (at a minimum) would have

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263. Anderson, *supra* note 22, at 280 ("[P]roposes the legalization of issuer-licensed insider trading as one effective means of reforming the current regime but anticipates the 'it's just not right' objection."); *see also* ANDERSON, *supra* note 1, at 235–61 (citing the need for a new enforcement regime).

264. *See* MODEL BUS. CORP. ACT: BUSINESS OPPORTUNITIES § 8.70 (AM. BAR ASS'N, Revision 2016).

265. DEL. CODE ANN. tit. 8, § 122 (2022).

266. Securities Exchange Act of 1934 §§ 20A(b)(3) and 21A(a)(3).

267. Securities Exchange Act of 1934 § 16(b), 15 U.S.C. § 78p.

derivative standing to sue on behalf of the corporation.[268] Each of the above changes would also require explicit statutory language addressing the application of the following statutes in insider trading cases: section 17(a) of the Securities Act, sections 10(b) and 14(e) of the Exchange Act, Rule 10b-5, 18 U.S.C. §§ 1341, 1343, and 1348.

A greater commitment to the property and revealed-preferences approach might require a more extensive adoption of the principles identified in the *Restatement (Second) of Torts*. This approach would expand defenses against liability to include all universal defenses against liability.[269] In addition to consent, defendants in insider trading cases could avoid private liability by convincing information owners to discharge or forgive their liability. For corporate fiduciaries, this means approval through the formal ratification process. Unsurprisingly, a more extensive adoption of common law principles outlined in the Restatements may increase the scope of illegal trading beyond unauthorized trades by corporate fiduciaries.[270] In addition to breaches of duty of trust and confidence, section 551 of the *Restatement (Second) of Torts* identifies four other instances in which a person might face liability for fraudulent nondisclosure. These alternatives include non-fiduciaries facing liability for failing to disclose a defect that a reasonable person would consider material.[271] This limitation is akin to the doctrine that the presence of material or fatal defects may nullify a contract. In the context of insider trading over a public exchange, it might make sense to view a security as containing a material defect if the seller has reason to believe that the security will be delisted from the exchange. It would not be reasonable, however, for the material defects doctrine to penalize all trading on negative information. Publicly traded companies regularly announce negative information that can cause the price of their securities to decrease temporarily. Any competent adult participating in securities markets should recognize that stock prices sometimes decrease after the announcement of unexpected bad news. This is a feature, not a bug, of securities markets.

Part VI.B. describes the property approach as limiting the kind of equality pursued through insider trading law to some form of political equality or equal dignity under the law. Adhering to this principle would require officials to use different methods to openly foster the distributive commitments hidden in the current law. There are at least three viable alternatives for lawmakers to achieve these goals. First, lawmakers can simply continue to rely on the several non-insider trading statutes and rules that facilitate the pursuit of various forms of economic equality in clear and feasible ways. For example, the law regulating tender offers protects the offerors' property rights in information for up to ten days after the offerors have obtained 5% of a company's outstanding voting

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268. *Id.*

269. *See* RESTATEMENT (SECOND) OF TORTS: DIVISION TWELVE, DEFENSES APPLICABLE TO ALL TORT CLAIMS (AM. L. INST. 1979) (describing consent and several other universal defenses against tort liability); *see also supra* note 128 and accompanying text.

270. *See* Donna M. Nagy, *Reframing the Misappropriation Theory of Insider Trading Liability: A Post-*O'Hagan *Suggestion*, 59 OHIO ST. L.J. 1223, 1288 (1998) ("Nondisclosure by a fiduciary, however, constitutes only one of many well recognized categorical exceptions to the rule that silence in a business transaction is generally not fraudulent.").

271. RESTATEMENT (SECOND) OF TORTS: LIABILITY FOR NONDISCLOSURE § 551(2)(e) (AM. L. INST. 1977) (discussing "facts basic to the transaction").

stock.[272] Ten days after the offerors hit the 5% threshold, the law uses mandatory disclosure to promote information equality. Another example is the SEC's best-price rule, which only requires price equality during the period when the tender offer is officially open and only for those parties who accept the tender offer.[273] These tender offer rules feasibly pursue mutually exclusive fairness principles by pursuing only one principle at a time and by creating clear limits on the population of investors who have a legal right to equal pricing. Second, lawmakers could begin to take a profession-neutral approach to the promotion of civilian productivity. For example, the tax code could be amended to tax any income made for working over 40 hours a week at the same reduced tax rate applied to capital gains and dividends. Similarly, we could make the tax rate for any income generated by small business owners the same as the tax on dividends. Third, there is always the option of following the traditional advice of economists, which would require only using our tax and redistribution programs to foster any form of economic equality.

