2015

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https://scholar.smu.edu/smurl/vol68/iss3/16

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THE LAW ON INSIDER TRADING LACKS NEEDED DEFINITION

Roberta S. Karmel*

The prosecution of insider trading has long been a key Securities and Exchange Commission (SEC) enforcement priority. In addition to SEC civil actions, criminal prosecutions of traders on inside information by the Department of Justice (DOJ) are also prevalent. Yet, insider trading is not defined in the federal securities laws. It is, essentially, a common law crime, interpreted by the courts. Further, the SEC has not posited a theoretical justification for its insider trading program beyond such platitudes as investor protection and fairness.

Initially, the ban against trading on inside information was justified under the equal access to information theory. However, this theory was explicitly rejected by the Supreme Court. Later in the 1980s, during the heyday of junk bond financing of tender offers, the SEC's insider trading program concentrated on trading in advance of tender offers. From time to time, security analysts have also been the focus of insider trading cases. Most recently, the SEC and DOJ have aggressively pursued traders for hedge funds. According to Andrew Ceresney, the Director of the Division of Enforcement, "[p]olicing insider trading has long been central to the Commission's mission of ensuring confidence in the markets." Over the past five years, the SEC has prosecuted more than 590 defendants in civil insider trading cases.

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5. Id.
Insider trading cases tend to be headline-grabbing prosecutions, often against colorful individuals. These blockbuster cases are used to prop up the SEC’s image as a tough cop on Wall Street, particularly after periods of deregulation leading to market collapses and scandals. While I do not believe that trading on insider information is salutary, or should be lawful, I do believe that the number and types of insider trading cases currently being brought by both the SEC and DOJ is a misallocation of enforcement resources, especially since most prosecutions are of lower level players, rather than high-level executives. Further, it is wrong for a person to be jailed for an undefined crime. The absence of a well-articulated justification for these prosecutions is also a problem. If the ban on trading on inside information were anchored in the SEC’s primary mandate of full disclosure by public corporations, its enforcement would be more viable from a theoretical perspective. Instead of continuing to develop insider trading violations through litigation, the SEC should advocate for a statutory definition of this currently undefined crime.

I. DEVELOPMENT OF DOCTRINE IN THE COURTS AND SEC PUSH BACK

The prohibition against trading on inside information under the federal securities laws derives from Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5 thereunder. Rule 10b-5, makes it unlawful for any person in connection with the purchase or sale of a security,

   (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made ... not misleading, or (c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit on any person.

It is important to note that Rule 10b-5 makes no reference to insiders, but prohibits certain fraudulent conduct by any person upon any other person.

The typical insider trading case involves silence by a buyer or seller of securities, and a failure by traders to disclose their possession of material non-public information. Since no untrue statement is made, the violation must implicate either clause (a) or (c) of Rule 10b-5. While Rule 10b-5 generally prohibits fraudulent and deceptive practices in the public securities markets, it does not outlaw all breaches of fiduciary duty or overreaching. The term “inside information” is generally defined as nonpublic information about events or circumstances related to a company’s assets or earning power known only to corporate management and

7. 17 C.F.R. § 240.10b-5.
its confidants, and which can reasonably be expected to have a material effect on the company's share price. However, some insider trading cases do not involve this type of corporate information, but rather trading by professionals on nonpublic market information, such as information about an upcoming tender offer. Finally, insider trading violations can also include the “tipping” of such information. The SEC's web site states that “illegal insider trading generally occurs when a security is bought or sold in breach of a fiduciary duty or other relationship of trust and confidence while in possession of material nonpublic information.” As explained below, the SEC’s definition appears to go beyond the holdings of relevant case law.

The first insider trading case under Rule 10b-5 was In re Cady, Roberts & Co., an administrative action against a broker-dealer. This broker-dealer’s liability was rooted in the conduct of one of its principals, who was the director of a corporation that decided upon a dividend cut. The director left the board meeting and immediately sold securities in customer accounts of the broker-dealer, including accounts in which he had a beneficial interest. In finding that this conduct violated Rule 10b-5, the SEC stressed the existence of a relationship that afforded the director access to inside information intended to be available only for a corporate purpose. In addition, the SEC emphasized the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure.

