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Insider Trading as Private Corruption

Sung Hui Kim

ABSTRACT

Deep confusion reigns over federal insider trading law, even over the essential elements of an insider trading violation. On the one hand, this uncertainty seems to have encouraged the Securities and Exchange Commission (SEC) and some lower courts to push the boundaries well beyond the limits previously established by the U.S. Supreme Court. On the other hand, influential academics continue to express normative skepticism as to why there is even a ban on insider trading at all. Without a satisfying theory of what constitutes insider trading and why it is wrong, doctrinal development in the lower courts has reached a crisis, with the economic stakes only getting higher. This Article offers a new theory of insider trading law. It maintains that insider trading is a form of private corruption, defined as "the use of an entrusted position for self-regarding gain." The corruption theory not only provides answers to the normative skeptics but, as compared to the two leading alternatives, the property theory and the unjust enrichment theory, more closely aligns with the core features of the received insider trading doctrine. And, on careful analysis, the corruption theory reveals an implicit and previously unappreciated coherence to the doctrine. Finally, the corruption theory provides relatively concrete guidance in hard cases, which is the sort of pragmatic theory that the SEC and the courts desperately need.

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INTRODUCTION

Federal insider trading law seems to be a "theoretical mess."[1] According to the consensus view among experts, it is "seriously flawed,"[2] "ill-defined,"[3] "inconsistent,"[4] "astonishingly dysfunctional,"[5] "enigma[tic],"[6] and even "an ass."[7] To outsiders, such a consensus might be hard to believe in light of the high stakes involved, including prison, bankruptcy, and billions of dollars. For example, in May 2011, Raj Rajaratnam, the former head of the Galleon Group hedge fund, received an eleven-year prison sentence for insider trading, the longest prison sentence ever imposed for the crime.[8] More recently, in November 2013, SAC Capital Advisors hedge fund pleaded guilty to insider trading charges and agreed to pay $900 million in criminal penalties,[9] adding to civil fines of $900 million for a record-breaking total penalty of $1.8 billion.[10] Despite these enormous stakes, a satisfying theory of insider trading law has yet to emerge.[11] And this is not for want of trying.[12]

1. *See* Alan Strudler & Eric W. Orts, *Moral Principle in the Law of Insider Trading*, 78 TEX. L. REV. 375, 379 (1999).
2. Jill E. Fisch, *Start Making Sense: An Analysis and Proposal for Insider Trading Regulation*, 26 GA. L. REV. 179, 184 (1991).
3. Donald C. Langevoort, *Insider Trading and the Fiduciary Principle: A Post-*Chiarella *Restatement*, 70 CALIF. L. REV. 1, 3 (1982).
4. Thomas Lee Hazen, *Identifying the Duty Prohibiting Outsider Trading on Material Nonpublic Information*, 61 HASTINGS L.J. 881, 886 (2010).
5. Saikrishna Prakash, *Our Dysfunctional Insider Trading Regime*, 99 COLUM. L. REV. 1491, 1493 (1999).
6. Stephen Bainbridge, *The Insider Trading Prohibition: A Legal and Economic Enigma*, 38 U. FLA. L. REV. 35, 37 (1986).
7. Fisch, *supra* note 2, at 179 ("When Charles Dickens wrote 'the law is a[n] ass,' he might well have been describing the law governing insider trading.").
8. SEC v. Rajaratnam, 822 F. Supp. 2d 432, 433 (S.D.N.Y. 2011) (noting Rajaratnam's prison sentence imposed in the criminal case against him).
9. Ben Protess & Peter Lattman, *After a Decade, SAC Capital Blinks*, N.Y. TIMES DEALBOOK (Nov. 4, 2013, 8:54 PM), http://dealbook.nytimes.com/2013/11/04/after-a-decade-sac-capital-blinks; Nate Raymond & Joseph Ax, *SAC Capital Pleads Guilty in Criminal Court*, REUTERS (Nov. 8, 2013, 5:52 PM), http://www.reuters.com/article/2013/11/08/us-sac-plea-entered-idUSBRE9A710M20131108.
10. Protess & Latman, *supra* note 9 (noting that the $1.8 billion punishment sets a record for insider trading cases).
11. *See* James D. Cox, *Insider Trading and Contracting: A Critical Response to the "Chicago School,"* 1986 DUKE L.J. 628, 634 (noting lack of "a coherent, let alone articulated, philosophy of regulation").
12. Lawrence E. Mitchell, *The Jurisprudence of the Misappropriation Theory and the New Insider Trading Legislation: From Fairness to Efficiency and Back*, 52 ALB. L. REV. 775, 775 (1988) ("Many forests have been destroyed in the quest to understand and explain the law of insider trading.").

The absence of a satisfying theory of insider trading law may have real-world consequences. Numerous lower courts as well as the Securities and Exchange Commission (SEC) have recently attempted to expand liability beyond what many thought to be the well-settled parameters established by the U.S. Supreme Court. In *SEC v. Dorozhko*,[13] for example, the question presented was whether a hacker's infiltration of a company's server and his subsequent trading on the extracted financial information violated federal insider trading law.[14] According to established precedent, the hacker would not be liable for insider trading[15] because insider trading generally requires the breach of a fiduciary duty or similar duty arising out of a relation of trust and confidence.[16] Such a duty was absent because the hacker was not a fiduciary to anyone. Nevertheless, the Second Circuit Court of Appeals held that liability could be found—even without a breach of fiduciary duty—as long as the defendant "affirmatively misrepresented himself in order to gain access to material, nonpublic information, which he then used to trade."[17] This holding was notwithstanding the district court's express concern that doing so "would . . . undo decades of Supreme Court precedent."[18]

Accepting for the moment that the district court's assessment was correct, was the Second Circuit nonetheless justified in casting aside the fiduciary duty requirement in order to punish the hacker? How would one know? It would be nice to be able to derive a determinate answer from the plain text of the relevant securities statute and regulations. But as detailed below, that text is vague; thus, we must interpret the case law. Yet without a theory of insider trading law that can explain, for example, why a breach of fiduciary duty was judicially mandated in the first place, we cannot know whether the Second Circuit's holding was a fundamental error or long overdue doctrinal improvement.

This Article offers a new theory of insider trading law that provides answers to questions that have long been posed by scholars and litigants alike: Insider

13. SEC v. Dorozhko, 606 F. Supp. 2d 321, 326 (S.D.N.Y. 2008) (*Dorozhko I*), *vacated*, SEC v. Dorozhko, 574 F.3d 42 (2d Cir. 2009) (*Dorozhko II*). Another hack-and-trade case, which was settled, is *SEC v. Stummer*. *See* SEC Files Settled Illegal Trading Charges Against Day Trader Who Traded on Information He Fraudulently Obtained From His Brother-in-Law, Litigation Release No. 20529, 93 SEC Docket 115 (Apr. 17, 2008), *available at* http://www.sec.gov/litigation/litreleases/2008/lr20529.htm.
14. *Dorozhko II*, 574 F.3d at 42.
15. The district court noted that the defendant's conduct might have violated the Computer Fraud and Abuse Act, 18 U.S.C § 1030(a)(4) (2012), and the mail and wire fraud statutes, 18 U.S.C. § 1341 *et seq*. *Dorozhko I*, 606 F. Supp. 2d at 324. In addition, the defendant may also be prosecuted for trespass. *See* N.Y. PENAL LAW § 140.05 (McKinney 2010).
16. *See infra* note 64.
17. *Dorozhko II*, 574 F.3d at 49–50.
18. *Dorozhko I*, 606 F. Supp. 2d at 323.

trading is a form of private corruption. By viewing insider trading in this light, we get a normatively plausible account of why there is a ban on insider trading in the first place. Moreover, this understanding helps rationalize and reconceptualize many of the key doctrinal choices made by the Supreme Court that previously seemed idiosyncratic or accidental. In other words, by viewing insider trading as corruption, what appeared initially as a mess starts to cohere and make sense. We begin to see that the courts all along may have been groping toward the intuitive understanding that insider trading is corrupt.

Part I reviews the state of the doctrine and commentary to explain why insider trading law needs a unifying theory. Despite decades of judicial elaboration, confusion and disagreement persist about fundamental doctrinal issues, even over the essential elements of an insider trading violation. The SEC seems to have benefitted from such confusion and disagreement as it has attempted to expand the scope of liability. Pushing in the opposite direction, influential academics continue to challenge the very existence of the insider trading ban. They see insider trading as a victimless crime that actually benefits society by inducing share price movements, making the markets more efficient. Without a theory of insider trading law that explains the core features of the doctrine and provides the normative justification for its prohibitions, doctrinal instability—of which *Dorozhko* is just one example[19]—will only worsen.[20]

Part II introduces the theory of insider trading as private corruption. Acknowledging that corruption is most commonly understood in public sector terms, I begin my analysis with the standard definition of public corruption—*the use of public office for private gain*. This definition is then transposed into the private context by making two key substitutions. First, "public office" is replaced with "entrusted position," a term that encompasses private sector roles in which the individual is expected to act loyally in the context of trust.

19. In addition to the Supreme Court insider trading cases discussed in Part I.A, *Dorozhko II* is in tension with many precedents. *See, e.g.*, Regents of the Univ. of Cal. v. Credit Suisse First Bos. (USA), Inc., 482 F.3d 372, 389 (5th Cir. 2007) ("[T]he [Supreme] Court . . . has established that a device, such as a scheme, is not 'deceptive' unless it involves breach of some duty of candid disclosure."); SEC v. Cherif, 933 F.2d 403, 412 (7th Cir. 1991) (stating that a person breaching a fiduciary duty to the source "betray[s] a trust in a way that a mere thief does not"); United States v. Cassese, 273 F. Supp. 2d 481 (S.D.N.Y. 2003) (dismissing claim due to absence of a fiduciary-like relationship between the defendant and the source); United States v. Kim, 184 F. Supp. 2d 1006, 1015 (N.D. Cal. 2002) (dismissing claim due to absence of a fiduciary or "similar relationship of trust and confidence" between the defendant and the source); SEC v. Switzer, 590 F. Supp. 765, 766 (W.D. Okla. 1984) (dismissing claim due to absence of fiduciary ties to the source of information).

20. *Cf.* Jonathan R. Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9, 47 (1984) ("It is this lack of a 'grand unifying theory' that accounts for the current confusion and incoherence in the law.").

Second, "private gain" is replaced with "self-regarding gain," defined as "supererogatory gain to the individual or her relatives, friends, or acquaintances."[21] By making these substitutions, the admittedly vague notion of private corruption is operationalized into a more specific, analytic definition—*the use of an entrusted position for self-regarding gain.* To complete the basic analysis, I show that a paradigmatic case of insider trading falls under the definition of private corruption.

But a good theory of insider trading law must also be normatively plausible. In other words, it must help make the normative case of why insider trading should be banned in the first place. The corruption theory does so by helping us appreciate that insider trading inflicts the same types of costs seen in the public corruption context—namely, temptation, distraction, and legitimacy costs. By taking stock of these three types of costs, one can better respond to those who quarrel with the very idea of banning insider trading.

I do not propose the corruption theory in a vacuum. Therefore, Part III examines the two leading alternative theories of insider trading law. Property theory conceptualizes inside information as corporate property. Trading on inside information is thus like pilfering property belonging to the firm. Although this framing is comprehensible, internally coherent, and connects to a rich literature on information as property, it has an obvious deficiency: insufficient descriptive power. Even though it is attractive in the abstract, the property theory diverges too much from the relevant Supreme Court jurisprudence for it to accurately describe the law of insider trading as it stands.

The other serious contender is the unjust enrichment theory, which suggests that insider trading amounts to an unjust enrichment of the defendant whose profits should be disgorged. By shifting focus from the alleged victim's loss to the wrongdoer's ill-gotten gain, unjust enrichment theory ably responds to commentators who see insider trading as causing no harm. But on close appraisal, this theory not only begs the fundamental question of what counts as unjust but also departs materially from the received doctrine. Regrettably, neither of the two contender theories adequately describes or explains federal insider trading law.

By contrast, the corruption theory does a better job of both fitting and explaining the core features of the received doctrine. It also provides a satisfying account of why decades ago the Supreme Court originally mandated the breach of fiduciary duty element for an insider trading violation and has since maintained that requirement. The doctrinal fit of the corruption theory is not

21. *See infra* Part II.A.2.a.

perfect, however. As explained below, the sites where the corruption theory diverges from the received doctrine constitute areas ripe for doctrinal reform.

Part IV explores implications of the corruption theory for insider trading law. In particular, it examines how this new framing helps resolve some difficult insider trading cases, such as *Dorozhko*, that continue to divide courts and commentators.

I. THE STATE OF FEDERAL INSIDER TRADING LAW

In Part I, I explain the need for a unifying theory of insider trading law. I begin with a brief summary of the so-called "mess" that is federal insider trading law, which has been heavily shaped by the Supreme Court in three key cases. Next, I describe the doctrinal instability that has arisen from this mess as revealed by an examination of several lower court decisions. Last, I discuss the normative skepticism that has long plagued the ban on insider trading.

A. The Doctrinal Mess

1. The Received Doctrine

Two key provisions anchor federal insider trading law: Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and SEC Rule 10b-5, which was adopted in 1942.[22] In Section 10(b), Congress made it unlawful to use "in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention" of rules promulgated by the SEC.[23] In Rule 10b-5, the SEC proscribed "engag[ing] in any act, practice, or course of business which operates . . . as a fraud or deceit upon any person, in connection with the purchase or sale of any security."[24] Given the vagueness of these proscriptions, it is not surprising that federal insider trading law has developed through incremental common-law–like elaboration. In telling the story of this legal accretion, commentators consistently mark three Supreme Court cases as critical.

22. By "insider trading law," I exclude the short-swing profits rule of Section 16(b) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. § 78p(b) (2012), which has a much narrower scope than the insider trading prohibition under Section 10(b), and Rule 14e-3, 17 C.F.R. § 240.14e-3 (2013) enacted under Section 14(e) of the Exchange Act and thus grounded in a separate policy rationale.
23. 15 U.S.C. § 78j(b).
24. 17 C.F.R. § 240.10b-5(c).

a. *Chiarella* and the Classical Ban: Fraud and Fiduciary Duty

First, in *Chiarella v. United States*,[25] the U.S. Supreme Court grounded federal insider trading law in the common law of fraud. Vincent Chiarella was an employee of a financial printer, Pandick Press, which had been engaged by clients to prepare their takeover bids of target companies. Despite the printer's best efforts to keep the clients anonymous, Chiarella divined their true identities, purchased (and later sold) the targets' stock, ultimately pocketing over $30,000 in profit.[26]

The jury convicted Chiarella of violating Section 10(b), and the Second Circuit Court of Appeals affirmed the conviction based on circuit precedent that embraced a broad policy of equality of access to information.[27] According to this precedent, anyone in possession of material, nonpublic information for any reason was subject to a duty to disclose or abstain. Such person must either disclose the information to the investing public or abstain from trading on it.[28]

The Supreme Court rejected the equal access policy as overbroad[29] and announced the "classical theory"[30] as the basis for imposing on defendants the duty to disclose or abstain. In an effort to comply with the text of Section 10(b) as proscribing "manipulative or deceptive device[s] or contrivance[s]," the Court framed the question as simply one about fraud.[31] Did Chiarella commit fraud when he traded while possessing nonpublic information? On the one hand, the common law of fraud generally requires an affirmative misrepresentation or a half-truth,[32] which was absent because Chiarella (like most insider traders) traded silently. On the other hand, the Court identified an exception to the rule. After noting that "one who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so," the Court observed that "the duty to disclose arises when one party has information 'that the other [party] is entitled to

25. 445 U.S. 222 (1980).
26. *Id.* at 224.
27. *See* United States v. Chiarella, 588 F.2d 1358, 1365 (2d Cir. 1978).
28. *Id.*
29. *Chiarella*, 445 U.S. at 233 ("[N]either the Congress nor the Commission ever . . . adopted a parity-of-information rule.").
30. Here, theory is used more narrowly, merely to identify different doctrines that have established liability based on different sets of elements.
31. *Chiarella*, 445 U.S. at 226 ("Section 10(b) was designed as a catchall clause to prevent fraudulent practices.").
32. Langevoort, *supra* note 3, at 4–5.

know because of a fiduciary or other similar relation of trust and confidence between them.'"[33]

But after pointing out this crucial exception—based on a fiduciary or fiduciary-like duty to disclose—the Court found no liability on the facts of the case. Importantly, Chiarella was a "complete stranger who dealt with the sellers only through impersonal market transactions."[34] He owed no preexisting duty to disclose; thus, the Court reversed his conviction.

b. *Dirks* and the Ban on Tipping: Derivative Fiduciary Duties

A few years later, in *Dirks v. SEC*,[35] the Court addressed the harder question of tipper-tippee liability. Ronald Secrist, a former officer of Equity Funding of America, tipped off Raymond Dirks, a securities analyst, that employees of Equity Funding were engaged in widespread fraud. After confirming Secrist's allegation through an investigation, Dirks communicated his findings to the SEC,[36] the *Wall Street Journal*,[37] and his clients, who then promptly liquidated their holdings and avoided large losses.[38] Although Dirks acted as a whistleblower, the SEC still censured him for telling his clients about the fraud.[39] The SEC argued that the mere knowing receipt of material, nonpublic information from an insider could give rise to the duty to disclose or abstain.[40]

The Supreme Court disagreed. Recall that in *Chiarella*, the Court highlighted the fiduciary duty exception to the general rule that fraud requires an affirmative misstatement. In *Dirks*, the Court expanded the reach of this duty along two axes. First, the Court recognized a chain of derivative fiduciary obligations flowing from tipper to tippee. Even if Dirks—the tippee—had no direct fiduciary relationship to the counterparties of the trade, he could still have inherited a fiduciary relationship from Secrist—the tipper.[41] According to the Court, "[T]ransactions of those who knowingly participate with the fiduciary in such a breach are 'as forbidden' as transactions 'on behalf of the trustee' himself."[42]

33. *Chiarella*, 445 U.S. at 228.
34. *Id.* at 232–33.
35. 463 U.S. 646 (1982).
36. *Id.* at 650 n.3.
37. *Id.* at 649–50.
38. *Id.* at 648–50 (avoiding about $16 million in losses).
39. *Id.* at 650.
40. *Id.* at 651, 655–56.
41. *Id.* at 660.
42. *Id.* at 659 (quoting Mosser v. Darrow, 341 U.S. 267, 272 (1951)).