Information-Equality-Based Fairness and Correcting Prices

The harmony between economic-equality-based fairness and the market-failure approach to policy analysis gives lawmakers the option of effectively prioritizing information equality in the doctrine and market efficiency (or correct prices) as their policy goal. Under this economic-equality and market-failure approach, the law would penalize any party that participates in a securities transaction while in possession of a material information advantage—advanced information about changes in a securities price. To keep the law as coherent and practicable as possible, lawmakers should not directly prohibit (1) price discrimination or (2) unequal opportunities to generate trading profits. In addition to fostering greater feasibility, limiting the proscription to informed trading would keep the law in harmony with the current mandatory disclosure approach taken in federal securities regulation. Limiting the prohibition to informed trading is also in harmony with the economic models that identify information equality as sufficient for achieving perfect competition and efficient markets.[274] The information-equality approach would expand liability for insider trading beyond defendants who have breached a duty of loyalty to an information owner. It would mean prohibiting market participants from consenting to transactions with more informed parties.

Adopting the economic-equality and market-failure approach may mean that defendants in cases like *Dirks v. SEC*[275] and *SEC v. Switzer*[276] would face liability for insider trading. "Neither Dirks nor his firm owned or traded any Equity Funding stock, but throughout his investigation, he openly discussed the information he had obtained with a number of clients and investors."[277] However, some of these clients "sold their holdings of Equity Funding securities, including five investment advisers who liquidated

272. Securities Exchange Act of 1934 § 13(d), 15 U.S.C. § 78m.
273. *See* 17 C.F.R § 240.14d-1(c)(2).
274. *See* KNIGHT, *supra* note 237, at 76–79 (1957); Fama, *supra* note 237, at 387.
275. 463 U.S. 646 (1983).
276. 590 F. Supp. 756 (W.D. Okla. 1984).
277. *Dirks*, 463 U.S. at 649.

holdings of more than $16 million."[278] Dirks urged a journalist in the Wall Street Journal's Los Angeles office to write a story on the fraud allegations. Unfortunately, that journalist did not believe "that such a massive fraud could go undetected and declined to write the story."[279] After the accounting fraud was announced to the public, the SEC charged Dirks with aiding and abetting violations of insider trading law by selectively "repeating the allegations of fraud to members of the investment community" before "publicly [disclosing] that information."[280] Justice Powell dismissed the case on the grounds that (1) a fiduciary is under no obligation to aid and abet a crime and (2) a breach of the duty of loyalty requires the fiduciary to receive an unauthorized personal benefit.[281] A broad ban on informed trading may require finance professionals in Dirks' position to rely on whistleblower rewards to incentivize their disclosure of corporate crimes. Barry Switzer purchased securities after hearing positive inside information at a track meet.[282] The SEC accused Switzer of colluding with the parties who disclosed the information during the track meet. Switzer avoided liability because the judge in his case, acting as the fact finder, determined that he obtained the information through luck, not criminal collusion. Like Justice Ginsberg in *O'Hagan*, the court in Switzer's case declared that it is not illegal to trade on information advantages obtained by luck.[283] A commitment to the economic-equality and market-failure approach may require prohibiting trading on (1) information advantages obtained by luck and (2) other information advantages that would not trigger a common law violation of private rights.

Modifying current securities law to facilitate this economic-equality and market-failure approach would require several steps. First, Congress and the judiciary would have to eliminate all references to statutes and administrative rules aimed at protecting property and other private rights. This means disassociating insider trading law from the antifraud provisions in securities statutes and relying exclusively on mandatory disclosure provisions. These changes would require explicit statutory language excluding the application of the following statutes in insider trading cases: Section 17(a) of the Securities Act, sections 10(b) and 14(e) of the Exchange Act, Rule 10b-5, and the mail and wire fraud statutes (18 U.S.C. §§ 1341, 1343, and 1348). Section 16 of the Exchange Act could be amended to provide a clear statement of the prohibition. In addition, Congress should amend sections 13 and 15 of the Exchange Act to provide explicit statutory support for the ban on selective disclosure found in Regulation FD.[284] Congress should also amend section 14(e) to openly prohibit warehousing. A greater commitment to the economic-equality and market-failure approach may require amending section

278. *Id.*

279. *Id.* at 649–650.

280. *Id.* at 651.

281. *Id.* at 666–67.