The SEC’s views on the illegality of insider trading were initially affirmed by the Second Circuit in SEC v. Texas Gulf Sulphur Co. In this case, the SEC obtained an injunction against an issuer, its officers and employees, forbidding them from trading and tipping others to trade stock and options on the basis of material, undisclosed information concerning a major copper strike by the issuer in Canada. The decision was predicated on the theory that investors who trade on impersonal exchanges should have relatively equal access to material information. The SEC argued in Texas Gulf Sulphur and subsequent cases that Rule 10b-5 requires a parity of information among all traders in the public securities markets.

10. Id. at 852.
13. Id. at 909.
14. Id.
15. Id. at 913.
16. Id. at 911-13.
18. Id. at 849.
However, this view was not fully accepted by all SEC Commissioners, and was later rejected by the Supreme Court. In re Investors Management Co. was an administrative proceeding against investment advisers and mutual fund managers who sold stock in McDonnell Douglas Corp. because they had received selective disclosure from the underwriter of Douglas's debentures of a reduction in Douglas's earnings. The Commission held that a person who obtains material, nonpublic corporate information, which he has reason to know emanates from a corporate source and which places him in a position superior to other investors, acquires a relationship with respect to that information giving rise to a legal duty under Rule 10b-5. In a concurring opinion, Commissioner Smith asserted that tippee responsibility must relate back to insider responsibility. More precisely, the tippee must know that the information was given to him in breach of a duty by a person having a special relationship to the issuer. Additionally, the information must be shown not only to be material and nonpublic, but also to have substantially contributed to the trading that occurred.

Although the In re Investors Management Co. decision is forty-five years old and there have been hundreds of insider trading prosecutions since then, the differing perspectives of the majority of the Commission and Commissioner Smith have never been resolved. The questions remaining from this debate include the following: (1) Is mere possession of material and nonpublic information sufficient for a violation, or must there be use or trading on the information; and (2) Must the tippee who trades on the information know that it was given to him in breach of a duty by a person having a special relationship with the corporation not to disclose the information.

In Chiarella v. United States, the Supreme Court rejected the SEC's parity of information theory, expressing the view that not every instance of financial unfairness violates Rule 10b-5. The Supreme Court reversed the conviction of a printer who learned about upcoming tender offers for several target companies, purchased shares in the companies, and then sold at a profit after the tender offer was announced. The names of the target companies were apparently coded rather clumsily, and the printer figured out the code. Thus, he was not actually tipped by anyone. The Supreme Court held that silence in connection with a purchase or sale constitutes fraud only if liability is premised on a duty to

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20. Id. at 636-37.
21. Id. at 641.
22. Id. at 640-41.
23. Id.
25. Id. at 231-32.
26. Id. at 224.
27. Id.
disclose arising from a relationship of trust and confidence.\textsuperscript{28}

Chief Justice Burger's dissent in \textit{Chiarella} proved very important in the development of insider trading law. He wrote that a rule, permitting parties to an arm's length business transaction to refrain from disclosing information absent a confidential or fiduciary relation, "permits a businessman to capitalize on his experience and skill in securing and evaluating relevant information; it provides incentive for hard work, careful analysis, and astute forecasting."\textsuperscript{29} Nevertheless, these very policies should limit the doctrine so that "a person who has misappropriated non-public information has an absolute duty to disclose that information or refrain from trading."\textsuperscript{30} Since \textit{Chiarella} was a 5-4 decision, with Justice Powell unwilling to address a theory that had not been argued below, the misappropriation doctrine presumably commanded a majority of the Court's justices.\textsuperscript{31}

The SEC, not willing to accept the Supreme Court's limited view of insider trading violations, passed Rule 14e-3 to try and avoid the full implications of \textit{Chiarella} in the case of tender offers.\textsuperscript{32} Since so many of the SEC's prosecutions at this time involved advance knowledge of tender offers, Rule 14e-3 proved useful. In addition, the SEC and the DOJ prosecuted numerous cases based on the misappropriation theory.