Second, the Court clarified that the relevant fiduciary or fiduciary-like duty would not fall solely on traditional corporate insiders, such as directors and officers. Instead, the Court observed that some outsiders—for example, underwriters, accountants, lawyers, or consultants—could be deemed constructive insiders by virtue of the fact that they "have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes."[43]

Having made these two doctrinal expansions, the Court finally addressed whether Dirks had violated insider trading law. The answer turned on whether Secrist, the insider-tipper, had himself breached a fiduciary duty in telling Dirks. If so, that breach could travel down derivatively to Dirks. But for Secrist to breach his fiduciary duty, he would have had to tip for an improper purpose[44]—that is, in order to personally benefit from the disclosure.[45] In the Court's judgment, Secrist tipped Dirks not to obtain any personal benefit but to bring Equity Funding's fraud to light. Accordingly, he violated no fiduciary duty. Because the tipper himself breached no fiduciary duty, there could be no derivative breach by the tippee, Dirks.[46]

c. *O'Hagan* and the Misappropriation Ban on Outsider Trading

In *United States v. O'Hagan*,[47] a corporate bidder retained a law firm to help plan a tender offer for the shares of a publicly traded target company. The defendant, James O'Hagan, was a partner at that law firm. Although not working on the matter, he got wind of the tender offer, bought up call options and shares of the target company, and eventually turned a $4.3 million profit.[48] The trial court convicted O'Hagan under various statutes, including Section 10(b),[49] but the Eighth Circuit reversed the Section 10(b) conviction.[50]

Under the classical theory, O'Hagan could not be held liable for insider trading because he had no fiduciary or fiduciary-like relationship with the shareholders of the target company whose stock he traded. Like Chiarella, he

43. *Id.* at 655 n.14.
44. *Id.* at 662 ("Whether disclosure is a breach of duty therefore depends in large part on the purpose of the disclosure.").
45. *Id.* ("[T]he test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders.").
46. *Id.* at 666–67.
47. 521 U.S. 642 (1997).
48. *Id.* at 648.
49. *Id.*
50. United States v. O'Hagan, 92 F.3d 612, 628 (8th Cir. 1996).

was an outsider with respect to the issuer of the traded securities.[51] Also, O'Hagan inherited no derivative fiduciary duties on a tipper-tippee basis. The information originated from the bidder, who was not an insider or constructive insider of the target company. Moreover, the bidder did not leak information obtained from the target company for any improper purpose. Rather, the bidder was confidentially sharing its own information with its law firm for the legitimate purpose of planning its tender offer. As a result, the Court found O'Hagan not to have aided and abetted any fiduciary's breach.

Nevertheless, the Supreme Court insisted on finding O'Hagan liable for insider trading. It did so by relying on the "misappropriation theory."[52] Writing for the *O'Hagan* majority, Justice Ginsburg declared that "a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality" violates Section 10(b) and Rule 10b-5 because such trading "defrauds the principal of the exclusive use of that information."[53] In other words, it sufficed that O'Hagan was a fiduciary to his principal—his law firm—and that he used information provided by his principal for selfish gain in breach of a duty of loyalty and confidentiality. Thus, liability under the misappropriation theory is premised on a preexisting fiduciary or fiduciary-like relationship between the defendant trader and the source "who entrusted him with access to confidential information."[54] In this way, liability could be assigned to outsiders, who need not have any relationship whatsoever with the issuer of the securities in which they trade, so long as their trading "breach[ed] a recognized duty"[55] owed to the information's source. For this reason, insider trading in violation of the misappropriation theory—and not the classical theory—is often referred to as "outsider trading."[56]

51. *See* SEC v. Clark, 915 F.2d 439, 443 (9th Cir. 1990) (defining "outsiders" as "persons who are neither insiders of the companies whose shares are being traded, nor tippees of such insiders"). Further, O'Hagan was not a constructive insider.
52. The majority in *Chiarella* did not consider a version of this theory because it had not been properly presented to the jury. Chiarella v. United States, 445 U.S. 222, 237 n.21 (1980).
53. *O'Hagan*, 521 U.S. at 652.
54. *Id.*
55. *Id.* at 666.
56. *See, e.g.*, Hazen, *supra* note 4, at 884 n.11. The overlap between the terms "insider trading" and "outsider trading" is complex and depends on the context. Often the term "insider trading" is used generally to refer to those violations of Rule 10b-5 that involve the silent trading on material, nonpublic information, including acts of outsider trading. Sometimes, insider trading is used more specifically to focus on trading by corporate or constructive insiders (under classical theory) as distinguished from outsider trading, which always focuses on trading by those who have no fiduciary-like ties to the issuer of the traded securities (under misappropriation, not classical, theory). To be sure, all classical theory violations could

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Over the past decades, the Supreme Court has given specific substantive content to the vague verbiage of Section 10(b) and Rule 10b-5. In *Chiarella*, the Court rejected any grand theory of insider trading law as equalizing access to relevant information. Instead, it embraced a simpler, narrower, and seemingly straightforward understanding of "insider trading-as-common law fraud." This approach had immediate path-dependent consequences,[57] such as a need for a fiduciary-like relationship because inside trades generally lack affirmative misrepresentations. In subsequent cases, *Dirks* and *O'Hagan*, the Court retained its official commitment to fraud while expanding the scope of insider trading liability. It did so through various doctrinal innovations—additional steps along the same purported path. But were these tweaks to the doctrine coherent, internally consistent, and sustainable within a fraud framework? Or were they kludges that merely postponed insider trading law's collapse into confusion?

2. The Uncertain Future

a. Centrality of Fiduciary Duty

On close examination, the straightforward pronouncements on the basic elements of an insider trading violation turn out not to cohere as much as they initially seemed. Consider, for example, the black letter requirement of the breach of a fiduciary (or fiduciary-like) duty. Recall that in *Chiarella*, the fiduciary duty element was originally offered as a solution to the act/omission problem: Even though insider trading does not involve the *act* of affirmative misrepresentation, an *omission*—the failure to disclose—could nevertheless count as fraud if the defendant was already subject to a duty to disclose.[58] Over time, however, this duty has mutated in puzzling ways.

In *Dirks*, the Court advanced the idea of derivative fiduciary duties that travel from tipper to knowing tippee. In doing so, the Court silently substi-

alternatively be recharacterized as misappropriation theory violations. But this is typically not done in the doctrine or the commentary.

57. *See* Stephen M. Bainbridge, *Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud*, 52 SMU L. REV. 1589 (1999).

58. *See* Chiarella v. United States, 445 U.S. 222, 228 (1980); Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties Into the Federal Insider Trading Prohibition*, 52 WASH. & LEE L. REV. 1189, 1194 (1995) ("[T]he Court made clear that liability could be imposed only if the defendant was subject to a duty to disclose prior to trading.").

tuted the insider's duty of disclosure owed to the shareholders—the basis for *Chiarella*'s classical theory—with the insider-tipper's duty of loyalty and confidentiality not to use confidential corporate information for personal benefit.[59] The insider-tipper's breach of his duty of loyalty and confidentiality, which is owed to the corporation,[60] was then transformed back into a breach by the tippee of a duty of disclosure owed to the corporation's shareholders.[61] This mutation (of the specific duty and the beneficiary of the duty) enabled the Court to reach the result that it wanted, namely, to proscribe tipping. But in doing so, the Court departed from the original purpose of the fiduciary duty requirement, which was to cure the absence of an affirmative misrepresentation within a fraud framework. In *O'Hagan*, the Court even more explicitly embraced the importance of the duty of loyalty and confidentiality.[62]

If the fiduciary duty requirement can mutate in its features, might it vanish altogether?[63] Consider the hypothetical of the ninja trader. In the dead of night, a ninja scales the building that houses Acme Manufacturing Company, a publicly traded industrial explosives corporation. After prying open the window, the thief enters the office of the chief accounting officer and sifts through documents sitting on a desk. The ninja comes across a memo, marked "Confidential," which describes Acme's plans to unveil a revolutionary, environmentally friendly, and nontoxic industrial explosive. The thief exits the window, sprints home, and buys shares of Acme stock

59. *See* Dirks v. SEC, 463 U.S. 646, 653–54, 659 (1982) (explaining liability as arising from "the 'inherent unfairness involved where one takes advantage' of 'information intended to be available only for a corporate purpose and not for the personal benefit of anyone'" and noting that insiders are "forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage"); Bainbridge, *supra* note 58, at 1195 ("What is proscribed is not merely a breach of confidentiality by the insider, but rather a breach of the duty of loyalty imposed on all fiduciaries to avoid personally profiting from information entrusted to them.").

60. *See, e.g.*, Bainbridge, *supra* note 57, at 1615 ("[T]he duty at issue in tipping cases is not a duty to disclose, but rather a duty to refrain from self-dealing in confidential information owed by the tipper to the source of the information.").

61. *See* A.C. Pritchard, United States v. O'Hagan*: Agency Law and Justice Powell's Legacy for the Law of Insider Trading*, 78 B.U. L. REV. 13, 27 (1998) (noting Justice Powell's "transformation of the tipper's breach of his duty of confidentiality owed to the corporation into a breach by the tippee of a duty of disclosure to shareholders").

62. *See* United States v. O'Hagan, 521 U.S. 642, 652 (1997) ("Under this theory, a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information."); *id.* at 656 ("[T]he fiduciary's fraud is consummated, not when the fiduciary gains the confidential information, but when, without disclosure to his principal, he uses the information to purchase or sell securities.").

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

through his online brokerage account. Once news of Acme's new product goes public, the price of Acme stock skyrockets—to the ninja's enormous profit. Without question, the ninja clearly violated state criminal laws by breaking and entering. But did he also violate federal insider trading law?

A lay reader might answer "yes" because the ninja is a thief who used nonpublic information to make money in the securities markets. But the textbook answer is "no." Under *Chiarella* and *O'Hagan*, the defendant-trader must have breached a fiduciary or fiduciary-like duty.[64] But the ninja has no fiduciary-like ties to the selling shareholders of Acme, as required by the classical theory. Nor does the ninja have a fiduciary-like relationship with Acme (the source of information), as required by the misappropriation theory. The ninja is a fiduciary to no one. Nevertheless, lower courts have succumbed to the instinct to punish people like the ninja. Instead of a fictional ninja scaling brick-and-mortar walls, there is, for instance, a real-world hacker infiltrating firewalls in the previously mentioned case of *SEC v. Dorozhko*.[65]

Or consider something less radical than tossing out the fiduciary duty requirement altogether and instead allowing contract to stand in its place. In 2000, the SEC adopted a controversial regulation that established that—for purposes of the misappropriation theory—a duty of "trust or confidence" exists "[w]henever a person agrees to maintain information in confidence."[66] In other words, the rule provided that a breach of a mere promise of confidentiality could substitute for a breach of a fiduciary-like duty.

This rule was tested in 2009, when the SEC brought a civil enforcement action against Mark Cuban, the owner of the Dallas Mavericks, who had been a large minority shareholder of Mamma.com. In *SEC v. Cuban*,[67] the federal district court concluded that liability under the misappropriation theory could attach even in the absence of a preexisting fiduciary or fiduciary-like relationship so long as there was a specific type of agreement.[68] The court, however, distinguished between an agreement of confidentiality and an agreement not to use information for personal gain. For insider trading liability, the court insisted on the latter—an agreement not to use information for

64. *See O'Hagan*, 521 U.S. at 653–60; Chiarella v. United States, 445 U.S. 222, 227–30 (1980); *see also* cases cited *supra* note 19.
65. *See supra* text accompanying notes 13–19; *see also infra* Part IV.A.1 for further discussion of this case.
66. 17 C.F.R. § 240.10b5-2(b)(1) (2013).
67. SEC v. Cuban (*Cuban I*), 634 F. Supp. 2d 713 (N.D. Tex. 2009), *vacated*, SEC v. Cuban (*Cuban II*), 620 F.3d 551 (5th Cir. 2010).
68. *Cuban I*, 634 F. Supp. 2d at 725.

personal gain.[69] Finding no such contractual duty pled in the complaint, the court dismissed the case. With respect to the SEC regulation, it held that if the rule permitted a mere confidentiality agreement—without a nonuse component—to substitute for a fiduciary duty, then the SEC had overstepped its authority and the regulation was invalid.[70]

The Fifth Circuit Court of Appeals disagreed with the district court's ruling and remanded the case to determine whether the facts supported a finding of a nonuse agreement.[71] It declined to address the validity of the SEC rule[72] and refused to contradict the district court's claim that liability could attach even in the absence of a fiduciary-like duty.[73] The Fifth Circuit's decision was notwithstanding the amicus brief submitted by leading securities law experts, which emphasized that all the relevant Supreme Court precedents—*Chiarella*, *Dirks*, and *O'Hagan*—"require a breach of a fiduciary duty or functional equivalent before there can be a violation under Section 10(b)."[74]

b. Centrality of Fraud

Even if the fiduciary duty requirement has been mutated and in some cases even jettisoned by lower courts, surely the bedrock requirement of fraud (in the common law sense) must be stable. Yet consider what the Court did in *O'Hagan*. By adopting the misappropriation theory, the Court switched its focus from what the defendant did to the counterparties of the trade to what the defendant, as an agent, did to his principal. Accordingly, the Court relied not on the common law of fraud and deceit that undergirded *Chiarella*, but the common law of agency, citing extensively to the Restatement (Second) of Agency relating to an "agent's disclosure obligation regarding use of confidential information."[75]

69. *Id.*
70. *Id* at 730–31.
71. *Cuban II*, 620 F.3d at 557.
72. *Id.* at 558 n.40 ("Nor must we reach the validity of Rule 10b5-2(b)(1).").
73. *Id.* at 558 ("[W]e decline to first determine or place our thumb on the scale in the district court's determination of [the duty's] presence or to now draw the contours of any liability that it might bring . . . ."). On remand, the district court noted that the Fifth Circuit had "declined to address the analysis and legal conclusions" of its prior opinion. SEC v. Cuban, No. 3:08-CV-2050-D, slip op. at 4 (N.D. Tex. Mar. 5, 2013).
74. Brief of Amici Curiae Law Professors in Support of Defendant-Appellee at 18, *Cuban II*, 620 F.3d 551 (No. 09-10996) [hereinafter Appellate Amicus Brief]. The Appellate Amicus Brief was filed on behalf of Professors Stephen Bainbridge, Allen Ferrell, M. Todd Henderson, and Jonathan R. Macey.
75. United States v. O'Hagan, 521 U.S. 642, 654–55 (1997) (citing RESTATEMENT (SECOND) OF AGENCY §§ 390, 395 (1958)).

On the one hand, there is usually an element of duplicity whenever an agent betrays the trust of his principal—in this case, by exploiting confidential client information to profit from a transaction with a third party. On the other hand, this kind of duplicity does not normally amount to common law fraud. Rather, the principal's most obvious recourse would be to sue the agent for breach of fiduciary duty.[76] During *O'Hagan*'s oral argument, Deputy Solicitor General Michael Dreeben conceded to a skeptical Chief Justice Rehnquist that fraud under the misappropriation theory departs significantly from the common law of fraud.[77] But Dreeben added, "[T]he securities laws are not framed to pick up only those violations that are covered by common law fraud."[78]

Consider what this means. As early as *O'Hagan*, the Supreme Court effectively untethered federal insider trading law from the common law of fraud and deceit. This move created the desired flexibility to proscribe more and more acts committed by a wider range of defendants as insider trading. But where should courts draw the line, especially given that insider trading violations can be criminally prosecuted?[79]

The question is not entirely academic. For example, *SEC v. Rocklage*[80] tested a curious loophole within misappropriation theory. In *Rocklage*, a wife (apparently well versed in securities law) acquired confidential information from her husband, promptly notified him that she would pass that information to her brother who would use it to trade (to the husband's alleged shock and dismay), and then proceeded to do so.[81] Why did she give notice to her husband? She did so because, according to *O'Hagan*, "if the fiduciary discloses to the source that he plans to trade on the nonpublic information, there is no 'deceptive device' and thus no § 10(b) violation."[82] Presumably, the same logic applies to tipping. But the First Circuit Court of Appeals was unwilling to

76. *See, e.g.*, RESTATEMENT (THIRD) OF AGENCY §§ 8.01, 8.02, 8.05 (2006).
77. *See* Pritchard, *supra* note 61, at 39 (citing to *O'Hagan* transcript).
78. *Id.*
79. Today, insider trading is subject to a criminal fine of $5 million for individuals and $25 million for entities and imprisonment for up to twenty years. 15 U.S.C. § 78ff(a) (2012). Under the Securities Exchange Act, any violation of any provision can be criminally prosecuted so long as the violation was committed willfully. *Id.* A recent study published by the *Wall Street Journal* reported that insider trading sentences have become longer and those convicted are now more likely to spend time in prison. Chad Bray & Rob Barry, *Long Jail Terms on Rise*, WALL ST. J., Oct. 13, 2011, http://online.wsj.com/news/articles/SB10001424052970204774604576626991955196026.
80. 470 F.3d 1 (1st Cir. 2006).
81. *Id.* at 4.
82. United States v. O'Hagan, 521 U.S. 642, 655 (1997).

permit this all-too-clever strategy and denied the defendants' motion to dismiss, notwithstanding the wife's pre-tipping disclosure.[83] In so doing, however, the Court all but eviscerated the fraud requirement.[84]

* * *

The closer one looks at insider trading law, the messier it appears. In what seemed like a reasonable strategy, the Supreme Court initially adopted an insider trading as common law fraud approach. But as the Court sought to punish different sorts of trading misbehavior, it initiated doctrinal extensions and mutations, stretched even further in unexpected ways by lower courts, which now seem to threaten insider trading law's basic stability and internal coherence. Indeed, we now have reason to question the centrality of breach of fiduciary duty and even fraud.