282. SEC v. Switzer, 590 F. Supp. 756, 762 (W.D. Okla. 1984).

283. *See id.* at 766 (concluding that the "information was inadvertently overheard by Switzer at the track meet" and that "Rule l0b-5 does not bar trading on the basis of information inadvertently revealed by an insider"); *see also* United States v. O'Hagan, 521 U.S. 653, 685–59 (1997) (stating that the misappropriation theory prohibits trading on information obtained "from contrivance, not luck").

284. *But see generally* Richard A. Epstein, *Returning to Common-Law Principles of Insider Trading After* United States v. Newman, 125 YALE L.J. 1482 (2016) (arguing that private sanctions should suffice to control selective disclosure in Regulation FD).

20A of the Exchange Act to provide standing to those market participants who trade contemporaneously with and *in the same direction* as defendants in insider trading cases. If informed trading harms all investors, all investors should have standing to sue and obtain a remedy. In addition, to mirror the scope of section 21A, section 20A should explicitly exclude information owners from having standing to sue insider trading defendants if the information owners were negligent in preventing the illegal trades.

B. How Effective are Current Legislative Proposals?

Momentum for a statutory definition of insider trading began after two prominent enforcement officials called for a fix in 2018. In a 2018 *New York Times* opinion piece, Preet Bharara, a former U.S. attorney, and Robert J. Jackson, Jr., then an SEC commissioner, announced they would form a task force on insider trading. They described the Task Force as a response to the failure of past legislatures, courts, and enforcement officials to provide a clear standard of what is and is not insider trading.[285] The Task Force's January 2020 report proposed model legislation that effectively mirrors the Insider Trading Prohibition Acts, which the House of Representatives first passed in December 2019 and again in May 2021. The Act defines insider trading as trading while aware of information that a person knows "has been obtained wrongfully, or [when trading] would constitute a wrongful use of such information."[286]

Using the standard of clarity identified above, this Subpart explores the virtues and vices of the current House bill and the Bharara Task Force proposal. I conclude that the proposed reforms cannot effectively clarify the law. First, the reformers seem to have their hearts in the right place—a commitment to increasing notice and, thereby, the rule of law. The Bharara Task Force identifies four principles for improving the law, and the very first principle aims "for clarity and simplicity."[287] Further, it states that elements of the legislation that "are subject to [interpretation] should be defined as clearly as possible." Second, simply aiming to create an insider trading statute is a step in the right direction. A statute has the potential to increase the level of awareness that ordinary investors have of the scope and limits of the law. Third, the House bill would eliminate vicarious liability for employers who "did not participate in, or directly or indirectly induce the acts constituting a violation."[288] This amendment would reduce the chance that the victims of insider trading will be punished for the crime. Finally, the House bill provides at least three affirmative defenses against insider trading liability, which implies limits to the authority granted under this statute.

Unfortunately, the vices of these reform proposals far outweigh their virtues. Critically, both proposals continue the tradition of using fatally ambiguous moral language to describe the law's central motivation. Describing the law as penalizing the "wrongful" use of information is the functional equivalent of penalizing the "unfair" use of information. Neither proposal mentions—let alone clarifies—the role of consent. The list of affirmative defenses in the House bill provides a safe harbor for "directed

285. Bharara & Jackson, *supra* note 4.
286. H.R. 2655, 117th Cong. § 16A(a) (2021).
287. BHARARA REPORT, *supra* note 6, at 14.
288. H.R. 2655 § 16A(d).

trading," which involves trading solely for the benefit of another person. However, the bill says nothing about trading for one's personal benefit with the consent of the information owner. This omission fails the Task Force's declared commitment to clearly defining terms and elements "subject to interpretation." Given the source of confusion in the current law, passing legislation containing fatally ambiguous moral language negates any rule-of-law benefits that could come from having a written law.

Equally troubling, both proposals contain statements that imply the continuation of trying to simultaneously promote property-based fairness and economic-equality-based fairness doctrines. The Bharara Task Force proposal begins by identifying a commitment to the protection of property rights as motivating their rejection of the advice of economists who defend the "benefits of allowing insider trading."[289] The proposal asserts that "allowing insiders to profit from confidential corporate information [would discredit] the principle of fairness in the U.S. markets." As repeated throughout this Article, a commitment to property doctrine requires protecting transactions authorized by the right kind of consent. Similarly, economists who promote ending the prohibition suggest that information owners should be free to authorize or prohibit the use of their information by third parties. Therefore, what the Task Force denotes as a commitment to property rights bears a closer resemblance to a commitment to the vice-law-like inalienability rules identified by Calabresi and Melamed in *One View of the Cathedral*.[290] The House bill suggests a commitment to protecting property rights by explicitly prohibiting the use of information obtained by theft, conversion, and misappropriation. However, the bill simultaneously commits to fostering trading at equal prices by focusing liability on the use of "*any nonpublic information* . . . that has, or would reasonably be expected to have, a material effect on the *market price*."[291]