In \textit{Dirks v. SEC},\textsuperscript{33} however, the Supreme Court reaffirmed its rejection of the equal access or parity of information theory.\textsuperscript{34} \textit{Dirks} was an insurance company analyst who, after receiving information from a former officer of Equity Funding, pursued an independent investigation and discovered that Equity Funding was engaging in massive fraud.\textsuperscript{35} Dirks kept both his clients and potential clients apprised of his investigation and many of them sold Equity Funding stock.\textsuperscript{36} Before the facts became public, the price of Equity Funding stock fell from $26 to less than $15 a share.\textsuperscript{37} The SEC brought an administrative case against Dirks arguing that when tippees come into possession of material information they know is confidential, they must publicly disclose it or refrain from trading.\textsuperscript{38} The Court overturned the SEC's sanctions against Dirks and held

\begin{itemize}
\item \textsuperscript{28} \textit{Id.} at 230. This was the common law rule. \textit{See Strong v. Repide}, 213 U.S. 419, 431 (1909).
\item \textsuperscript{29} \textit{Chiarella}, 445 U.S. at 240 (Burger, J., dissenting).
\item \textsuperscript{30} \textit{Id.}
\item \textsuperscript{31} \textit{See generally Chiarella}, 445 U.S. 222 (1980).
\item \textsuperscript{32} 17 C.F.R. \textsection 240.14e-3 (2014) establishes a "disclose or abstain" from trading rule for any person who is in possession of material information relating to a tender offer which information he knows or has reason to know is nonpublic and emanates from the offeror or target company. The SEC argued that this is a prophylactic rule and neither scienter nor breach of duty was required for its violation. \textit{See Tender Offers, Exchange Act Release No. 17120, 45 Fed. Reg. 60,410 (Sept. 4, 1980)}.
\item \textsuperscript{33} \textit{Dirks v. SEC}, 463 U.S. 646 (1983).
\item \textsuperscript{34} \textit{Id.} at 657–58.
\item \textsuperscript{35} \textit{Id.} at 648–49.
\item \textsuperscript{36} \textit{Id.}
\item \textsuperscript{37} \textit{Id.} at 650.
\item \textsuperscript{38} \textit{Id.} at 651.
\end{itemize}
that a tippee's liability is derivative. Thus, a tippee cannot be held liable unless use of the information breaches a fiduciary duty that the tipper owed to either its clients or its organization and, in addition, the insider must have realized a personal benefit. This holding essentially endorsed Commissioner Smith's prior opinion in *Investors Management*.40

After the *Dirks* decision, the SEC attempted to push back with regard to selective disclosure. It attempted to distinguish *Dirks* in *SEC v. Stevens*,41 in which a CEO placed a series of unsolicited telephone calls to several securities analysts to advise them that quarterly results to be announced the next day would be lower than expected.42 The SEC asserted that the CEO took this action for his personal benefit—enhancing both his reputation and his status as a manager.43 The case was settled, so this theory was never tested in court. However, the SEC then adopted Regulation FD to regulate the disclosure practices of public companies in their communications with analysts. This regulation imposes a duty on public companies that disclose material nonpublic information to analysts or others in the securities industry to simultaneously disclose such information publicly.44 Interestingly, Regulation FD was not promulgated under Section 10(b) or (14) of the Exchange Act and cannot be the basis for a private damages suit or criminal prosecution.