B. Normative Skepticism

Aside from the doctrinal mess, insider trading law suffers from skepticism about its very purpose. Although forty years have elapsed since the first insider trading prosecution, the ban on insider trading remains one of the most controversial aspects of securities regulation.[85] And the simple claim that insider trading amounts to common law fraud has not appeased the critics of the ban. A theory of insider trading law should be able to respond to this normative skepticism with a plausible reason for banning insider trading at all.

1. Why Ban Insider Trading and Tipping?

Henry Manne launched one of the earliest criticisms of the insider trading ban in his seminal 1966 book, *Insider Trading and the Stock Market*. According to Manne, no one publicly questioned the morality of insider trading before 1910[86] and, for him, no one has since successfully explained why insider

83. *Rocklage*, 470 F.3d at 11–14.
84. To be sure, the *Rocklage* facts suggest an element of deception. As noted below in Part IV.B, the court argued that the wife deceived her husband while she was in the process of acquiring the information from him. *Id.* at 4. Still, this type of deception does not normally amount to common law fraud.
85. *See* Bainbridge, *supra* note 6, at 36. Admittedly, the controversy persists mostly within the academy.
86. HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET 1 (1966).

trading is morally wrong.[87] That sentiment is captured well by convicted insider trader Dennis Levine, who reportedly compared insider trading to the typical goings on in a deli: "You take home pastrami every night for free. It's the same with information on Wall Street."[88]

Such skepticism is grounded in the claim that insider trading does not directly harm anyone.[89] Although corporate insiders can earn billions in profits at the expense of investors, the impersonal nature of securities markets makes it difficult to demonstrate injury in the traditional sense. In contrast to face-to-face transactions, an investor trading over an impersonal exchange does not expect to receive any disclosure from an insider because she has no way of knowing whether she is trading with an insider.[90] In fact, the "identity of the person on the other side of the transaction is a mere fortuity,"[91] completely independent of the investor's decision to sell and to sell at a particular price. As a result, the investor could not have actually relied on the insider's duty to disclose when making the trade. In other words, it would be difficult to show that the particular inside trade caused that investor's misfortune, except in an abstract sense.[92] And because of the "near impossibility of matching trades in an impersonal market,"[93] it is difficult to even identify the specific unlucky victim of insider trading.

But skeptics of the insider trading prohibition push even harder. They argue that insider trading affirmatively benefits society and the issuer of the traded securities. Although several versions of the argument have been advanced, the one that has garnered the most support[94] is that insider trading

87. *Id.* at 5, 10.
88. DANIEL FISCHEL, PAYBACK: THE CONSPIRACY TO DESTROY MICHAEL MILKEN AND HIS FINANCIAL REVOLUTION 42 (1995).
89. *See, e.g.*, Stephen M. Bainbridge, *Insider Trading*, *in* 3 ENCYCLOPEDIA OF LAW AND ECONOMICS 772, 785–86 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000).
90. This is, of course, not the case with large block trades between an institutional investor and a block positioner. *See* William K.S. Wang, *Stock Market Insider Trading: Victims, Violators and Remedies—Including an Analogy to Fraud in the Sale of a Used Car With a Generic Defect*, 45 VILL. L. REV. 27, 30 (2000).
91. Pritchard, *supra* note 61, at 25.
92. *See* DONALD C. LANGEVOORT, INSIDER TRADING: REGULATION, ENFORCEMENT & PREVENTION § 1.3, at 1–13 (2012).
93. Pritchard, *supra* note 61, at 27.
94. Another version of the probenefits argument contends that insider trading efficiently compensates entrepreneurial managers in large corporations for creating valuable new information. *See* MANNE, *supra* note 86, at 110. For a critique of the compensation argument, see, for example, Robert A. Prentice & Dain C. Donelson, *Insider Trading as a Signaling Device*, 47 AM. BUS. L.J. 1, 4–6 (2010). Even Manne, the original proponent of the compensation claim, has acknowledged problems with its implementation. *See* Henry G. Manne, *Insider Trading: Hayek, Virtual Markets, and the Dog That Did Not Bark*, 31 J. CORP.

(and tipping) improves the efficiency of stock market pricing by moving the market price of an affected security toward the price that the security would command if the inside information were publicly disclosed.[95] This theoretically benefits firms and society by improving allocative efficiency, decreasing the volatility of securities prices, and increasing investor confidence in the accuracy of securities prices.[96]

2. Why Ban Outsider Trading?

The ban on outsider trading has been criticized even more passionately.[97] Under the misappropriation theory, the critical inquiry is whether the defendant has breached a fiduciary-like duty owed to the source of information by trading on that information, regardless of whether the source is the issuer of the traded securities or is even a market participant. Because the relevant relationship can arise outside of the traditional corporate context, the reach of the misappropriation theory is very broad.

More worrisome, it is not entirely clear who falls within the misappropriation theory's grasp. The *O'Hagan* Court failed to provide any concrete guidance on how to identify a fiduciary or fiduciary-like relationship, a notoriously fuzzy concept.[98] Although it referenced the term "fiduciary" seventeen times,[99] the Court merely pointed out that the misappropriation theory is "limited to those who breach a recognized duty."[100] The breadth and vagueness of the misappropriation theory have disturbed commentators.[101] More funda-

L. 167, 173 (2005) [hereinafter Manne, *Insider Trading*] ("[I]t must be recognized that insider trading cannot be a perfect form of incentive compensation. . . . [T]here are significant problems with the scheme, which many of my critics hasten[] to elaborate."). Recently, however, Manne has resumed his claim that insider trading remains "the system par excellence of compensating entrepreneurs in large, publicly held companies." Henry G. Manne, *Entrepreneurship, Compensation, and the Corporation*, *in* RESEARCH HANDBOOK ON INSIDER TRADING 67, 76 (Stephen M. Bainbridge ed., 2013).

95. *See* STEPHEN M. BAINBRIDGE, SECURITIES LAW: INSIDER TRADING 136–44 (2d ed. 2007); MANNE, *supra* note 86, at 80–90.
96. *See* Bainbridge, *supra* note 89, at 777–78.
97. For an exception, see Ian Ayres & Stephen Choi, *Internalizing Outsider Trading*, 101 MICH. L. REV. 313, 321 (2002), which argues in favor of the presumptive prohibition of outsider trading but allowing insider trading with employer consent.
98. *See* Sung Hui Kim, *The Last Temptation of Congress: Legislator Insider Trading and the Fiduciary Norm Against Corruption*, 98 CORNELL L. REV. 845, 903 (2013).
99. *See* Nagy, *supra* note 63, at 1332.
100. United States v. O'Hagan, 521 U.S. 642, 666 (1997).
101. *See* Richard W. Painter et al., *Don't Ask, Just Tell: Insider Trading After* United States v. O'Hagan, 84 VA. L. REV. 153, 188 (1998).

mentally, commentators question why federal securities law should intrude into noninvestment spheres.[102]

* * *

Fundamental objections persist about the existence of the insider and outsider trading bans. By raising these objections in this Article, the point is not to engage in a full, disinterested evaluation of the substantive merits of such objections or even to suggest that the skeptics are right. Indeed, other commentators have amply addressed these objections. For example, on the supposed lack of harm, William Wang has provided a compelling articulation of what that harm is and who the victims are.[103] And on the supposed pricing benefit, both the empirical[104] and theoretical cases[105] are mixed, and surely there are more narrowly tailored mechanisms to promote efficient pricing.[106]

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102. *See, e.g.*, Fisch, *supra* note 2, at 205; Painter et al., *supra* note 101, at 168–69.

103. The victim of insider trading is not necessarily the party on the other side of the inside trade but the induced or preempted traders. *See* William K.S. Wang, *Trading on Material Nonpublic Information on Impersonal Stock Markets: Who Is Harmed, and Who Can Sue Whom Under SEC Rule 10b-5?*, 54 S. CAL. L. REV. 1217, 1234–40 (1981) (advancing the "Law of Conservation of Securities" which posits that inside trades preempt trades of the same type that otherwise would have occurred or induce opposite trade transactions that otherwise would not have occurred); *see also* Leo Katz, *Crime, Consent, and Insider Trading*, 5 J. CONTEMP. LEGAL ISSUES 217 (1994) (explaining Wang's theory from a moral-philosophical perspective).

104. *See, e.g.*, Matthew Brigida & Jeff Madura, *Sources of Target Stock Price Run-up Prior to Acquisitions*, 64 J. ECON. & BUS. 185, 186 (2012) (observing target stock price run-up from informed trading but not opining on whether such trading is "legal or illegal"); Lisa K. Meulbroek, *An Empirical Analysis of Illegal Insider Trading*, 47 J. FIN. 1661 (1992). *But see* Angelo Aspris et al., *Does Insider Trading Explain Price Run-up Ahead of Takeover Announcements?*, 2012 ACCT. & FIN. 19 (concluding based on findings that attribution of prebid price run-ups to illegal insider trading may be overstated).

105. *See, e.g.*, Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 631 (1984) (concluding that deregulating insider trading is "unlikely to have much effect on the efficiency of securities prices"); Marcel Kahan, *Securities Laws and the Social Costs of "Inaccurate" Stock Prices*, 41 DUKE L.J. 977, 1004 (1992) (recounting the various reasons as to why insider trading may not reduce pricing inaccuracy). *But see* Hayne E. Leland, *Insider Trading: Should It Be Prohibited?*, 100 J. POL. ECON. 859, 883–84 (1992) (concluding that when insider trading is permitted, stock prices will better reflect information but that markets will be less liquid and outside investors and liquidity traders will be hurt); Hsiu-Kwang Wu, *An Economist Looks at Section 16 of the Securities Exchange Act of 1934*, 68 COLUM. L. REV. 260, 266 (1968) (arguing that insider speculation increases both allocational and promotional efficiency).

106. *Cf.* Kahan, *supra* note 105, at 1002, 1004 (noting the alternative of direct public disclosure but acknowledging that this may be unfeasible for any number of reasons). Also, the importance of short-term price efficiency may be overstated. *See, e.g.*, Lynn A. Stout, *The Unimportance of Being Efficient: An Economic Analysis of Stock Market Pricing and Securities Regulation*, 87 MICH. L. REV. 613, 692–95 (1988).

The goal here is merely to highlight that academics continue to challenge the existence of a basic ban on insider trading and that the insider trading-as-fraud approach has failed to assuage the skeptics. Therefore, a theory of insider trading law needs to help answer these objections.

C. The Need for a Theory

To counter serious doctrinal instability and to answer persistent normative skepticism, we need a better theory of insider trading law. I use the word "theory" humbly because that term is at once familiar yet slippery to define. In insider trading law commentary, theory is used loosely as a concept, policy, metaphor, or framing that both describes the body of law and helps justify its content. Theory in this context is both less and more than that body of law itself. It is less in that theory simplifies and abstracts away from the myriad particulars of the specific cases that constitute the body of law. But it is also more in that theory goes beyond the existing array of legal examples and tries to provide a deeper explanation and justification of those examples.

An adequate theory of insider trading law should do at least two things. First, it must be normatively plausible in the sense that it can respond to the critics of the insider trading ban. Second, the theory should be mindful of the law that already exists. The point is not to make a pure normative policy analysis untethered to the doctrine. Although such analysis could be useful and persuasive to legislators engaged in hypothetical comprehensive statutory reform, it is less so for judges who must grapple with hard cases under constraints of precedent and institutional role. By being both normatively plausible and by having adequate doctrinal fit, a good theory can help insider trading law achieve greater internal consistency, perhaps by revealing an underlying theme that was previously underappreciated.

With this clarification in mind, arguably no good theory of insider trading law has existed even since *Chiarella*. One might ask, didn't the Supreme Court adopt fraud as the basis for insider trading in that case and, if so, why doesn't common law fraud count as a good theory of insider trading law? If common law fraud has been the theory, that theory has been a failure. As a descriptive matter, insider trading as fraud was too narrow, thus prompting disingenuous extensions and contortions, as seen in *O'Hagan*.[107] The actual common law of fraud also provided weak support for the proposition that a corporate insider defrauds a shareholder simply by purchasing or selling stock

107. *See supra* Part I.A.2.b.

on the open market.[108] In these anonymous sales and purchases, there is little evidence that the insider caused or induced reliance on the counterparty to the inside trade.[109] As a normative matter, and as Frank Easterbrook declared of *Chiarella*, "the Court articulated no concept of why insider trading is wrongful, of who suffers as a result, or of what costs should be borne to stamp out the practice."[110]

One might next ask, isn't breach of fiduciary duty a good theory of insider trading law? My inclination is to classify this as an element of the cause of action and a path-dependent consequence of the Court's embrace of fraud, rather than as a more encompassing theory. Recall that the fiduciary duty to disclose arose in *Chiarella* as a response to the lack of affirmative misrepresentations as generally required in the common law of fraud. But if we were to take the question more seriously and appraise fiduciary duty as a full-blown theory of insider trading law, we would have to unpack what that theory would mean. It could not possibly mean that all breaches of fiduciary duty should count as insider trading violations. For example, it is highly unlikely that a mere breach of the duty of care would generate liability for a tipper.[111] But could it mean conversely that all proscribed acts of insider trading must violate the fiduciary duty to disclose?

If that is the theory, it is too narrow for two reasons. First, the Court long ago went beyond the duty to disclose. Recall in *Dirks* how the fiduciary duty to disclose mutated into the insider-tipper's duty of loyalty and confidentiality—duties not to use confidential information for one's personal benefit. And *O'Hagan* borrowed *Dirks*'s duty of loyalty and confidentiality to

108. *See* Pritchard, *supra* note 61, at 26 ("[T]he common law of deceit does not support the proposition that a corporate insider defrauds a shareholder when trading in an impersonal market on the basis of confidential information.").

109. *See also* Michael P. Dooley, *Enforcement of Insider Trading Restrictions*, 66 VA. L. REV. 1, 59 (1980) ("[I]nsider trading in no way resembles deceit. No representation is made, nor is there any reliance, change of position, or causal connection between the defendant's act and the plaintiff's losses."); Donald C. Langevoort, *"Fine Distinctions" in the Contemporary Law of Insider Trading*, 2013 COLUM. BUS. L. REV. 429, 440 ("[Insider trading] is not really fraud, even though we have chosen to call it fraud in order to preserve and embellish the useful message of investor protection.").

110. Frank H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 SUP. CT. REV. 309, 322.

111. *See* Dirks v. SEC, 463 U.S. 646, 662 (1983); SEC v. Switzer, 590 F. Supp. 756, 766 (W.D. Okla. 1984) (finding no liability where an insider inadvertently disclosed market-moving information in a public place); A.C. Pritchard, *Justice Lewis F. Powell, Jr., and the Counterrevolution in the Federal Securities Laws*, 52 DUKE L.J. 841, 942 (2003) (noting that under Powell's reasoning, "[g]arden variety breaches of the duty of care were clearly out; tipping required a breach of the duty of loyalty").

proscribe the trading of outsiders who received information from a source that was not the issuer of the traded securities.[112] Second, the Court in *Dirks* clearly went beyond fiduciaries and their ilk to catch aiding and abetting tippees. Accordingly, a theory of insider trading law as requiring the breach of fiduciary duty (to disclose) inadequately describes and justifies the insider trading law that we have.

* * *

We need a better theory of insider trading law. The theory should respond to normative skeptics by helping to justify the basic ban on insider trading. But that theory should not be written on a blank slate; instead, it should fit at least the core features of the received doctrine.[113]

II. CORRUPTION THEORY

In Part II, I offer a new theory of insider trading law—that insider trading should be viewed as a form of private corruption. Despite its long lineage and growing attention from regulators,[114] private sector corruption has received only modest academic attention.[115] Therefore, to facilitate analysis and application to insider trading law, I propose a definition of private corruption. First, I transpose elements of the conventional definition of public corruption to the private sector context. Next, I demonstrate that a paradigmatic example of insider trading falls within the proposed definition. Finally, I show how understanding insider trading as private corruption helps us appreciate the costs of insider trading, providing a normatively plausible account of why we ban insider trading in the first place.

112. *See supra* text accompanying note 62.

113. I recognize the slipperiness of talking about fitting the so-called "received doctrine" as if it were a stable canon while I simultaneously point out its instability. When I use this term, I generally mean to privilege Supreme Court holdings and dictum, which are substantially more settled than the case law of the lower courts. To the extent that the Supreme Court has not addressed the issue but the lower courts have embraced a consensus view, I also treat such a view as part of the received doctrine.

114. For recent regulatory and prosecutorial developments in the United States and abroad, see Sarah Clark, *New Solutions to the Age-Old Problem of Private-Sector Bribery*, 97 MINN. L. REV. 2285 (2013).

115. *See* TANYA RABL, PRIVATE CORRUPTION AND ITS ACTORS: INSIGHTS INTO THE SUBJECTIVE DECISION MAKING PROCESSES 18 (2008) ("[P]rivate corruption . . . is still a neglected topic."); *see also infra* note 143.

A. Theory Introduced

1. From Public Corruption

When we think of corruption, the corrupt politician pops into mind. This is because we are inclined to think first of public corruption. Although notoriously difficult to define,[116] public corruption tends to be defined in the political science and political economy literatures as the "use of public office for private gain."[117] The term "public office" is relatively clear. It includes, among others, those persons whom the electorate has entrusted with power to advance the public interest.[118] Unfortunately, private gain is harder to define

116. *See, e.g.*, Ulrich von Alemann, *The Unknown Depths of Political Theory: The Case for a Multidimensional Concept of Corruption*, 42 CRIME, L. & SOC. CHANGE 25, 26 (2004) ("[A] universal definition [of corruption] . . . is like the Holy Grail.").