Fortunately, the shortcomings of the current proposals can be addressed with one small amendment. The House bill simply needs to add a provision to the proposed section 16A(c), which identifies the law's "Standard and Knowledge Requirement." The additional provision, section 16A(c)(E), would state whether trading with the consent of the owner of the information is a defense against liability. Similarly, the Task Force's proposed definition of "wrongful" would need to add an additional sentence stating whether trading with the consent of the owner of the information is a defense against insider trading charges. Neither amendment would have to make distinctions about general as opposed to informed consent or identify the source of consent because those issues are already covered by state corporate law.

VIII. CONCLUSION

This Article has demonstrated that confusion in U.S. insider trading law is explained by the insurmountable conflict between property-based fairness doctrines and economic-equality-based fairness doctrines. Premising liability on defendants violating some party's exclusive-use rights in confidential information while simultaneously premising liability on defendants violating notions of fairness based on fostering equal

289. BHARARA REPORT, *supra* note 6, at 3.
290. *See supra* note 20 and accompanying text.
291. H.R. 2655, 117th Cong. § 16(A)(a) (emphasis added).

access to the same information for all market participants creates an arbitrarily-inclusive standard. Reformers interested in creating a clear doctrine and fostering the rule of law should prioritize one of these principles and reject or limit the other. At a minimum, reform requires clarifying whether an information owner's consent is a defense against liability. Accepting consent as a defense against liability means adopting the property-based fairness doctrines found in other areas of business law. Rejecting consent as a defense clears the path for an economic equality-based fairness doctrine.

Further, demonstrating the systemic quality of fatal ambiguity, this Article has identified critical errors in policy analyses that rely on theories of "market efficiency" to assess how legal changes will impact "allocative efficiency." Because the assumptions underlying most theories of market efficiency qualify as forms of economic equality, policy analysts unintentionally oscillate between focusing on maximizing wealth and focusing on equally distributing certain types of wealth. Fortunately, deciding whether consent is a defense against insider trading liability will also resolve the policy confusion. Making the consent of the information owner a defense adopts the revealed-preferences approach and is compatible with analysis focused on maximizing wealth. Rejecting information owner consent as a defense adopts the market-failure approach and is compatible with analysis focused on correcting—and therefore equalizing—securities prices. Therefore, lawmakers can avoid any perceived tension between pursuing fairness and economic efficiency; they can either pursue property-based fairness in tandem with allocational efficiency or they can pursue information-equality-based fairness in tandem with market efficiency.

The long tradition of legally prohibiting some morally suspicious behaviors while leaving other moral issues to private decision-making supports the viability of lawmakers prioritizing one form of fairness and rejecting the other. The best example is that most lying is considered morally unacceptable, but only a subset of lying is prohibited under fraudulent misrepresentation laws.

In a future Article, I will explain why I would adopt reform proposals in line with property-based fairness doctrines and a revealed-preferences approach to economic efficiency. Fundamentally, this reform proposal abandons the concept of "correct price."[292] The proposal takes for granted that all prices are the product of some combination of civilian consent and government controls. Therefore, any securities transaction authorized with the right kind of consent should be recognized as doctrinally fair and protected by law. This approach poses at least four challenges. First, whose consent is required to authorize insider trading in the securities of a publicly traded company?[293] Second, what kind of process should be required to convey and document that consent?[294] Third, when should courts find the authorizing parties' consent to insider trading ineffective?[295] Finally, what are viable alternatives for openly pursuing the

292. Instead, I recognize that investors have the potential to be correct about price changes, but prices themselves cannot be correct or incorrect. I credit Ben Johnson for helping me to appreciate the importance of the "correct prices" concept for understanding disputes in modern securities regulation.

293. As between shareholders or directors.

294. Amendments to the company's bylaws or articles of incorporation, simple disclosure in the company's annual reports, etc.

295. *See* MODEL PENAL CODE § 2.11(3) (AM. L. INST. 1985) (defining ineffective consent); *see also*

distributional goals hidden beneath our current system of mandatory disclosure?[296]

RESTATEMENT (SECOND) OF TORTS: EFFECT OF CONSENT § 892A (AM. L. INST. 1979) (describing the requirements for effective consent).

296. Three viable alternatives are raised *supra* Part VII.A.1.