Another type of insider trading case the SEC believed the courts were not properly interpreting involved the tipping of family members by insiders. In *United States v. Chestman*,45 a husband tipped a stockbroker concerning information that the husband had learned from his wife, who had learned it from her mother, who had learned it from his brother, a corporate insider.46 The stockbroker traded on the information and was subsequently prosecuted.47 The Second Circuit overturned his Section 10(b) conviction,48 holding that kinship did not suffice for establishing the fiduciary relationship required by *Chiarella* and *Dirks*.49 In response, the SEC then passed Rule 10b5-2, which defined circumstances in which a person has a duty of trust and confidence for purposes of the misappropriation theory to include the following:

(1) Whenever a person agrees to maintain information in confidence; (2) whenever the person communicating the information and the person to whom it is communicated have a history, pattern or practice of sharing confidences, such that the recipient of the in-

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39. *Id.* at 659.
42. *Id.*
43. *Id.*
44. 17 C.F.R § 243.100 (2014).
46. *Id.* at 555.
47. *Id.*
48. However, his conviction under Rule 14e-3 was affirmed. *Id.* at 571.
49. *Id.* at 568.
information knows or should know that confidentiality is expected; or
(3) whenever a person receives or obtains material nonpublic informa-
tion from his or her spouse, parent, child or sibling; provided
however, that the person receiving or obtaining the information may
demonstrate that no duty of trust or confidence existed with respect
to the information.\textsuperscript{50}

Whether the SEC has the power to reverse court decisions in this way,
especially for the purpose of creating criminal liability, is unclear.

Another unsettled issue after \textit{Dirks} that the SEC also attempted to
settle by rulemaking was what causal connection has to be shown be-
tween a trader's possession of insider information and his trading. In
\textit{United States v. Teicher} the Second Circuit took the view that "knowing
possession" is sufficient to establish insider trading liability.\textsuperscript{51} But in \textit{SEC
v. Adler}, the Eleventh Circuit held that "use" was required.\textsuperscript{52} Addition-
ally, in \textit{United States v. Smith}, the Ninth Circuit required that "use" be
proven in a criminal case because criminal intent cannot rest upon a legal
presumption.\textsuperscript{53} Once again, the SEC attempted to settle this issue
through rulemaking. In Rule 10b5-1, trading "on the basis" of material
nonpublic information is defined to mean if the trader "was aware of" the
inside information when he or she made the trade.\textsuperscript{54}

The next insider trading case after \textit{Dirks} to be heard by the Supreme
Court was \textit{United States v. O'Hagan}, a criminal conviction of an attorney
who traded in the securities of a target company when the bidder was a
client of the defendant's law firm.\textsuperscript{55} In upholding the conviction under
both Rule 10b-5 and 14e-3, the Court endorsed the misappropriation the-
ory and held that the SEC could regulate non-deceptive activities as a
reasonably designed means of preventing manipulative acts under § 14(e)
of the Exchange Act.\textsuperscript{56} The Court did not specifically address whether
trading while in knowing possession of insider information was sufficient
to sustain a conviction, but described the crime as trading "on the basis of
material, nonpublic information."\textsuperscript{57} In \textit{O'Hagan}, it is noteworthy that Jus-
tice Scalia protested that a criminal conviction based on judge made law
cravened the principle of lenity.\textsuperscript{58}

A case demonstrating the problems of limiting insider trading to
breach of fiduciary duty or misappropriation is \textit{SEC v. Dorozhko}, in
which the defendant hacked into Thomson Financial's servers and stole a
confidential earning report from a company called IMS Health.\textsuperscript{59} He then

\textsuperscript{50} 17 C.F.R. § 240.10b5-2.
\textsuperscript{51} United States v. Teicher, 987 F.2d 112, 120 (2d Cir. 1993).
\textsuperscript{52} SEC v. Adler, 137 F.3d 1325, 1338 (11th Cir. 1998).
\textsuperscript{53} United States v. Smith, 155 F.3d 1051, 1069 (9th Cir. 1998).
\textsuperscript{54} 17 C.F.R. § 240.10b5-1.
\textsuperscript{56} Id. 666–73.
\textsuperscript{57} Id. at 651–52.
\textsuperscript{58} Id. at 679 (Scalia, J., dissenting).
\textsuperscript{59} SEC v. Dorozhko, 574 F.3d 42, 44 (2d Cir. 2009).
traded on the stolen information. The defendant was an employee of neither Thomson Financial nor IMS Health. The district court dismissed the case, because there was neither a breach of a fiduciary duty nor a misappropriation under the theories generally used in misappropriation cases. The Second Circuit reversed on a theory of affirmative deception.