117. *See* Kim, *supra* note 98, at 894–900 (defining public corruption and citing sources); *see also* DENNIS F. THOMPSON, ETHICS IN CONGRESS: FROM INDIVIDUAL TO INSTITUTIONAL CORRUPTION 7 (1995) (noting that corruption ordinarily involves the "improper use of public office for private purposes"); Michael Johnston, *The Political Consequences of Corruption: A Reassessment*, 18 COMP. POL. 459, 460 (1986) (defining corruption as "the abuse of public roles and resources for private benefit"); Daniel Kaufmann, *Corruption: The Facts*, 107 FOREIGN POL'Y 114, 114 (1997) (defining corruption as "the abuse of public office for private gain"); Joseph J. Senturia, *Corruption, Political*, *in* ENCYCLOPAEDIA OF THE SOCIAL SCIENCES 448 (Erwin R.A. Seligman & Alvin Johnson eds., 1931) (defining corruption as "the misuse of public power for one's own personal profit"); *Transparency International: What We Do*, TRANSPARENCY INT'L, http://www.transparency.org/whatwedo (last visited Feb. 26, 2014) (defining corruption as "the abuse of entrusted power for private gain"). Transparency International's Corruption Perceptions Index (CPI) is the "most widely used indicator of corruption worldwide." *See What Is the Corruption Perceptions Index?*, TRANSPARENCY INT'L, http://cpi.transparency.org/cpi2012/in_detail (last visited Feb. 26, 2014).

The definition of (public) corruption that I borrow, though popular in modern academic and nongovernmental organization circles, is, of course, not the only one. This definition relates to individual corruption, as opposed to more capacious notions of institutional or systemic corruption. For the distinction between individual and institutional corruption, see Sung Hui Kim, *What Governmental Insider Trading Teaches Us About Corporate Insider Trading*, *in* RESEARCH HANDBOOK ON INSIDER TRADING, *supra* note 94, at 166, 174 n.41. Also, this definition emphasizes more objectively observable behavior over mental or moral states. *But see* LAURA S. UNDERKUFFLER, CAPTURED BY EVIL: THE IDEA OF CORRUPTION IN LAW 2 (2013) (arguing that the "idea of the *capture by evil* . . . drives our understanding of corruption in law"). My emphasis on behavior should lend itself to greater analytical clarity when evaluating conduct for purposes of determining whether to proscribe it. That said, corrupt behavior usually involves some form of intentional mental state. For a brief discussion on how the corruption theory might handle mens rea issues, see *infra* note 142. In campaign finance cases, the Supreme Court has "vacillated between expansive and restrictive conceptions of corruption." Deborah Hellman, *Defining Corruption and Constitutionalizing Democracy*, 111 MICH. L. REV. 1385, 1387 (2013) (citing sources).

118. At minimum, they are elected officials and those appointed officials with significant discretionary responsibilities. For example, the Supreme Court has interpreted the federal

because it could conceivably cover something as unobjectionable as earning an official salary. As I have explained elsewhere, private gain is better understood as "personal gain that is supererogatory[119]—neither part of the explicit compensation allocated to the public official nor *culturally* viewed as an acceptable or unavoidable perquisite of the role."[120] The crucial point is that the private gain must somehow be inconsistent with the role of public office.[121]

Of course, relying on cultural views is precarious because they are shifting, vague, contradictory, and hard to measure.[122] Given such difficulties, it is tempting to define "private gain" more narrowly, for example, as gain that breaches some formal rule or law.[123] But this alternative definition would buy clarity at the cost of accuracy because corruption undeniably incorporates a cultural dimension.[124] While corrupt conduct is often illegal, the terms are not coextensive.[125] To provide one historical example, bribery of Congress members was not formally banned until 1853[126] although it was likely viewed

bribery statute to extend to any "person [who] occupies a position of public trust with official federal responsibilities." Dixson v. United States, 465 U.S. 482, 496 (1984).

119. "Supererogatory" sometimes has a virtuous connotation, which is not the meaning intended here. *See* Kim, *supra* note 98, at 899 n.312.

120. *Id.* at 899; *see also* SUSAN ROSE-ACKERMAN, CORRUPTION AND GOVERNMENT: CAUSES, CONSEQUENCES, AND REFORM 91 (1999) (noting that corruption is the "misuse of public power for private gain" but acknowledging that this definition assumes a clear distinction between one's public and private roles, which may not be the case in some societies). For example, what even constitutes a bribe is culturally contingent. *See* ROSE-ACKERMAN, *supra*, at 110 ("The definition of bribes and gifts is a cultural matter, but 'culture' is dynamic and constantly changing."); *see also* JOHN T. NOONAN, JR., BRIBES xi (1984).

121. *Cf.* Hellman, *supra* note 117, at 1393 (arguing that "in any plausible theory of corruption, a corrupt act is one that violates a norm or standard of the proper functioning of the institution").

122. Cultural views about corruption reflect "few sharp divisions between right and wrong, but rather a spectrum of finely graded judgments." Johnston, *supra* note 117, at 460.

123. *See, e.g.*, Michael Johnston, *Right & Wrong in American Politics: Popular Conceptions of Corruption*, 18 POLITY 367, 369 (1986) (describing a formal as opposed to a social definition of corruption); J. S. Nye, *Corruption and Political Development: A Cost-Benefit Analysis*, 61 AM. POL. SCI. REV. 417, 419 (1967) (positing a formal definition of corruption premised on the deviation from formal duties or the violation of rules).

124. *See* Johnston, *supra* note 117, at 461 (acknowledging the cultural dimension of corruption).

125. *See* Pranab Bardhan, *Corruption and Development: A Review of Issues*, 35 J. ECON. LITERATURE 1320, 1321 (1997); Johnston, *supra* note 123, at 387; John G. Peters & Susan Welch, *Political Corruption in America: A Search for Definitions, or if Political Corruption Is in the Mainstream of American Politics Why Is It Not in the Mainstream of American Politics Research?*, 72 AM. POL. SCI. REV. 974, 974–75 (1978); *see also* Daniel Kaufmann & Pedro C. Vicente, *Legal Corruption*, 23 ECON. & POL. 195 (2011).

126. Act of Feb. 26, 1853, ch. 81, 10 Stat. 170 (Act to Prevent Frauds Upon the Treasury of the United States); NOONAN, *supra* note 120, at 453.

as corrupt well before.[127] Indeed, there is almost always a lag between the time that society condemns an act as corrupt and its legal proscription.[128] When people refer to a given act as corrupt, as opposed to illegal, they are not emphasizing the fact that a formal rule has been violated but, rather, that the actor has offended the social norms attached to the role. In short, they are invoking a sociocultural conception of corruption.[129]

In addition to this modern, analytic definition of corruption (the use of public office for private gain), there is an older, more classical understanding that invokes organic metaphors of disease and decay.[130] According to this conception, corruption is a "disease of the body politic," "[l]ike a virus invading the physical body," which would "enfeebl[e] the spirit of the laws and undermin[e] the principles of the regime."[131] In other words, corruption involves an improper commingling of spheres that should remain separate and independent from each other.[132] In the case of the corrupt politician, the private sphere in which the individual is motivated by personal, selfish, materialistic gain has leaked into the public sphere in which the individual should be motivated by a commitment to the public interest. This classical understanding of corruption—of something pure (the public interest) being spoiled by something foul (private gain)—is vague and metaphorical. Yet this notion of tainted admixture provides a valuable connotation that proves useful later.

127. For example, in 1846, New York passed a statute outlawing bribery, providing a ten-year imprisonment for offering money or property to the governor, lieutenant governor, or any member of the legislature with intent to influence his vote, opinion, or judgment on any question. *See* NOONAN, *supra* note 120, at 452.

128. *Cf.* Johnston, *supra* note 123, at 379 (citing empirical findings demonstrating a divergence between formal and social definitions of corruption).

129. The literature also recognizes that corrupt behavior, not all of which is illegal, varies in intensity and is differentially tolerated within a given society. *See* Arnold J. Heidenheimer, *Perspectives on the Perception of Corruption*, *in* POLITICAL CORRUPTION: A HANDBOOK 149, 158 (Arnold J. Heidenheimer et al. eds., 1989) (categorizing corrupt behavior as (i) "petty" or "white," (ii) "routine" or "grey," and (iii) "aggravated" or "black").

130. NOONAN, *supra* note 120, at xvii–xviii.

131. THOMPSON, *supra* note 117, at 28.

132. The notion of separate spheres appears in various contexts, such as to explain ingrained social taboos against mingling intimate social relations and economic transactions, to explain why governments should not impinge on educational freedom or religion. *See, e.g.*, VIVIANA A. ZELIZER, THE PURCHASE OF INTIMACY 22 (2005) ("An old, influential tradition asserts the existence of separate spheres and hostile worlds . . . . [A] sharp divide exists between intimate social relations and economic transactions . . . . Contact between them produces moral contamination."); ABRAHAM KUYPER, SOVEREIGNTY IN ITS OWN CIRCLE 461–90 (1880) (discussing "sphere sovereignty").

2. To Private Corruption

The next task is to transpose the idea of public corruption into the private context, in which most insider trading takes place.[133]

a. From Private Gain to Self-Regarding Gain

Let us begin with the second component of the analytic definition of public corruption—private gain. In the private sector context, all gain is arguably private; thus, the term fails to distinguish proper interests from those that smack of corruption. Still, one can reasonably argue that an individual's pursuit of personal gain should be irrelevant to decision making on behalf of organizations. For example, officers and directors are legally tasked with deliberating in the best interest of the corporation. Accordingly, it is improper for those individuals to use officially licensed corporate power to further their financial self-interest. Therefore, an alternative term, such as "personal gain," may be more appropriate.

But this term might be construed too narrowly as financial gain strictly to the individual in question. Accordingly, the more expansive term "self-regarding gain," which also includes gains accrued by an individual's relatives, friends, and acquaintances, seems more apt. After all, an important facet of corruption is its "expression of particularism—the felt obligation to help, to give resources to persons to whom one has a personal obligation, to the family above all but also to friends and membership groups."[134] Therefore, improper gain should presumptively cover advantages garnered through nepotism,[135] cronyism, and certain forms of favoritism.[136]

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133. Of course, trading on material, nonpublic information by public officeholders could be classified as a form of public corruption. *See* Kim, *supra* note 98, at 901–02. For histories of governmental insider trading, see Richard W. Painter, *Ethics and Corruption in Business and Government: Lessons From the South Sea Bubble and the Bank of the United States* (Univ. of Minn. Law Sch. Legal Studies Research Paper Series, Paper No. 06-32, 2006), *available at* http://ssrn.com/abstract=920912, and Michael A. Perino, A Scandalous Perversion of Trust: Modern Lessons From the Early History of Congressional Insider Trading (Sept. 6, 2013) (unpublished manuscript) (on file with author).

134. Seymour Martin Lipset & Gabriel Salman Lenz, *Corruption, Culture, and Markets*, *in* CULTURE MATTERS: HOW VALUES SHAPE HUMAN PROGRESS 112, 119 (Lawrence E. Harrison & Samuel P. Huntington eds., 2000).

135. Concern about public sector nepotism is reflected in the federal anti-nepotism statute, enacted in 1967 as part of the Federal Postal Act, 5 U.S.C. § 3110 (2012). See also anti-nepotism restrictions in H.R. DOC. NO. 112-161, at 936 (2013), *available at* http://www.gpo.gov/fdsys/pkg/HMAN-113/pdf/HMAN-113-pg934.pdf, and state level anti-nepotism restrictions, for example, ALA. CODE § 41-1-5 (1975).

136. THOMPSON, *supra* note 117, at 80–84.

Finally, as with positions in the public sector, the relevant private sector roles are generally not charitable ones. Society does not demand individuals in the private sector to work for free. Accordingly, the term "self-regarding gain" should similarly be confined to gain that is supererogatory—neither part of the explicit compensation allocated to the individual nor culturally viewed as an acceptable or unavoidable perquisite of the role.

b. From Public Office to Entrusted Position

Finding a substitute for the first component of the definition of public corruption—public office—is more challenging. The term "public office" covers both elected and appointed positions. What are the comparable positions in the private sector? The classical intuition of corruption as the improper commingling of two realms helps to answer this question. On the one hand, there is the realm of self-regarding gain, in which the individual is expected to act in accordance with his own self-interest. In economic terms, the individual acts as the principal, not as an agent. The relevant norms are market norms that emphasize the calculated maximization of self-interest. The individual's interactions with other market players are impersonal and at arm's length.

On the other hand, imagine a sphere that is the polar opposite, a sphere that the world of self-regarding gain should not contaminate. Instead of being the principal, the individual may be acting as an agent, working on behalf of someone else, or serving in some other trusted capacity. Instead of market norms, obligations of loyalty characterize this sphere. Communal norms that require subordination of the individual's own self-interest would prevail.[137] Most importantly, the individual would interact with others in the context of trust and solidarity, not of arms-length transactions negotiated by self-interested parties.[138] By trust, I mean "reliance without recourse"[139]—dependence on the individual without any guarantee of perfect or even adequate recourse if

137. For the distinction between market and communal norms, see Sung Hui Kim, *The Diversity Double Standard*, 89 N.C. L. REV. 945, 990 (2011) (defining "communal norms" as "the unspoken social rules that govern those relations characterized by mutual concern for each other's welfare" and defining "market norms" as those norms "which govern market exchange relationships and are more tightly associated with business environments").

138. *See generally* ZELIZER, *supra* note 132, at 14–15.

139. Justin Hurwitz, *Trust and Online Interaction*, 161 U. PA. L. REV. 1579, 1584 (2013).

that individual betrays that trust.[140] This mirror-image world can be called the sphere of "entrusted position."[141]

By making these twin substitutions—substituting private gain with self-regarding gain and public office with entrusted position—private corruption can be roughly defined as "the use of[142] one's entrusted position for self-regarding gain."[143] The definition is abstract, but the fundamental idea is easy

140. To be clear, I do not mean to suggest that trust must be explicitly conferred to the individual. Rather, trust is implicitly presumed from the purpose of the relationship and the individual's role therein. *Cf.* Ethan J. Leib et al., *A Fiduciary Theory of Judging*, 101 CALIF. L. REV. 699, 707 (2013) ("Across a range of fiduciary relations, trust is presumed rather than earned or explicitly conferred."). In other words, the relationship at least implicitly "depend[s] on particularized knowledge received, and attention provided by" the individual—"knowledge and attention that are not widely available to third parties." ZELIZER, *supra* note 132, at 14.

141. In imagining polar opposite spheres, the goal is to demarcate a full spectrum within which real-world cases will inevitably fall.

142. For public corruption, to say that a public official *uses* her public office for private gain, she must at minimum voluntarily engage in the behavior and, at the time of the behavior, be consciously aware of the attendant private gain. Certain anticorruption statutes have imposed more specific forms of intentionality. See, for example, the federal bribery statute, 18 U.S.C. § 201(b)(1)–(2) (2012) (requiring a corrupt intent to influence, or be influenced in, the performance of an official act), which has been interpreted to require proof of a quid pro quo—"a specific intent to give or receive something of value in exchange for an official act." United States v. Sun-Diamond Growers, 526 U.S. 398, 404–05 (1999). But for a sociocultural definition of corruption, quid pro quo is much too narrow. One need only be reminded of George Washington Plunkitt's famous but unpersuasive defense of "honest graft," in which he admitted to conduct widely regarded as corrupt but lacking in the element of quid pro quo. *See* Kim, *supra* note 117, at 176–77. As discussed in greater detail elsewhere, "use of" implies the presence of a proximate causal nexus between the entrusted role and the improper enrichment. *See* Kim, *supra* note 98, at 899–900; Kim, *supra* note 117, at 175–76.

While acknowledging that an individual may engage in corrupt conduct without having a strong awareness of its wrongfulness, an intuitive understanding of corruption often carries a connotation of intentional betrayal, a connotation that the corruption theory perhaps should reflect. That said, specifying the mens rea conditions under the corruption theory is beyond the scope and space constraints of this Article. Suffice it to say that the corruption theory would not find liability for mere breaches of duties of care and should impose some form of a motivational requirement for tipping liability—even in misappropriation theory cases, and should probably embrace the narrower "use" standard over the "possession" standard. *See* Langevoort, *supra* note 109, at 440 ("[Insider trading] is about violating an expectation of faithfulness, exploiting privileged access, and taking advantage of others. These are active verbs connoting deliberation beyond mere awareness, and bad faith."). *But see* Blake E. Ashforth & Vikas Anand, *The Normalization of Corruption in Organizations*, 25 RES. ORG. BEHAV. 1, 29 (2003) (noting that power "tends to non-consciously activate personal goals and biases, guiding information processing and behavior—which the individual then rationalizes in socially desirable terms").

143. This definition of private corruption is similar to other definitions of organizational corruption previously posited by experts in organizational behavior. *See, e.g.*, Blake E. Ashforth et al., *Re-viewing Organizational Corruption*, 33 ACAD. MGMT. REV. 670, 671 (2008) (defining organizational corruption as the "illicit use of one's position or power for perceived personal or collective gain"); Donald Lange, *A Multidimensional Conceptualization*

to grasp. To call something corrupt is not merely to call something fraudulent, unjust, wrongful, or harmful. It is to emphasize the betrayal of an entrusted position. Put another way, the self-regarding gain is achieved in a manner that is inconsistent with and violates the trust granted to the position.

3. Insider Trading as Private Corruption

Let us now apply this definition of private corruption to a prototypical example of insider trading. In *SEC v. Texas Gulf Sulphur Co.*,[144] officers, directors, and employees traded on material, nonpublic information about their company's mammoth copper ore strike and profited handsomely. These facts represent a paradigmatic example of insider trading.[145] They also fall squarely under the proposed definition of private corruption.

First, there is self-regarding gain. Any gain accruing because of the trading on or the tipping of material, nonpublic information will be supererogatory. Compensation packages do not explicitly contemplate profits from insider trading. That was true in *Texas Gulf Sulphur* and is true generally.[146] Nor is insider trading culturally tolerated as an acceptable perquisite of executive (or employee) status, as suggested by available opinion surveys.[147]

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of Organizational Corruption Control, 33 ACAD. MGMT. REV. 710, 710 (2008) (defining organizational corruption as "the pursuit of individual interests by one or more organizational actors through the intentional misdirection of organizational resources"). *See also generally* Alan Doig & Stephanie McIvor, *Corruption and Its Control in the Developmental Context: An Analysis and Selective Review of the Literature*, 20 THIRD WORLD Q. 657, 659 (1999) (citing one definition of corruption as "any activity motivated by self interest, violating the binding rules of distribution, the application of which is within one's responsibility" with the rules of distribution referring "not only to the letter of law, but also to norms recognized as binding by society and/or to the system's 'official' norms and operational codes"); Kaufmann & Vicente, *supra* note 125, at 195 (defining corruption as "abuses of public office or entrusted power for private gain"); Vilmos F. Misangyi et al., *Ending Corruption: The Interplay Among Institutional Logics, Resources, and Institutional Entrepreneurs*, 33 ACAD. MGMT. REV. 750, 751 (2008) (defining corruption generally as "the misuse of a position of authority for private or personal benefit . . . where misuse typically constitutes a breach of legal norms").

144. 401 F.2d 833 (2d Cir. 1968) (en banc).

145. *See, e.g.*, STUART P. GREEN, LYING, CHEATING, AND STEALING: A MORAL THEORY OF WHITE-COLLAR CRIME 237 (2006) (referring to *Texas Gulf Sulphur* as a "paradigm example" of insider trading).

146. *See* Manne, *Insider Trading*, *supra* note 94, at 174 ("[T]here is no evidence that any company ever tried to develop insider trading as an explicit and integral part of an optimal compensation package."); *cf.* J.C. Bettis et al., *Corporate Policies Restricting Trading by Insiders*, 57 J. FIN. ECON. 191, 192 (2000) (finding that by late 1996, over 92 percent of the 626 sample firms have some type of policy restricting trading by corporate insiders).

147. *See, e.g.*, Stuart P. Green & Matthew B. Kugler, *When Is It Wrong to Trade Stocks on the Basis of Non-public Information? Public Views of the Morality of Insider Trading*, 39 FORDHAM URB. L.J. 445, 463 (2011) (finding that a majority of respondents believed insider trading is

Second, by trading on confidential information learned through their roles, the *Texas Gulf Sulphur* insiders used their entrusted positions to obtain the gain. Recall that entrusted positions are those in which the individual is expected to act in accordance with more communal norms and on the basis of trust. In *Texas Gulf Sulphur*, the defendants included officers and directors, who clearly occupied entrusted positions for purposes of the definition of private corruption. Vis-à-vis the corporation itself, officers and directors are legally classified as fiduciaries that have been charged by law to act solely in the best interest of the firm. They are granted tremendous discretion, and the corporation, as well as its shareholders, trusts that such discretion will be used appropriately.

But high-level corporate officials are not the only entrusted positions that society wants to insulate from improper influences. In the public realm, we not only worry about the corruption of high-level governmental authorities but also ordinary civil servants, which is why government ethics laws apply to them as well.[148] Similarly, in the securities context, it makes sense to designate most, if not all, corporate employees of public issuers as occupying entrusted positions. Thus, the final set of defendants in the *Texas Gulf Sulphur* case—mere employees—would also be seen as engaging in corruption. As employees, they are the corporation's agents and occupy entrusted positions. Given their lesser stature within the corporate hierarchy, their misbehavior may be regarded as a more petty form of corruption, but corruption nonetheless.

morally blameworthy and should be criminalized, according to a survey of forty-eight diverse, working adult Americans); William A. Kelly, Jr. et al., *Regulation of Insider Trading: Rethinking SEC Policy Rules*, 7 CATO J. 441, 441 (1987) (reporting that 52 percent believed that insider trading should be illegal, according to a *Business Week* poll); Alexandre Padilla, *How Do We Think About Insider Trading? An Economist's Perspective on the Insider Trading Debate and Its Impact*, 4 J.L. ECON. & POL'Y 239, 253 (2008) (reporting results from a recent study conducted by the author that 86 percent of student respondents believed that insider trading should be prohibited); Meir Statman, *Is It Fair? Perceptions of Fair Investment Behavior Across Countries*, 12 J. INVESTMENT CONSULTING 45 (2011) (finding that 95 percent of finance professionals and 64 percent of students surveyed in the United States found insider trading under the misappropriation theory unacceptable).

148. Ethics in Government Act of 1978, Pub. L. No. 95-521, 92 Stat. 1824 (amended by the Ethics Reform Act of 1989, Pub. L. No. 101-194, 103 Stat. 1716). In addition, under the principal federal bribery law, the offense of receiving a bribe can be committed by a member of Congress, a juror, a witness, or "an officer or employee or person acting for or on behalf of the United States, or any department, agency or branch of Government thereof." 18 U.S.C. § 201(a)(1) (2012).

Moving beyond the case study of *Texas Gulf Sulphur*, there is some empirical evidence in behavioral finance[149] that connects corruption more generally to insider trading. Meir Statman administered surveys to university students and finance professionals in eight different countries: Australia, India, Israel, Italy, the Netherlands, Tunisia, Turkey, and the United States.[150] Subjects were asked to read and evaluate various vignettes, describing activity ranging from clearly illegal under federal insider trading law to clearly innocent. Statman found strong correlations between the high levels of perceived public sector corruption in the country[151] and the tendency to view insider trading as acceptable.[152] The more corrupt that citizens judged their country, the less objectionable were the inside trades, and vice versa. Another study conducted by Julan Du and Shang-Jin Wei observed that countries with higher degrees of perceived corruption in a country's judicial system are likely to have more prevalent insider trading.[153] Although far from definitive, these correlations provide additional support to the idea that insider trading is best understood as a species of private corruption.

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Many details remain unspecified, but the big picture is coming into focus. We can roughly define private corruption as the use of an entrusted position for self-regarding gain. In the securities context, paradigmatic examples of insider trading, such as *Texas Gulf Sulphur*, can be understood as acts of private corruption. Individuals in entrusted positions, such as corporate insiders,

149. Behavioral finance is the "application of psychology to financial behavior—the behavior of practitioners." HERSH SHEFRIN, BEYOND GREED AND FEAR: UNDERSTANDING BEHAVIORAL FINANCE AND THE PSYCHOLOGY OF INVESTING 3 (2002).

150. Statman, *supra* note 147, at 49.

151. These levels were based on Transparency International's CPI, a composite index combining surveys and assessments of corruption collected by a variety of international institutions. *See supra* note 117. A 2002 study found "very strong significant correlation" between the CPI and two other proxies for corruption and real gross domestic product per capita. Paul G. Wilhelm, *International Validation of the Corruption Perceptions Index: Implications for Business Ethics and Entrepreneurship Education*, 35 J. BUS. ETHICS 177, 177 (2002).

152. Statman, *supra* note 147, at 53 ("The correlation between freedom from corruption and judgment of [hypothetical] behavior as acceptable by professionals is a negative 0.88 . . . . The corresponding correlation for students is a negative 0.76.").

153. Julan Du & Shang-Jin Wei, *Does Insider Trading Raise Market Volatility?*, 114 ECON. J. 916, 935 (2004) ("We observe that legal corruption is positively and significantly associated with insider trading: countries with a higher degree of legal corruption are also likely to have more prevalent insider trading."). The study's measures were derived from the Global Competitiveness Report, developed jointly by the World Economic Forum and Harvard University, which surveys corporate officers from about 3,000 firms around the world. *Id.* at 921.

take advantage of their roles to acquire material, nonpublic information. They then trade on that information to generate self-regarding gain that is inconsistent with the very position with which they have been entrusted. What is wrong with insider trading is not so much that it is fraud, property theft, or unjust enrichment. What is wrong with insider trading is that it is corrupt.[154]

B. Normative Plausibility

A good theory of insider trading law must be able to respond to the normative skepticism of securities law experts who have repeatedly asked: Why ban insider trading at all? The corruption theory responds by providing a particular typology of costs generated by insider trading. A key benefit of seeing insider trading as private corruption is that it allows us to see the harms of insider trading more generally as the harms of corruption. In the public sphere, corruption's harms can be usefully categorized into temptation, distraction, and legitimacy costs.[155]

1. The Costs of Corruption

a. Temptation Costs

When public officials pursue private gain from public office, they are invariably tempted to make decisions that favor their individual economic self-interest irrespective of any impact on the public interest. As cross-country empirical research reveals, corrupt bureaucrats tend to favor expensive capital-intensive projects in which the extraction of larger private benefits is easier to

154. To avoid confusion, viewing insider trading as private corruption is not to say that all forms of private corruption should be proscribed as insider trading. For example, petty theft from the cash register could be corrupt but without a nexus to a securities transaction, there can be no insider trading violation. This point applies equally well to the contender theories discussed below, property theory and unjust enrichment theory. For example, under a property approach, not all thefts of property should be proscribed as insider trading. Certainly, no one is arguing that the misappropriation of the firm's stapler should be prosecuted under Rule 10b-5.

155. Of course, there may also be deontological objections to private gain from public office. These objections are not well captured by terms such as costs or harms. Lawrence Lessig has adopted a strikingly similar typology of harms to describe the influence of campaign contributions on Congress. *See* LAWRENCE LESSIG, REPUBLIC, LOST: HOW MONEY CORRUPTS CONGRESS—AND A PLAN TO STOP IT 125–71 (2011) (positing "distraction," "distortion," and "trust" harms of Lessig's broader notion of "dependence corruption").

conceal.[156] Highly corrupt countries tend to misallocate public resources by spending less on education, overinvesting in public infrastructure, and maintaining lower levels of environmental quality.[157] Corruption is also statistically associated with lower levels of investment, productivity, and growth, which discourage both capital inflows and foreign direct investment.[158] Corruption distorts the incentives of public officials, leading them not only to suboptimal substantive outcomes on decisions but also to suboptimal agenda setting.[159]

Comparable mechanisms exist in the private sector. Insider trading may similarly distort managerial incentives and thereby misallocate corporate financial resources. Managers may be tempted not to enhance corporate value but to reap self-regarding gains generated by inside trades.[160] For example, "managers can accelerate receipt of revenue, change depreciation strategy, or alter dividend payments in an attempt to affect share prices and insider returns."[161] Alternatively, they may direct the company to pursue projects that are easier to conceal from public scrutiny or structure transactions in such a manner as to exploit informational advantages in trading stock.[162] They may push the firm into riskier projects or manipulate the timing and content of information release in a manner that will generate more price volatility than otherwise.[163] In the worst-case scenario, a manager may intentionally try to destroy corporate value to take advantage of a short sale of the company's stock. After all, it is far easier to destroy corporate wealth than to enhance it.

156. *See generally* Kaufmann, *supra* note 117, at 118; *see also* Andrei Shleifer & Robert W. Vishny, *Corruption*, 108 Q. J. ECON. 599, 614 (1993) (observing that managers and bureaucrats in poor countries import unnecessarily advanced, rather than appropriate, equipment, because it is more difficult to detect overpayment and overinvoicing for advanced technologies).

157. *See* Susan Rose-Ackerman, *The Law and Economics of Bribery and Extortion*, 6 ANN. REV. L. & SOC. SCI. 217, 218 (2010) (citing sources).

158. *Id.* (citing sources).

159. *See* LESSIG, *supra* note 155, at 107, 151 (identifying "substantive" and "agenda" distortion).

160. *See, e.g.*, Roy A. Schotland, *Unsafe at Any Price: A Reply to Manne,* Insider Trading and the Stock Market, 53 VA. L. REV. 1425, 1448–57 (1967).

161. Stephen M. Bainbridge, *Regulating Insider Trading in the Post-Fiduciary Era: Equal Access or Property Rights?*, *in* RESEARCH HANDBOOK ON INSIDER TRADING, *supra* note 94, at 80, 93.

162. *See* Saul Levmore, *Securities and Secrets: Insider Trading and the Law of Contracts*, 68 VA. L. REV. 117, 149 (1982) ("[The insider] might structure corporate transactions in a way that increases the number of occasions of secret-keeping. Overinvestment might develop in certain industries . . . and underinvestment in others, as insiders guide their firms into enterprises that generate 'events' that might be capitalized upon . . . .").

163. *See* Lucian Arye Bebchuk & Chaim Fershtman, *Insider Trading and the Managerial Choice Among Risky Projects*, 29 J. FIN. & QUANTITATIVE ANALYSIS 1, 1 (1994) (theorizing that "insider trading leads insiders to choose riskier investment projects" but noting that the effect might be beneficial if management is risk averse); Cox, *supra* note 11, at 651; Easterbrook, *supra* note 110, at 332.

If short selling seems far-fetched, remember that the 1934 Congress was worried enough to formally ban the practice of short selling and sales "against the box"[164] in part because of a real-world incident of short selling securities.[165] Another line of examples comes from professional sports. In 1919, several members of the Chicago White Sox intentionally lost the World Series in order to profit from wagers placed against their own team.[166] More recently, allegations of match fixing, game throwing, or point shaving have tainted the sports of badminton,[167] boxing,[168] basketball,[169] soccer,[170] sumo wrestling,[171] cricket,[172] horse racing,[173] and tennis.[174] In sum, corruption in both public

164. *See* Ellen Taylor, *Teaching an Old Law New Tricks: Rethinking Section 16*, 39 ARIZ. L. REV. 1315, 1322 (1997) ("Sales 'against the box' are similar to short sales, in that they involve the use of borrowed securities. However, in a sale 'against the box,' the seller owns securities substantially identical to those sold, but chooses to deliver borrowed securities instead.").

165. *See* 15 U.S.C. § 78p(d), (e) (2012) (banning short selling and sales "against the box"). The ban was enacted as a direct response to an actual incident of short selling by Albert H. Wiggins, President of Chase National Bank, who manipulated his bank operations precisely to create insider trading opportunities. *See* Dooley, *supra* note 109, at 57. Also, evidence suggests that insider traders profit almost as much from bad news as from good news. *See* Kenneth Scott, *Insider Trading: Rule 10b-5, Disclosure and Corporate Privacy*, 9 J. LEGAL STUD. 801, 816 (1980) (reporting that 42 out of 115 defendants—or 37 percent—traded on bad news).

166. *See* ELIOT ASINOF, EIGHT MEN OUT: THE BLACK SOX AND THE 1919 WORLD SERIES (1963); Donald Arthur Winslow & Seth C. Anderson, *From "Shoeless" Joe Jackson to Ivan Boesky: A Sporting Response to the Law and Economics Criticism of the Regulation of Insider Trading*, 81 KY. L.J. 295, 299 (1992–1993) (analogizing the regulation of insider trading to the extensive prohibition of gambling in baseball in response to the White Sox scandal). In response, Major League Baseball not only banned the suspected players from professional baseball for life but also implemented a rule that prohibits athletes, coaches, administrators, and staff from betting not just against their own teams but on any games hosted by the Major League. *See* MAJOR LEAGUE RULE 21(d).

167. Cam Cole, *Expelled Olympic Badminton Players Win Gold for Lack of Subtlety*, NAT'L POST, Aug. 1, 2012, http://sports.nationalpost.com/2012/08/01/expelled-olympic-badminton-players-cant-even-get-cheating-right.

168. *London Olympics 2012 Boxing Matches Were Fixed?*, ZEENEWS.COM (Aug. 11, 2011, 11:05 PM), http://zeenews.india.com/sports/london-olympics-2012/india-at-olympics/london-olympics-2012-boxing-matches-were-fixed_747303.html.

169. *Silman Gets 46 Months for His Part in ASU Point-Shaving Scandal*, CNNSI.COM (June 30, 1998, 8:34 PM), http://sportsillustrated.cnn.com/basketball/college/news/1998/06/30/asu_shaving.

170. Jeff Z. Klein, *Game Fixing Rattles Soccer Around World*, N.Y. TIMES, July 18, 2011, http://www.nytimes.com/2011/07/19/sports/soccer/widespread-match-fixing-cases-rattle-soccer.html.

171. Mark Duggan & Steven D. Levitt, *Winning Isn't Everything: Corruption in Sumo Wrestling,* 92 AM. ECON. REV. 1594, 1594 (2002).

172. *Condon Calls for Action*, SKY SPORTS (Nov. 6, 2011, 11:48 AM), http://www1.skysports.com/news/12040/7295230.

173. Kevin Carpenter, *Match-Fixing—The Biggest Threat to Sport in the 21st Century?*, 2 INT'L SPORTS L. REV. 13, 15 (2012).

174. *Id.* at 16.

and private contexts distorts the incentives of decision makers, leading to a misallocation of financial resources.

b. Distraction Costs

Corruption also generates distraction costs, which misallocate time and attention.[175] In the public context, distraction costs were the primary reason why, in 1989 and 1991, the U.S. House of Representatives and the U.S. Senate banned all honoraria, or payments for appearances, speeches or articles.[176] This across-the-board ban was the only practical means of ending what had become widespread abuse. According to one report, "members of Congress received $9.1 million in honoraria fees in 1988."[177] Dennis Thompson notes that "[h]onoraria had become more than merely personal gain; they had become the core of a system of income enhancement that interfered with institutional gain."[178]

Just as distraction can take place in the public context, it can also take place in private contexts. Insider trading opportunities will consume at least some of the manager's time that would otherwise be devoted to promoting the corporate interest.[179] In order to take advantage of these opportunities, the corporate insider trader will have to research, plan, and execute his insider trading strategies. Admittedly, the distraction costs posed by insider trading are unlikely to be great for the average corporate manager, because she ordinarily has easy and effortless access to inside information. That said, the total amount of distraction costs may not be trivial.

c. Legitimacy Costs

Finally, corruption inflicts legitimacy costs, which sap political, economic, and social institutions of faith, energy, and participation in sys-

175. *See, e.g.*, Kaufmann, *supra* note 117, at 119 (citing studies demonstrating a link between extent of corruption and the amount of time a supplier typically spends with public officials in nonproductive, corrupt activities).

176. 5 U.S.C. app. § 501(b) (2012); Congressional Operations Appropriations Act of 1992, Pub. L. No. 102-90, § 6(b), 105 Stat. 447 (amending 5 U.S.C. §§ 503(1)(B), 505(1)-(2)); *see also* CONGRESSIONAL PAY AND PERQUISITES: HISTORY, FACTS, AND CONTROVERSY 19–21 (1992).

177. Michael H. Chang, *Protecting the Appearance of Propriety: The Policies Underlying the One-Year Ban on Post-Congressional Lobbying Employment*, 5 KAN. J.L. & PUB. POL'Y 121, 127 n.31 (1996).