Perhaps emboldened by the Supreme Court’s endorsement of insider trader prosecutions in O’Hagan, and the Second Circuit’s decision in Dorozhko, the SEC and DOJ prosecuted insider trading cases with a vengeance. While most of these cases resulted in settlements or victories for the Government, some recent and exceptionally significant losses suggest that the SEC and DOJ may be pushing the envelope beyond the established doctrines acceptable to judges and juries.

In the seminal case, United States v. Newman, the Second Circuit dismissed with prejudice a conviction against two portfolio managers who were remote tippees. The court issued an opinion narrowing the parameters of the crime of trading on inside information. At the trial, the Government introduced evidence showing that a group of financial analysts received information from insiders at Dell and NVIDIA that disclosed earnings numbers before they were publicly announced. The analysts then passed on this information to defendants Newman and Chiasson, who executed trades in Dell and NVIDIA stock, earning $4 million and $68 million, respectively, in profits for their respective hedge funds. The defendants were three or four steps away from the tippers and there was no evidence that they were aware of the source of the inside information. Further, there was no proof that the corporate insiders provided the information in exchange for a personal benefit. The instructions given to

60. Id.
61. See id.
62. Id. at 49–51.
63. Id. at 49.
66. Id. at 443.
67. Id.
68. Id. at 444.
the jury stated that the Government needed to prove beyond a reasonable doubt that,

the material, nonpublic information had been disclosed by the insider in breach of a duty of trust and confidence . . . he must have known that it was originally disclosed by the insider in violation of a duty of confidentiality.69

The Second Circuit found these jury instructions wanting, because under Dirks it was necessary for the Government also to prove that the tippees knew the breach of duty was for a personal benefit.70 Furthermore, the Court in Dirks also held that a tippee's liability is derivative. Thus, a tippee cannot be held liable unless use of the information breaches a fiduciary duty that the tipper owed to its clients or organization and, in addition, the insider must have realized a personal benefit.71 In Newman, the Second Circuit interpreted this language as requiring that the tippee must have known about the personal benefit in order to be liable.72 According to the court, "insider trading liability is based on breaches of fiduciary duty, not on informational asymmetries. This is a critical limitation on insider trading liability that protects a corporation's interests in confidentiality while promoting efficiency in the nation's securities markets."73 The court therefore held that, in order to sustain an insider trading conviction against a tippee, the Government must prove beyond a reasonable doubt the following four elements:

(1) the corporate insider was entrusted with a fiduciary duty; (2) the corporate insider breached his fiduciary duty by (a) disclosing confidential information to a tippee (b) in exchange for a personal benefit; (3) the tippee knew of the tipper's breach, that is, he knew the information was confidential and divulged for personal benefit; and (4) the tippee still used that information to trade in a security or tip another individual for personal benefit.74

Moreover, the court took a narrow view of what might constitute a personal benefit, rejecting the idea that mere friendship was sufficient.75 Rather, the benefit must be objective, consequential, and represent a potential gain of a pecuniary or similarly valuable nature.76 The court found the Government's evidence with regard to a pecuniary benefit as insufficient under this standard and therefore reversed the convictions and remanded with instructions that the indictment be dismissed with prejudice.77 The holding of the Newman court, that the benefit of leaking information by a tipper cannot rest on friendship alone, is a variation of

69. Id.
70. Id. at 450.
72. Newman, 773 F.3d at 450.
73. Id. at 449.
74. Id. at 450.
75. Id. at 452–53.
76. Id. at 452.
77. Id. at 453.
this stumbling block from earlier cases, and ultimately raises a question as to the validity of Rule 10b-2.

II. STATUTORY DEFINITIONS

The SEC has generally resisted a definition of the wrong of insider trading on the grounds that such a definition would be a blueprint for fraud. Instead, it has merely passed rules to clarify the contours of insider trading in response to restrictive court decisions, as explained above. In the mid-1980s there was a serious attempt at a legislative enactment to define insider trading. However, such efforts never came to fruition, largely due to SEC intransigence.

In 1987, both the Senate and House proposed bills defining insider trading. Additionally, the SEC proposed its own bill. An important difference between these proposals was the liability provisions. The Senate bill and the SEC proposal would have given contemporaneous traders the right to recover damages; the House bill was a criminal statute. However, the proposals floundered on the controversy of possession versus use. The Senate bill attempted to outlaw,

information . . . used or obtained wrongfully only if it has been obtained by, or its use would constitute, directly or indirectly, theft, conversion, misappropriate or a breach of any fiduciary, contractual, employment, personal or other relationship of trust and confidence.

The SEC objected to this definition and after hearings, proposed a prohibition on trading while in possession of material, nonpublic information only if such information

has been obtained by, or its communication would constitute, directly or indirectly (A) theft, bribery, misrepresentation, espionage (through electronic or other means) or (B) conversion, misappropriation, or any other breach of any personal or other relationship of trust and confidence, or breach of any contractual or employment relationship.

The substitution of "possession" for a "use" standard proved too controversial and no action was taken on insider trading until the next session of Congress, when the Insider Trading and Securities Fraud Enforcement Act of 1988 was passed. This law significantly increased the sanctions for insider trading violations, but nevertheless did not contain any definition of insider trading.

78. See, e.g., United States v. Chestman, 947 F.2d 551 (2d Cir. 1991) (en banc).
82. S. 1380, at 2.
Currently, there are once again bills pending in Congress to define insider trading. These bills were introduced in an effort to counteract the Newman decision. The House bill would amend Section 10 of the Exchange Act to make it unlawful, "to purchase or sell any security, or any securities-based swap agreement, based on information that the person knows or, considering factors including financial sophistication, knowledge of and experience in financial matters, position in a company, and amount of assets under management, should know is material information and inside information." Further, "inside information" is defined as nonpublic, and obtained illegally, "directly or indirectly from an issuer with an expectation of confidentiality or that such information will only be used for a legitimate business purposes or in violation of a fiduciary duty."

The Senate bill would amend Section 10(b) to prohibit any person
(A) To purchase, sell, or cause the purchase or sale of any security on the basis of material information that the person knows or has reason to know is not publicly available, (B) To knowingly or recklessly communicate material information that the person knows or has reason to know is not publicly available to any other person under circumstances in which it is reasonably foreseeable that such communication is likely to result in a violation of subparagraph (A).

The Senate bill also defines "not publicly available" to "not include information that the person has independently developed from publicly available sources."

Although insider trading is generally viewed as wrongful, an overly broad definition could thwart legitimate corporate research. The threat this doctrine poses to security analysis has long been a barrier to statutory resolution of the problems with insider trading doctrine. How the SEC will react to the current efforts to define this violation remains to be seen. Moreover, in the current dysfunctional Congress, the chance of a bill defining insider trading gaining traction appears problematic. Nevertheless, the United States is out of step with most other jurisdictions in its lack of specific and clear legislation outlawing trading on insider information.

III. PHILOSOPHICAL JUSTIFICATIONS

Being against the ban on insider trading is like being against motherhood and apple pie, but in the midst of the SEC's aggressive enforcement of insider trading bans in the 1980s, some intrepid law and economics academics have argued that insider trading can be beneficial. This argu-

88. S. 702 § 2(2).
ment was first put forward by Henry Manne, who claimed that insider trading contributes to efficiency in stock market pricing and, in any event, insiders should be allowed to pocket the proceeds of trades on inside information as part of their compensation.\textsuperscript{90} This idea was endorsed by others who claimed that insider trading regulation is unnecessary and counterproductive because it frustrates prompt price adjustment to new private information.\textsuperscript{91} In rebuttal, most scholars condemned trading on inside information as unfair and wrong, primarily because giving insiders asymmetrical advantages erodes public confidence in the market.\textsuperscript{92}