178. *See* THOMPSON, *supra* note 117, at 21.

179. Schotland, *supra* note 160, at 1452.

temic[180] and hard-to-measure ways. Individuals participate within the rules of most systems not because they are directly compelled to do so. Instead, they participate because of an underlying faith in that system's legitimacy. When that faith erodes, people stop obeying the system's rules and opt out of participation. In the public context, wide-ranging evidence shows that corruption "undermine[s] social and political stability," "undermine[s] governmental institutions," and generates "alienating social effects, adding to growing cynicism about politics and the political process amongst citizens, often exacerbating inequality."[181]

Tom Tyler has carefully studied the mechanisms by which legitimacy is gained or lost. In his groundbreaking research,[182] Tyler discovered that when people perceive the system as procedurally fair, legal authorities are regarded as more legitimate. In addition, people are more likely to report abiding by the law in their day-to-day lives.[183] These effects held, regardless of the substantive outcome of the legal process experienced by respondents.[184] On the flip side, "people are reluctant to 'buy in' to a system that they do not perceive as fair or governed by neutral procedures."[185] The crucial role of perceived fairness in citizens' legitimacy judgments has been affirmed in

180. *Cf.* UNDERKUFFLER, *supra* note 117, at 4 (arguing that corruption as capture-by-evil "drives our understanding of corruption as a systemic effect and systemic influence").

181. Doig & McIvor, *supra* note 143, at 660 (summarizing findings from research); *see also* ROBERT KLITGAARD, CONTROLLING CORRUPTION 45 (1988) (noting that empirical case studies report cynicism, apathy, and regime instability in those developing countries that report widespread public perception of corruption); DONALD S. ROTHCHILD & NAOMI H. CHAZAN, THE PRECARIOUS BALANCE: STATE AND SOCIETY IN AFRICA (1988) (observing citizen withdrawal from politics); Rose-Ackerman, *supra* note 157, at 218 (reporting that "[o]verall, corruption reduces the perceived legitimacy of democratic governments" and citing sources).

182. *See* TOM R. TYLER, WHY PEOPLE OBEY THE LAW 64 (1990); Kim, *supra* note 117, at 182–83 (summarizing Tyler's research).

183. TYLER, *supra* note 182, at 62.

184. *Id.* at 139 ("[I]n judgments of procedural justice the absolute and relative favorability of one's outcome explained 1 percent of the variance beyond what can be explained by the other criterion of procedural justice. In contrast, noninstrumental criteria of fair procedure explained 47 percent of the variance in judgments of procedural justice beyond what could be explained by favorability of outcome."); Tom R. Tyler, *What Is Procedural Justice?: Criteria Used by Citizens to Assess the Fairness of Legal Procedures*, 22 LAW & SOC'Y REV. 103, 128 (1988) ("Once such fairness factors are taken into account, there is little independent effect of the favorability of the outcomes or procedures involved.").

185. Green & Kugler, *supra* note 147, at 454 (summarizing the conclusions of the psychological literature).

studies involving police officers,[186] judges and mediators,[187] arbitrators,[188] corporate managers,[189] and members of Congress.[190]

Just as public corruption can undermine the legitimacy of public institutions, private corruption can undermine the legitimacy of the securities markets. According to Tyler's findings, the mechanism may be perceived procedural unfairness. Investors in the United States generally view insider trading as unfair[191] and the profits made therewith as supererogatory.[192] That is at least in part because traders accrue such profits not through effort, ingenuity, risk-taking or even random luck, but through special, privileged access. As Victor Brudney has explained, "The unfairness [of insider trading] is not a function merely of possessing more information—[some] outsiders may possess more information than other outsiders by reason of their diligence or zeal—but of the fact that it is an advantage which cannot be competed away since it depends upon a lawful privilege to which an outsider cannot acquire access."[193] It is as if someone scored better on the Law School Admissions

186. Raymond Paternoster et al., *Do Fair Procedures Matter?* 31 LAW & SOC'Y REV. 163, 163–64 (1997); Jason Sunshine & Tom R. Tyler, *The Role of Procedural Justice and Legitimacy in Shaping Public Support for Policing*, 37 LAW & SOC'Y REV. 513, 513 (2003).

187. Katherine M. Kitzmann & Rorbert E. Emery, *Procedural Justice and Parents' Satisfaction in a Field Study of Child Custody Dispute Resolution*, 17 LAW & HUM. BEHAV. 553, 564–65 (1993).

188. ROBERT J. MACCOUN ET AL., ALTERNATIVE ADJUDICATION: AN EVALUATION OF THE NEW JERSEY AUTOMOBILE ARBITRATION PROGRAM (1988); E. Allen Lind et al., *Individual and Corporate Dispute Resolution*, 38 ADMIN. SCI. Q. 224 (1993).

189. Joel Brockner et al., *The Influence of Prior Commitment to an Institution on Reactions to Perceived Unfairness: The Higher They Are, the Harder They Fall*, 37 ADMIN. SCI. Q. 241 (1992); Roger Folger & Mary A. Konovsky, *Effects of Procedural and Distributive Justice on Reactions to Pay Raise Decisions*, 32 ACAD. MGMT. J. 115 (1989).

190. Tom R. Tyler, *Governing Amid Diversity: The Effect of Fair Decisionmaking Procedures on the Legitimacy of Government*, 28 LAW & SOC'Y REV. 809, 827–28 (1994).

191. *See, e.g.*, Statman, *supra* note 147, at 50 (finding that only 5 percent of finance professionals and 36 percent of students in the United States believed that the conduct of a hypothetical person modeled on the facts of the *O'Hagan* case was acceptable).

192. For example, in a recent study conducted on a sample of fifty working American adults, 83 percent and 79 percent of respondents believed that insider trading (based on nonpublic information about imminent tender offers) by executives at the acquiring and the acquired companies, respectively, should be criminally punished. But fewer thought such punishment was warranted for a secretary at the acquired company (77.1 percent), a mark-up man employed by a financial printer (60.4 percent), and a reporter (58.3 percent). From these studies, one can infer that fairness judgments vary depending on the identity of the defendant. Nonetheless, "[s]till, a strong majority criminalized the actions of [the mark-up man and the reporter], and this outcome provides support for the view that even corporate 'outsiders' who trade on the basis of inside information should be subject to prosecution in appropriate cases." *See* Green & Kugler, *supra* note 147, at 463.

193. Victor Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322, 346 (1979). Importantly, one's sense of fairness appears not to

Test because he received the questions in advance from his mother who works for the Law School Admissions Council. Basically, insider trading is viewed as cheating, a form of unfair competition in a high-stakes game.[194]

If investors come to see the securities markets as a rigged game—one that seems by design to systematically disadvantage ordinary investors—they could respond by discounting the amount that they are willing to pay for all securities, thereby raising the cost of capital. But without knowing the volume and frequency of insider trading, setting the proper discount would be nearly impossible.[195] The perception of rampant insider trading might also discourage investors from trading as much or as often, or may even catalyze exit en masse.[196] Either response would weaken the depth and liquidity of securities markets, which would decrease market efficiency.[197]

d. Some Empirical Support

Regardless of how intuitive and plausible this typology of temptation, distraction, and legitimacy costs might be, skeptics will demand hard evidence of net harms.[198] For example, many commentators have doubted that

be offended when material, nonpublic information is obtained by luck. *See* GREEN, *supra* note 145, at 241.

194. *Cf.* GREEN, *supra* note 145, at 240 (arguing that the moral wrongfulness of insider trading is best captured by the notion of cheating in the context of a "highly formalized, rule-governed game"—the stock market). According to Green, cheating involves the intentional violation of a prescriptive, mandatory conduct rule out of a desire to obtain an unfair advantage over a party with whom the actor is at least loosely engaged in a "mutually beneficial cooperative enterprise, such as a game, a market, or a political contest." *Id.* at 64. Although Green emphasizes that cheating often involves the breach of an explicit rule issued from a legitimate authority, the important feature seems to be that the norm is one that participants are expected to and generally do follow. *Id.* at 63. Under my typology, while insider trading might always be classified as a form of cheating, an act of cheating does not necessarily involve corruption, as cheating need not involve the use of an entrusted position.

195. William K.S. Wang, *Selective Disclosure by Issuers, Its Legality and Ex Ante Harm*, 24 COMPANY LAW. 144, 145 (2003).

196. For an exploration of how the legalization of insider trading might occasion the large scale exit of investors from the securities markets, see George W. Dent, Jr., *Why Legalized Insider Trading Would Be a Disaster*, 38 DEL. J. CORP. L. 247 (2013).

197. In addition, legitimacy costs might explain why the insider trading prohibition is handled mainly by federal, rather than state, securities laws. *See* Larry E. Ribstein, *Federalism and Insider Trading*, 6 SUP. CT. ECON. REV. 123 (1998) (arguing for the repeal of the federal prohibition and returning principal regulatory jurisdiction over to the states, absent explicit Congressional intent to regulate insider trading). *But see* Bainbridge, *supra* note 58, at 1262–66 (detailing the potential shortcomings of repealing the federal prohibition).

198. This debate has been characterized as one about whether insider trading improves the internal efficiency of corporations. For an overview of the debate, see Bainbridge, *supra* note 89, at 780–83, 786–90.

insider trading erodes investor confidence,[199] and Henry Manne has proclaimed that any such worry is "devoid of the scantest economic or empirical content."[200]

In response, I start with evidence for temptation and distraction costs. Arguably, the best available evidence comes from cross-country empirical studies investigating the relationship between corporate valuation and the relative strength of insider trading laws. In 2008, Laura Beny used cross-sectional data on the twenty largest firms from each of twenty-seven developed countries, to determine whether insider trading laws help firms to control agency costs.[201] She found that more stringent insider trading laws and enforcement were positively associated with higher corporate values for the sample firms. This finding is consistent with the hypothesis that stricter insider trading regimes help reduce the controlling shareholder's incentive to divert corporate value through insider trading.[202] Assuming that higher corporate values are reasonable proxies for lower agency costs[203] and that the incentives of controlling shareholders vis-à-vis insider trading operate similarly to the incentives of other corporate insiders,[204] Beny's study provides some support for the claim that insider trading generates temptation and distraction costs, both of which constitute agency costs.[205]

A subsequent study conducted by Art Durnev and Amrita Nain on 2189 firms sampled from twenty-one countries also found that "insider trading restrictions are on average associated with higher firm value,"[206] providing further support for the connection between insider trading and agency costs.

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199. *See, e.g.*, Bainbridge, *supra* note 58, at 1243; Macey, *supra* note 20, at 35 n.133.
200. Manne, *Insider Trading*, *supra* note 94, at 168 n.5.
201. Laura Nyantung Beny, *Do Investors in Controlled Firms Value Insider Trading Laws? International Evidence*, 4 J.L. ECON. & POL'Y 267, 277 (2008) (citing Rafael La Porta et al., *Investor Protection and Corporate Valuation*, 57 J. FIN. 1147, 1154 (2002)).
202. *Id.* at 270, 291 (reporting this finding for firms in common law countries, and noting that this "supports the claim that insider trading regulation mitigates agency costs"). See *id.* at 291–93 for discussion on why such effects were not found in civil law countries.
203. The dependent variable in Beny's study was Tobin's Q, a measure of corporate valuation and proxy for agency costs commonly employed in corporate finance studies. *Id.* at 278.
204. For explanations as to why Beny focused on corporations dominated by a controlling shareholder, see *id.* at 189, 269–70, 277.
205. *See* Laura Nyantung Beny & Anita Anand, *Private Regulation of Insider Trading in the Shadow of Lax Public Enforcement: Evidence From Canadian Firms*, 3 HARV. BUS. L. REV. 215, 247 (2013) (concluding that "there are reasons for [privately adopted insider trading policies] beyond pure window dressing and pure compliance/liability avoidance" and suggesting that there is a "desire of at least some firms to control insider trading to enhance corporate performance").
206. Art A. Durnev & Amrita S. Nain, *Does Insider Trading Regulation Deter Private Information Trading? International Evidence*, 15 PAC.-BASIN FIN. J. 409, 411 (2007).

In 2004, Julan Du and Shang-Jin Wei measured cross-sectional data on the stock market volatility of fifty-four countries against a well-known index of perceptions about insider trading.[207] They concluded that more prevalent insider trading is associated with higher market volatility even after controlling for the volatility of real output growth, volatility of monetary and fiscal policies, and maturity of the stock markets.[208] Although the precise mechanisms through which insider trading raises market volatility remain unclear, these findings are consistent with the claim that insider trading may generate temptation and distraction costs.[209]

As for legitimacy costs, Manne's assertions, even if they were defensible when he made them, are no longer empirically justified. Various studies suggest that insider trading impairs market liquidity[210] and increases the transaction costs of derivatives trading.[211] Conversely, policing insider trading appears to benefit many measures of stock market performance[212] associated with investor

207. *See* Du & Wei, *supra* note 153; *id.* app. B, *available at* http://www.res.org.uk/details/file/1455063/ecoj_249_app_pdf.html (listing the fifty-four countries in the sample).

208. Moreover, the quantitative effect of insider trading on market volatility is also significant when compared with the effect of economic fundamentals. Du & Wei, *supra* note 153, at 940.

209. *See id.* at 917 (summarizing potential mechanisms through which insiders may generate greater volatility when insider trading); *cf. supra* discussion on temptation costs in Part II.B.1.a. As the authors note, although a "certain degree of market volatility is unavoidable, even desirable, . . . excessive volatility that is not related to economic fundamentals would diminish the signaling function and impede resource allocation." Du & Wei, *supra* note 153, at 916.

210. Louis Cheng et al., *The Effects of Insider Trading on Liquidity*, 14 PAC.-BASIN FIN. J. 467, 471 (2006) (finding that increased trading by directors impairs market liquidity—wider spreads and lower depth (defined as "the impacts of the volume and dollar amounts of trading")—in the Hong Kong securities market); Raymond P.H. Fishe & Michel A. Robe, *The Impact of Illegal Insider Trading in Dealer and Specialist Markets: Evidence From a Natural Experiment*, 71 J. FIN. ECON. 461 (2004) (finding strong evidence that illegal insider trading has a negative impact on market liquidity; depth falls in both specialist and dealer markets but spreads increase only in specialist markets). *But see* Charles Cao et al., *Does Insider Trading Impair Market Liquidity? Evidence From Lockup Expirations*, 39 J. FIN. QUANTITATIVE ANALYSIS 25 (2004) (reporting only small and temporary increases in effective bid-ask spreads and substantial improvement in many measures of market depth and trading activity when insiders enter the market upon lockup expirations at 1497 firms).

211. *See* Stanislav Dolgopolov, *Risks and Hedges of Providing Liquidity in Complex Securities: The Impact of Insider Trading on Options Market Makers*, 15 FORDHAM J. CORP. & FIN. L. 387, 387 (2010) (concluding that "[e]xisting evidence in fact demonstrates the gravity of potential losses and potential adverse effects in the form of more costly transactions in derivatives, as one of the proven economic costs of insider trading"). For a review of the more divisive literature on *equity* market makers' bid-ask spreads, see Stanislav Dolgopolov, *Insider Trading and the Bid-Ask Spread: A Critical Evaluation of Adverse Selection in Market Making,* 33 CAP. U. L. REV. 83 (2004), and Fishe & Robe, *supra* note 210, at 486, which finds width differences in spreads between dealer and specialist markets.

212. For an overview of the studies supporting this conclusion, see Prentice & Donelson, *supra* note 94, at 67–71.

confidence. Cross-country empirical studies find that more stringent insider trading laws are generally associated with more dispersed equity ownership, more accurate stock prices, greater average stock market turnover and, thus, more liquid stock markets.[213] The enforcement of insider trading prohibitions is associated with a reduction in the cost of capital, increases in market liquidity (both trading volume and market depth), and increases in price efficiency.[214] And firms' voluntary adoption of restrictions on trading by their corporate insiders shrinks bid-ask spreads and increases liquidity in the market for the firm's shares.[215] The above findings are consistent with the narrative that perceptions of rampant insider trading could erode the legitimacy of the securities markets.

2. Justifying the Classical Ban

True Insiders. With this typology of costs in mind, I start with the classical theory of insider trading announced in *Chiarella*, which forbids corporate insiders and employees from trading on material, nonpublic information impacting the stock of their corporate employer. This ban can be justified on the ground of minimizing temptation and distraction costs. The idea is that we want these insiders to place the welfare of the corporation and its shareholders before their own financial interests and to apply their full-time energies to their entrusted tasks. A prophylactic ban on insider trading promotes these specific goals.

Constructive Insiders. Corporate insiders and employees are not the only entrusted positions for which a prophylactic ban on insider trading makes

213. Laura Nyantung Beny, *Insider Trading Laws and Stock Markets Around the World: An Empirical Contribution to the Theoretical Law and Economics Debate*, 32 J. CORP. L. 237, 237 (2007).

214. Hazem Daouk et al., *Capital Market Governance: How Do Security Laws Affect Market Performance?* 12 J. CORP. FIN. 560 (2006) (finding that, based on data collected from thirty-two countries with stock exchanges during the period 1969 and 1998, overall capital market governance in a country—of which the enforcement of insider trading laws is one component—is linked to a decrease in the cost of equity, an increase in market liquidity, and an increasing in pricing efficiency but also noting that these results are directionally consistent for each of the individual components of capital market governance); *see also* Utpal Bhattacharya & Hazem Daouk, *The World Price of Insider Trading*, 57 J. FIN. 75 (2002) (finding that, based on an analysis of data on all 103 countries with stock markets as of 1998, the enforcement of insider trading laws is associated with a reduction in the cost of equity in a country).

215. Bettis et al., *supra* note 146, at 218 (reporting, based on a sample of 284 firms, lower bid-ask spreads during periods when insiders are restricted from trading, suggesting that trading-window restrictions increase market liquidity).

sense. Courts have recognized that a subset of outsiders, such as underwriters, accountants, lawyers, or consultants, may become fiduciaries of the corporation's shareholders because they "have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes."[216]

Extending the ban to these constructive insiders is entirely consistent with concerns about distraction and especially temptation costs. Consider, for example, how a lawyer retained by a corporation to handle a material litigation matter could be tempted to harm her client. To maximize insider trading opportunities, the lawyer might distort the characterization of the litigation both to her client and in public disclosures in order to trigger more dramatic price swings. Or, for the same reason, the lawyer may encourage the corporation to try the case in court even though a quiet settlement would be in the corporation's best interest.

Tipping. Finally, *Dirks*'s ban on tipping can be justified as an incremental extension in pursuit of the same goals of reducing temptation and distraction costs. Permitting tipping would create a very large loophole whereby corporate and constructive insiders could indirectly obtain benefits through tippees who trade on inside information passed along to them for just this purpose.[217] Under *Dirks*, liability can be found not only when the tipper tips in anticipation of a financial kickback but also when the tipper merely "makes a gift of confidential information to a trading relative or friend."[218] From a temptation and distraction perspective, this makes sense because it does not strictly matter whether financial or nonfinancial motivations tempt or distract the tipper from his duties.

Moreover, by extending the classical theory to hold not only tippers but also knowing tippees[219] liable, the law attacks the problem from both the supply and demand sides. Such an enforcement structure exists in various domains ranging from bribery (punishing bribe-givers as well as bribe-takers) to prostitution (punishing customers as well as prostitutes). In other words, punishing

216. Dirks v. SEC, 463 U.S 646, 655 n.14 (1983).

217. *See id.* at 659 (explaining the ban on tipping by noting that a "contrary rule would open up opportunities for devious dealings in the name of others that the trustee could not conduct in his own" (internal quotation marks omitted)).

218. *Id.* at 664.

219. For liability under *Dirks*, the recipient of the gift must have knowledge (or, perhaps, reason to know) that the information was given to him as a gift from the insider. *See* LANGEVOORT, *supra* note 92, § 4.8, at 4–24. The liability for remote tippees, however, was not specifically addressed in *Dirks* and, as a result, is much less settled among the different circuits and thus not part of the received doctrine addressed by this Article. Hence, justification of remote tippee liability is beyond the scope of this project. *See id.* § 4.10, at 4–33.

the demand side is not unique to insider trading law. What corruption theory arguably adds is attention to legitimacy, which would be undermined if chums, classmates, colleagues, and cohabitants of tippers were entirely immunized from liability, even when they knowingly received tips that would trigger tipper liability.

3. Justifying the Misappropriation Ban

What does the corruption theory have to say about outsider trading? In some cases, one can explain the ban on outsider trading in terms of avoiding temptation and distraction costs. For example, a corporate manager might decrease the value of his own firm in order to generate a profitable trading opportunity in the stock of a competitor firm.[220] Or a manager might prefer a strategy of aggressive growth through acquisitions to slower-growth alternatives because anticipated acquisitions generally afford more profitable insider trading opportunities in the stock of the target companies. Such scenarios are plausible because, although misappropriation theory defendants may be strangers to the issuer of the traded securities, they are often key actors or intermediaries in the securities markets—corporate managers, lawyers, investment bankers, consultants, or accountants. These actors often operate just one step removed from the issuer of traded securities and tend to occupy some entrusted position.[221] In those cases, one can anticipate temptation and distraction costs being inflicted on *some* public issuer.

In other misappropriation theory cases, however, no temptation or distraction costs will be inflicted on any issuer of securities. Neither the source of information nor the defendant (typically an agent of the source) will be key actors or intermediaries of the securities markets—at least not in the sense that corporate managers, lawyers, and accountants are. Yet—and here is the special contribution from the corruption theory—there may still be legitimacy costs to worry about.

Legitimacy costs were precisely what concerned the Court in *O'Hagan* as it banned outsider trading. The Court noted that the misappropriation theory is "well tuned to an animating purpose of the Exchange Act: to insure honest securities markets and thereby promote investor confidence" and that "investors likely would hesitate to venture their capital in a market where trading

220. Ian Ayres & Joe Bankman, *Substitutes for Insider Trading*, 54 STAN. L. REV. 235, 281 n.141 (2001).

221. *See, e.g.*, SEC v. Singer, 786 F. Supp. 1158 (S.D.N.Y. 1992) (involving a lawyer who allegedly used confidential client information to trade in stock of nonclient corporation); United States v. Elliott, 711 F. Supp. 425 (N.D. Ill. 1989).

based on misappropriated nonpublic information is unchecked by law."[222] In affirming the liability of James O'Hagan, the Supreme Court appears to have acted to curb legitimacy costs, because the unrestrained trading on inside information by lawyers—crucial intermediaries of the securities markets[223] who are perceived as such by the investing public—would especially threaten legitimacy.

Service providers who occupy less discretionary roles, but who are nonetheless important repeat players in the securities markets, can also incur legitimacy costs. For example, financial printers, such as Pandick Press in *Chiarella*, provide essential support for transactions that are mediated through the securities markets. Employees like Vincent Chiarella have routine, privileged access to market-moving information about publicly traded issuers. Hence, their trading on such information could become widespread and systematic. In fact, of the first thirty-seven insider trading cases brought by the SEC, four named employees of financial printers as defendants.[224] While outsider trading by these defendants may inflict temptation and distraction costs on their employers' clients,[225] legitimacy costs may best explain why the ban applies to employees of financial printers, as is the case post-*O'Hagan*.[226]

* * *

Public corruption generates temptation, distraction, and legitimacy costs. Private corruption is not so different. Understanding insider trading as a form of private corruption thus prompts us to analyze the various insider trading bans in terms of these costs. When we do so, we find new and plausible reasons to normatively justify the existence of the bans.

To clarify, this Article has not engaged in any systematic cost-benefit analysis of banning insider trading. In other words, it has not attempted to

222. United States v. O'Hagan, 521 U.S. 642, 658 (1997).

223. For the role of lawyers in the securities markets, see, for example, Sung Hui Kim, *Gatekeepers Inside Out*, 21 GEO. J. LEGAL ETHICS 411 (2008).

224. *See* Dooley, *supra* note 109, at 9; *see also* SEC v. Materia, 745 F.2d 197, 201 (2d Cir. 1984) (holding financial printer liable for insider trading).

225. As an example of temptation costs, Chiarella's trading was in competition with Pandick Press's clients and, if done in a manner to signal the clients' takeover plans, threatened to derail them. In terms of distraction costs, Chiarella spent time decoding the identities of the target companies instead of concentrating on his assigned tasks.

226. *See* John R. Beeson, Comment, *Rounding the Peg to Fit the Hole: A Proposed Regulatory Reform of the Misappropriation Theory*, 144 U. PA. L. REV. 1077, 1147 (1996) (concluding that Vincent Chiarella would be found liable under misappropriation theory after *O'Hagan*); *see also Materia*, 745 F.2d at 203–04 (finding liability on facts similar to *Chiarella*).

calculate the claimed market efficiency benefits of insider trading offset by the costs subtotaled into temptation, distraction, and legitimacy values.[227] Instead, the goal is merely to defend the normative plausibility of the corruption theory. Why such a limited objective? Because in reality it is highly unlikely that anyone could produce a definitive accounting. Would any two people actually agree on the specific figures? Even though the corruption theory may be normatively appealing, perhaps even persuasive, the reader need accept for now only that it is normatively plausible. Any good theory of insider trading must provide at least this much.

III. COMPARISON WITH OTHER THEORIES

Normative plausibility is a relatively low threshold, which means that multiple theories are likely to be in contention. In Part III, I compare the corruption theory to the two leading theories of insider trading law—the property and unjust enrichment theories.[228] Although there is much to admire about both theories, I argue that they suffer from significant problems and that the corruption theory, though imperfect, provides a better explanation of insider trading law. In particular, among these normatively plausible theories, the corruption theory best fits core features of the received doctrine. I begin with property theory.

A. Property Theory

In 1991, Jonathan Macey declared, "It is now clear that the search for a coherent justification for prohibiting insider trading is over: the right to trade on a piece of information about a corporation is simply a part of the larger, and more venerable, question of whether and how to allocate property rights in intangible things."[229] In 1995, Stephen Bainbridge concurred: "There is an emerging consensus that the federal insider trading prohibition is most easily justified as a means of protecting property rights in information."[230]

227. I have also not provided what might be called a deontological account of why insider trading might be wrong.
228. I present these theories as they are advocated in the literature. There may be ways to improve or strengthen the property and unjust enrichment theories. My principal objective, however, is to propose and elaborate the corruption theory of insider trading law, not to reconstruct contender theories.
229. JONATHAN R. MACEY, INSIDER TRADING: ECONOMICS, POLITICS, AND POLICY 2 (1991).
230. Bainbridge, *supra* note 58, at 1252.

1. The Theory Explained

A property theory conceptualizes material, nonpublic information about the firm as property owned by the firm.[231] On this view, just as it is illegal to steal a firm's computers or customer lists, it should similarly be illegal to steal inside information and then trade on it. As a threshold matter, it is widely accepted that property rights can be recognized in intangible things, such as information. Consider the plethora of intellectual property laws.[232]

The standard story for why such property rights should be recognized in information turns on incentives.[233] Because information has the features of public goods—specifically, it is easily appropriable and can be consumed nonrivalrously—it will tend to be underproduced. By granting property rights to information (and thereby creating legal rights to exclude others), one can encourage investment in the research and development that produces the information. Just as we propertize ideas in the form of patents to incent the inventor, we can incent the corporation to develop socially valuable information by protecting the information as corporate property.

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231. *See, e.g.*, Carpenter v. United States, 484 U.S. 19, 26 (1987); United States v. Chestman, 947 F.2d 551, 576–78 (2d Cir. 1991) (Winter, J., concurring), *cert. denied*, 112 S. Ct. 1759 (1992); Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 861 (1983) ("[T]he insider trading debate is really a debate about whether the firm, as a matter of contract, should be able to allocate property rights in valuable information to managers or investors."); Easterbrook, *supra* note 110, at 312 (arguing that "the central question was whether the principal had a property interest sufficient to require the agent neither to use nor to disclose [inside information] without the principal's consent"); Macey, *supra* note 20, at 11 (observing that the Supreme Court's "analysis evinces a new understanding of the fact that privileged corporate information is a valuable asset in the nature of a property interest"); Scott, *supra* note 165, at 804 (discussing "protection to the property rights of the firm in inside information").

232. Bainbridge, *supra* note 58, at 1253; *see* 35 U.S.C. §§ 1–390 (2006) (patents); 17 U.S.C. §§ 1–1332 (2012) (copyrights); 15 U.S.C. §§ 1051–1141 (2012) (trademarks); UNIF. TRADE SECRETS ACT (amended 1985), 14 U.L.A. 529 (2005) (trade secrets). The classification of trade secret law as part of intellectual property law is more controversial. *See* Mark A. Lemley, *The Surprising Virtue of Treating Trade Secrets as IP Rights*, 61 STAN. L. REV. 311 (2008).

233. This is the standard story provided in the insider trading law literature. *See* Bainbridge, *supra* note 58, at 1253 ("[T]he rationale for prohibiting insider trading is precisely the same as the rationale for prohibiting patent infringement or theft of trade secrets: protecting the economic incentive to produce socially valuable information."); Macey, *supra* note 20, at 28 n.98 (citing John Locke and noting "[t]o encourage these wealth creating activities, we must provide the proper incentive for corporations to 'create' the information by conducting research activities. . . . Similarly, rules prohibiting insiders from trading decreases the production of such information"). For analysis of the Lockean arguments for intellectual property rights, see Seana Valentine Shiffrin, *Lockean Arguments for Private Intellectual Propert*y, *in* NEW ESSAYS IN THE LEGAL AND POLITICAL THEORY OF PROPERTY 138 (Stephen R. Munzer ed., 2007).

As a matter of initial allocation, the property right to the inside information in question will belong to the firm.[234] In such cases, trading on inside information is wrong for the same reason that theft or conversion of corporate property is wrong.[235] In other words, insider trading is like taking the firm's stapler, using the company car to take a personal vacation, or selling the firm's customer database to direct marketers—all without the firm's authorization.

The property theory also explains why tips are banned. Tipping is comparable to theft by the tipper, with the tippee knowing or having reason to know that she is receiving hot goods.[236] Because a property right can be enforced generally as against the world, the owner of inside information may proscribe the use of it by third-party tippees and not just the person with whom it is in contractual privity.[237] The property theory also explains why outsider trading is banned. Again, if one views the information as firm property, then anyone who trades on the information without authorization has wrongfully misappropriated the information for use in a securities transaction, regardless of whether that person has a prior connection to the issuer of the traded securities.

2. Problems With Property: Poor Doctrinal Fit

For many, there is a simple elegance to thinking of insider trading law as just another species of property law. Especially for economics-minded thinkers, it answers well the fundamental questions about the existence and scope of insider trading law.[238] Unfortunately, property theory suffers from a fundamental

234. This Article assumes that a property theory would allocate the initial entitlement to use inside information to the firm, as most commentators assume or argue. *See, e.g.*, Bainbridge, *supra* note 58, at 1255–56; Dooley, *supra* note 109, at 32. This assumption is generally consistent with intellectual property laws. *See* Dan L. Burk & Brett H. McDonnell, *The Goldilocks Hypothesis: Balancing Intellectual Property Rights at the Boundary of the Firm*, 2007 U. ILL. L. REV. 575, 594 ("[I]ntellectual property law tends to assign rights to firms where the ideas are developed within the scope of employment using firm resources."). For an argument that default rules should favor firm ownership over employee ownership, see Robert P. Merges, *The Law and Economics of Employee Inventions*, 13 HARV. J.L. & TECH. 1, 2–3 (1999). For a general analysis of efficiently allocating initial entitlements, see Jerry Kang, *Information Privacy in Cyberspace Transactions*, 50 STAN. L. REV. 1193, 1249–59 (1998).

235. *See* Macey, *supra* note 20, at 27.

236. *See* Fisch, *supra* note 2, at 224; Scott, *supra* note 165, at 814.

237. *See generally* Stephen M. Bainbridge, *Insider Trading Under the Restatement of the Law Governing Lawyers*, 19 J. CORP. L. 1, 27 n.96 (1993).

238. Such thinking also has critics who might be wary about simplistic notions of property and the tendency to focus on efficiency to the exclusion of other values, such as fairness. Such a discussion is beyond the scope of this Article. For a critique of the property theory that emphasizes the mandatory disclosure system, see Roberta S. Karmel, *The Relationship Between Mandatory Disclosure and Prohibitions Against Insider Trading: Why a Property Rights Theory of Insider Trading is Untenable*, 59 BROOK. L. REV. 149 (1993) (book review).

problem. It poorly fits the insider trading law that we have.[239] As a result, the theory may be a compelling normative approach to insider trading, but it lacks sufficient descriptive power.

a. Right to Exclude: The Ninja Problem

One of the core features of property is that the owner enjoys a right to exclusive possession generally as against the world.[240] This right to exclude is often touted as the most central stick within the bundle of sticks that is property.[241] Further, it is a right that applies usually against all others and not limited to some small category of people, such as fiduciaries. When someone steals your laptop, property law does not care if the thief happens to be your lawyer or a complete stranger. Moreover, this attribute generally holds for various forms of intellectual property.[242]

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239. Taking the contrary position, some property theory advocates point to how well property theory fits *Dirks*, which they interpret as effectively assigning the property right to the analyst rather than the affected corporation in an effort to improve market efficiency by encouraging analysts to spend resources to develop socially valuable information. *See* Dirks v. SEC, 463 U.S. 646, 658 (1983) ("Imposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market."); Bainbridge, *supra* note 57, at 1609–10. But this interpretation might be an overreading of *Dirks*. Although the Court expressed solicitude for the role of analysts in enhancing market efficiency, the Court also crafted a rule that privileges concerns about improper motivation over market efficiency. As noted by James Cox, "[m]arket efficiency is enhanced regardless of whether the analyst or other financial intermediary confers a benefit, financial or otherwise, upon the tipping insider." Cox, *supra* note 11, at 632. Clearly, the finding of an improper purpose trumps any protection of market analysts. Under the reasoning in *Dirks*, if Secrist had passed on information to Dirks not out of a desire to bring the fraud to light but instead with the intention of cultivating a mutually beneficial financial relationship, Dirks would be liable for improper tipping so long as he was aware of Secrist's improper motivation. *See* Macey, *supra* note 20, at 39.

240. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 67 (4th ed. 1992); Lemley, *supra* note 232, at 329 ("Exclusivity is the hallmark of an IP right.").

241. *See, e.g.*, THOMAS W. MERRILL & HENRY E. SMITH, PROPERTY: PRINCIPLES AND POLICIES, at v (2007) ("The most basic principle is that property at its core entails the right to exclude others from some discrete thing."); *cf.* Kaiser Aetna v. United States, 444 U.S. 164, 176 (1979) (characterizing the right to exclude as "one of the most essential sticks in the bundle of rights that are commonly characterized as property"). *But see* Stephen R. Munzer, *A Bundle Theorist Holds on to His Collection of Sticks*, 8 ECON. J. WATCH 265 (2011); Stephen R. Munzer, *Property and Disagreement*, *in* PHILOSOPHICAL FOUNDATIONS OF PROPERTY LAW 289 (James Penner & Henry E. Smith eds., 2013) (challenging the view that the right to exclude is the essence of property).

242. *See* Robert G. Bone, *A New Look at Trade Secret Law: Doctrine in Search of Justification*, 86 CALIF. L. REV. 241, 243–44 (1998) (discussing the right to exclude for copyright, patent, trademark, publicity rights, and various unfair competition torts). Trade secret law also

Now, recall the ninja trader from Part I.A.2, who broke in and took information belonging to Acme Manufacturing Company. Under a property theory of insider trading, the ninja's trading activities, which exploit stolen property, should clearly be proscribed. But, as noted, the textbook answer is that the ninja is not liable under insider trading law[243] because he neither owed nor inherited any fiduciary duty to be breached.[244] The following exchange between Justice O'Connor and Deputy Solicitor General Michael Dreeben during the *O'Hagan* oral argument makes this clear:

> MR. DREEBEN: The misappropriation theory . . . involves . . . an agent entrusted with information by a principal under the understanding between the parties that the agent would not use that information for any personal gain without obtaining the principal's agreement.
>
> JUSTICE O'CONNOR: Well, Mr. Dreeben, then if someone stole the lawyer's briefcase and discovered the information and traded on it, no violation?
>
> MR. DREEBEN: That's correct, Justice O'Connor.[245]

The ninja is analogous to Justice O'Connor's briefcase thief. Accordingly, even under the more expansive misappropriation theory, the ninja would not be liable given the absence of a fiduciary-like relationship to the source of information.