One critique of the prevailing rationalization of insider trading bans is that the justification rests to some extent on the parity of information theory rejected by the Supreme Court. The acceptance of the misappropriation theory as a basis for insider trading bans then led to the property rights justification.\textsuperscript{93} The property right theory was endorsed by the Supreme Court in \textit{O'Hagan}, where the Court stated: "A company's confidential information . . . qualifies as property to which the company has a right of exclusive use. The undisclosed misappropriation of such information, in violation of a fiduciary duty . . . constitutes fraud akin to embezzlement."\textsuperscript{94} The trouble with this theory is that the federal securities laws are concerned with fairness and the protection of investors, not the protection of business property rights in information.

My view has long been that the ban on insider trading is necessary to maintain the SEC’s disclosure system.\textsuperscript{95} If insider trading could be engaged in with impunity, as urged by Henry Manne and Daniel Fischel, there would not be an incentive for public companies to make prompt disclosure of nonpublic information, especially information not required to be disclosed by regulation. The SEC’s Regulation FD is an effort to abolish selective disclosure by public companies. Nevertheless, to the extent Regulation FD chills communications between public companies and security analysts, it may be too blunt an instrument for encouraging the dissemination of public company information. The SEC assumes that information about public companies should get into the securities markets only through SEC disclosure documents, but this regime can add to mar-


ket volatility. When a lid has been kept on material news and that news is then put out, it can result in almost instantaneous and sharp changes in the price of a company's stock. In today's fast markets, the general public is not in a position to absorb the information and trade on it before market professionals do so. So what is a very rigorous ban on insider trading accomplishing?

Trading on market information, and particularly information about an upcoming tender offer, has a different focus. In such situations, the ban on trading on inside information is for the protection of the bidder. However, as a policy matter, it is unclear why the bidder should be protected. The SEC could eliminate much of the insider trading that is fodder for its enforcement cases if it closed the ten-day window during which bidders need not announce a tender offer.96

I am not advocating in favor of trading on inside information, but I believe that the Government is utilizing too many resources chasing after insider traders for the sake of bringing prosecutions, without an analysis of how these cases are implementing general SEC policies, especially with regard to disclosure. The "disclose or abstain" from trading doctrine is quite an artificial construct as applied to tippees and remote tippees. The SEC's program with regard to insider trading, instead of racking up prosecutions, should instead be aimed at compelling issuers and bidders to make prompter disclosure.

In recent years, many of the insider trading prosecutions were aimed at hedge funds and expert networks, without an articulation by the Commission as to its goals or how it believes hedge fund activities are contrary to the public interest. Why does the SEC believe that the "edge" hedge funds are seeking is unfair or otherwise destructive of investor confidence? In the past, the SEC took similar aim at security analysts. Does the SEC believe that it should enjoy a monopoly on the transmission of information that is issued by a public company into the marketplace? Or should public companies be making more timely disclosures?

So far, the SEC seems to have a knee jerk reaction of responding to the Newman case by claiming it is wrong and will stand in the way of further prosecutions. As a result, it will bring insider trading cases administratively, rather than in the courts where judges and juries can overturn the government's prosecutorial decisions.97 Instead of continuing with this enforcement precedent, the SEC should review its insider trading program to articulate the underlying policies for the program and refine the types of cases that are central to the program.

The Supreme Court and now the Second Circuit seem critical of the SEC's and DOJ's theories underlying their more aggressive insider trading prosecutions. While the SEC is unhappy with these seminal court decisions, it should nevertheless tailor its prosecutions to the law set forth

by the Supreme Court and encourage Congress to define insider trading violations by statute. Some of the Government’s motivation in prosecuting so many insider trading cases may have been to burnish its image after the Madoff debacle and the 2008 financial meltdown, but losing cases does not enhance the SEC’s reputation.