Two final points bear mention. First, as noted above, it is true that some opinions such as *Dorozhko* have questioned the centrality of the breach of fiduciary duty requirement. But that is very much a minority view. As a leading securities law commentator observed, *Dorozhko* is "an end run around the basics of insider trading law."[246] Second, holding steadfast to property theory

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confers rights against the world (including strangers) but liability is imposed only when the means of appropriation are deemed wrongful. *See* Lemley, *supra* note 232, at 331–32 ("Trade secret law precludes acquisition of information by strangers using improper means—computer hacking and other forms of corporate espionage. Further, it extends the reach of the law beyond privity of contract to anyone who comes into contact with a secret knowing that they have acquired it by accident, mistake, or by another's malfeasance."). But the right to exclude is not absolute. For example, in both trade secret law and copyright law, the owner does not have a claim against someone "who develops the idea independently, or who reverse engineers a product on the open market to learn the secret." *Id.* at 330.

243. *See supra* note 15.

244. *See supra* note 64.

245. *See* Transcript of Oral Argument at 5, United States v. O'Hagan, 521 U.S. 642 (1997) (No. 96-842), 1997 WL 182584, at *5; *see also* Painter et al., *supra* note 101, at 181.

246. *See* Stephen Bainbridge, *The Second Circuit's Egregious Decision in* SEC v. Dorozhko, PROFESSORBAINBRIDGE.COM (July 29, 2009, 4:36 AM), http://www.professorbainbridge.com/

(which casts aside any fiduciary duty requirement) will often expand liability in cases such as the ninja trader. Most property enthusiasts do not champion expanding insider trading liability.[247]

How does the corruption theory fare by comparison? Would it hold the ninja liable for insider trading? Or does it similarly cast aside decades of Supreme Court precedent? Recall that private corruption is the use of an entrusted position for self-regarding gain. While the ninja's gain is personal and improper and thus potentially classifiable as self-regarding, he did not accrue it through the use of any entrusted position. Rather, the information was accessed via trespass. Building security exists precisely because thieves are not to be trusted. Even though the means by which the ninja acquired the information were unlawful, his actions cannot be called corrupt as defined here. Under the corruption theory, the ninja trader would not be liable. In this way, the corruption theory better fits the received insider trading doctrine, which demands a breach of a fiduciary or fiduciary-like duty.

b. Property is Alienable: The Superstar CEO Problem

After the right to exclude, arguably the next most central feature of property is alienability.[248] Accordingly, property theory would consider the right to inside trade as transferable by the firm.[249] To be sure, not all property rights are fully alienable.[250] Indeed, a robust literature examines inalienability especially in the contexts of "'contested commodities' (such as organs and babies), negative externalities (such as pollution or overharvesting), and fundamental

professorbainbridgecom/2009/07/the-second-circuits-recent-decision-in-sec-v-dorozhko-available-here-dealt-with-one-of-the-questions-left-open-by-the.html.

247. *See, e.g.*, MACEY, *supra* note 229, at 5; Carlton & Fischel, *supra* note 230, at 865; David D. Haddock & Jonathan R. Macey, *A Coasian Model of Insider Trading*, 80 NW. U. L. REV. 1449, 1467–68 (1987). Of course, in the long run, there might be a net decrease in liability if firms come to generally adopt the practice of contracting away rights to trade on inside information. *But see* James J. Park, *Rule 10b-5 and the Rise of the Unjust Enrichment Principle*, 60 DUKE L.J. 345, 373–74 (2010) ("But given the unlikelihood that insider trading would be widely authorized, on balance, a property-rights theory would prohibit a broader range of conduct than the classical theory.").

248. *See, e.g.*, RESTATEMENT (FIRST) OF PROPERTY § 489 cmt. a (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."); Lee Anne Fennell, *Adjusting Alienability*, 122 HARV. L. REV. 1403, 1443 (2009) (describing alienability as one of the primary incidents of property ownership and suggesting that, if something is completely inalienable, categorizing it as "'property' is highly questionable").

249. *See, e.g.*, Bainbridge, *supra* note 58, at 1255 n.278; Fisch, *supra* note 2, at 225–26.

250. For a typology, see Susan Rose-Ackerman, *Inalienability and the Theory of Property Rights*, 85 COLUM. L. REV. 931 (1985).

rights,"[251] such as the right to vote or the right to associate.[252] But the right to use inside information about the firm in securities transactions does not obviously fall in any of those domains. Moreover, intellectual property rights—to which the property right to use inside information is most similar—are generally transferable by contract.[253]

Consider the hypothetical of the superstar chief executive officer (CEO). If, in her employment contract, she negotiates for the transfer of ownership of a company car as part of her compensation package, the car is hers. This is a private exchange of property for services. So long as the corporation properly authorized the employment contract and made the requisite disclosures, the law asks no further questions. But suppose that the CEO negotiates not for a car but for inside information and the option to trade on it. Under property theory, there should be no different treatment between a car and inside information.[254] Indeed, this is precisely what some property enthusiasts have advocated.[255]

Current law, however, would forbid such an employment contract.[256] Because the duty to disclose or abstain imposed under the classical theory is owed directly to the individual shareholders of the firm, a knowing and intelligent waiver of that duty by the firm's shareholders would ordinarily be needed to exonerate an instance of insider trading.[257] Given the anonymous nature of the trading markets, it would be nearly impossible to obtain a valid waiver.[258] In addition, the property rights approach suggests that corporations, as the owners of material, nonpublic information, should themselves be free to profit from such information by trading on it. Yet, under the classical theory, the corporation itself remains subject to the insider trading ban.[259]

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251. Jennifer E. Rothman, *The Inalienable Right of Publicity*, 101 GEO. L.J. 185, 209 (2012).
252. Some property scholars would not regard such fundamental rights as property rights at all.
253. *See* Burk & McDonnell, *supra* note 234, at 597.
254. *See, e.g.*, Fisch, *supra* note 2, at 224; *cf.* Easterbrook, *supra* note 110, at 331.
255. *See supra* note 247. But not all property theorists in all cases advocate allowing firms to contract out of the insider trading prohibition. *See* Bainbridge, *supra* note 237, at 38 (concluding that "[a] mandatory rule [prohibiting insider trading by lawyers] is thus likely to be Kaldor-Hicks efficient"); Easterbrook, *supra* note 110, at 338 ("Although I think it likely that legal restrictions on such trading are beneficial, the questions ultimately are empirical.").
256. *See* Pritchard, *supra* note 61, at 46 n.213 (noting that "[a] corporation could not authorize such trading in its own shares because it would run foul of the classical theory" and citing sources). This conclusion also follows from the fact that the corporate issuer itself is subject to the insider trading ban.
257. *See id.*; *see also infra* note 267.
258. *See* Pritchard, *supra* note 61, at 46 n.213.
259. McCormick v. Fund Am. Cos., 26 F.3d 869, 876 (9th Cir. 1994) (stating that "[n]umerous authorities have held or otherwise stated that the corporate issuer in possession of material

Again, we are confronted with a material divergence between property theory and actual doctrine. Property theory embraces the alienability of inside information whether it is negotiated ex ante in an employment contract or even ex post via waiver. But under established insider trading doctrine, the corporation cannot contractually assign the right to trade on inside information or, for that matter, trade on inside information itself.

How would the corruption theory handle the superstar CEO? Let us begin with the easier case in which the board authorizes an employment agreement that permits insider trading without public disclosure, in violation of SEC disclosure regulations.[260] Because the office of the CEO is clearly an entrusted position through which the gain in question was obtained, the first component of the corruption definition is easily satisfied. But what about the second component, self-regarding gain?

Self-regarding gain is supererogatory—"neither part of the explicit compensation . . . nor culturally viewed as an acceptable or unavoidable perquisite of the role."[261] Because the board actively concealed the insider trading term of the employment contract from investors and regulators, the insider trading profits should not count as explicit compensation.[262] Hence, the gain in question would be classified as self-regarding. Both parts of the corruption definition are satisfied. Accordingly, the corruption theory again fits the doctrine better than property theory.

Let us make the case harder by changing one important fact. Suspend disbelief and suppose that this time the firm discloses its insider trading authorization with the same good faith that it discloses all other aspects of its officers' compensation packages in the requisite SEC filings.[263] In this variation, the right to inside trade would be part of the explicit compensation package.

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nonpublic information, must, like other insiders in the same situation, disclose that information to its shareholders or refrain from trading with them" and citing sources); LANGEVOORT, *supra* note 92, § 3:6, at 3-8 to 3-10.

260. *See* 17 C.F.R. § 229.402 (2013).

261. *Supra* note 120 and accompanying text.

262. One might object that it should not matter if the board concealed the relevant term from third parties. As the argument goes, what counts as explicit compensation should be a matter of contract and should only concern the two parties to the contract. But any concept's meaning turns on the purpose for which the concept is used. And I am using "explicit compensation" here to flesh out a definition of private corruption, which means that keeping things hidden from third parties, presumably because collective norms are offended, is highly relevant.

263. Because insider trading profits will necessarily be tough to estimate ex ante, full transparency of the type we are accustomed to seeing in SEC filings will be unlikely.

Property theory would again permit such an employment arrangement. Under current law, would the firm's disclosure in SEC filings amount to the full discharge of the insider's duty to disclose or abstain? Although it is hard to provide a definitive answer because no such explicit employment arrangement has ever been seen or litigated,[264] the more plausible interpretation of the requisite duty would find mere disclosure of the option to inside trade to be insufficient. A fiduciary's duty to disclose or abstain requires not just some vague notice that the fiduciary may or may not be trading on inside information during the duration of his employment. Rather, discharging the duty ordinarily requires the disclosure of the specific inside information on which he was trading.[265] (Of course, any such disclosure of information would immediately erode the trading advantage and thus eliminate the incentive to inside trade in the first place.) Despite the public disclosure of the authorization, without more, the employment arrangement would still probably run afoul of the law.

What about the corruption theory? Would greater transparency alter the outcome under the corruption theory? No, at least not necessarily.[266] In

264. *See, e.g.*, Manne, *Insider Trading*, *supra* note 94, at 174 ("[T]here is no evidence that any company ever tried to develop insider trading as an explicit and integral part of an optimal compensation package."). Of course, none of this is to deny that firms may regard insider trading profits as a form of implicit compensation, especially in countries where insider trading laws and enforcement are less stringent. For recent cross-country evidence, see David J. Denis & Jin Xu, *Insider Trading Restrictions and Top Executive Compensation*, 56 J. ACCT. & ECON. 91, 109 (2013), which concludes that "it is possible that insider trading is an implicit form of compensation and incentives," but acknowledging that the study does "not address the efficiency of [insider trading] laws, nor . . . why some countries impose more stringent restrictions on insider trading than do others," and Darren T. Roulstone, *The Relation Between Insider-Trading Restrictions and Executive Compensation*, 41 J. ACCT. RES. 525 (2003), which finds that firm restrictions on insider trading are positively associated with explicit compensation levels.

265. *See* Chiarella v. United States, 445 U.S. 222, 227 (1979) ("[A] corporate insider must abstain from trading in the shares of his corporation unless he has first disclosed *all material inside information* known to him." (emphasis added) (citing In re Cady, Roberts & Co., 40 S.E.C. 907, 911 (1961))); McCormick v. Fund Am. Cos., 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." (emphasis added) (citing Smith v. Duff & Phelps, Inc., 891 F.2d 1567, 1572–75 (11th Cir. 1990))); W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 106, at 738–39 (5th ed. 1984) (noting that where the parties to a transaction stand in "some confidential or fiduciary relation," "full and fair disclosure of all material facts," and not just the fact that one is holding material facts, is required).

266. Because corrupt behavior offends collective norms, transparency is unusual. Still, transparency and corruption are not mutually exclusive. For an argument that disclosure of campaign contributions can perversely increase quid pro quo corruption by raising the

order not to be deemed as self-regarding, the compensation must not only be explicit but also be "culturally viewed as an acceptable or unavoidable perquisite of the role." The fact that the corporation has made boilerplate disclosures would likely not alter the strong cultural sentiment that insider trading amounts to cheating in a high-stakes game.[267]

At this juncture, one might object that our culture has long embraced norms that respect the freedom of contract and, consequently, it is not so clear what the overall cultural judgment would be. I concede the point and recognize that with fuller disclosure, cultural reactions will be more heterogeneous. But it is also worth noting that contracting is culturally viewed (and legally classified) as impermissible in many domains.[268] To take the clearest example, consider bribery. What is a bribe but a contract in the most explicit sense—a political favor in exchange for dollars? Notwithstanding the presence of an offer, acceptance, and consideration, a bribe—regardless of boilerplate disclosure that an elected official may or may not take a bribe during his tenure—would still be viewed as corrupt.

Increased transparency cannot fully shake the general impression that corporate elites have given themselves a green light to their own benefit, and at the expense of average investors, simply by drafting some lawyerly written disclosure statement. In other words, the board's agreement to this employment contract still sounds like cronyism, even though all the proper procedures have been followed. Indeed, the very notion of alienability seems deeply inconsistent with the moral outrage against insider trading even

expected benefit of corruption by increasing the certainty that parties to corrupt transactions will keep their promises, see Michael D. Gilbert & Benjamin Aiken, *Disclosure and Corruption* 3 (Va. Pub. Law & Legal Theory Research Paper No. 2013-37, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2334454.

267. *See supra* text accompanying notes 191–194. Some commentators have cleverly argued that there would be no liability under the classical theory if the board, "through charter amendment, stockholder vote, or the equivalent, authorized its management to trade on the basis of inside information, [as] there would be no breach of management's duty to stockholders upon which to predicate classical insider trading liability." Fisch, *supra* note 2, at 224. While possible, in light of the likely harm to the corporation and its shareholders resulting from insider trading, the board would still have to overcome the allegation of waste, which normally requires unanimous shareholder approval. *See* Pritchard, *supra* note 61, at 46. For an argument that such an arrangement would create harm to shareholders by raising the cost of capital for that corporation, see Morris Mendelson, *The Economics of Insider Trading Reconsidered*, 117 U. PA. L. REV. 470, 477–78 (1969) (reviewing MANNE, *supra* note 86).

268. For examples, see Katz, *supra* note 103, at 221–26. Blackmail is an obvious case of impermissible contracting.

when more transparently disclosed.[269]

In conclusion, whereas the property theory would permit this conduct as an acceptable form of executive compensation, the corruption theory would not (or at least not obviously). This aligns more closely with the probable result under the classical theory. With respect to doctrinal fit, corruption theory outperforms one of its rivals, the property theory.

Yet the corruption theory's doctrinal alignment is imperfect. Readers well versed in insider trading doctrine will object that this discussion of inalienability, while pertinent to classical theory, does not apply to the misappropriation context. Under the misappropriation theory, the duty flows not to shareholders but to the source of information. Hence, so long as the source consents to the recipient's use of the information for securities trading purposes, there is no obvious breach of fiduciary duty and thus no liability under the misappropriation theory.[270] So, for example, if James O'Hagan had obtained the consent of his law firm and the firm's client to trade on the information about the target company, then he could not have violated Rule 10b-5 under the misappropriation theory. By contrast, under the corruption theory, the source's consent alone would not matter.

But perhaps this divergence from the received doctrine should be celebrated, not scorned.[271] Since *O'Hagan*, alienability under the misappropriation theory has always been in tension with inalienability under the classical theory, especially in light of *O'Hagan*'s statement that the two theories complement each other.[272] Also, permitting alienability under the misappropria-

269. *Cf. id.* at 220 (claiming that we would have a "strong aversion" to insider trading, even if preauthorized by the stock exchange and even if insider trading were demonstrated to be highly efficient).

270. *See* Donna M. Nagy, *Reframing the Misappropriation Theory of Insider Trading Liability: A Post-*O'Hagan *Suggestion*, 59 OHIO ST. L.J. 1223, 1256 (1998); Painter et al., *supra* note 101, at 179 (observing that *O'Hagan* "permits a fiduciary to trade on material, nonpublic information with the consent of the principal").

271. Perfect doctrinal fit is neither necessary nor desirable. It is not necessary because insider trading law is doctrinally inconsistent, and no coherent theory can perfectly replicate such inconsistency. It is not desirable because a successful theory must be able to critique that which has been received.

272. *See* United States v. O'Hagan, 521 U.S. 642, 652 (1997) ("The two theories are complementary, each addressing efforts to capitalize on nonpublic information through the purchase or sale of securities."). To be sure, a property theorist could counter that property theory also resolves this inconsistency by permitting alienability under the classical theory. But such a change would be much more normatively problematic, given the social condemnation of insider trading by corporate insiders. *See* Green & Kugler, *supra* note 147, at 463 (reporting that 83 percent of respondents believed that insider trading under a hypothetical classical theory scenario should be criminally punished). Even with the firm's

tion theory has always seemed at odds with the social condemnation of insider trading, which does not sharply distinguish between the classical and misappropriation contexts.[273] To resolve this doctrinal inconsistency, the same rule should prevail in both contexts. The corruption theory rejects alienability in both classical and misappropriation contexts.

* * *

Property theory offers elegant answers to basic questions about insider trading. And it gives clear guidance in many cases and controversies. For example, on the centrality of either fiduciary duty or fraud, property theory gladly discards both. Property rights are rights generally against the entire world (not just fiduciaries), and the owner's right to exclude does not protect only against fraud. But with this confident clarity comes the deficiency of the property theory. Although normatively appealing to many, the property theory poorly fits the doctrine as handed down by *Chiarella*, *Dirks*, and *O'Hagan*. It may explain insider trading law in some alternate universe, but it fails to adequately describe it in this universe.

Property theory enthusiasts might respond to this assessment in two ways. The first is to argue that the concept of property has long accepted countless exceptions to various sticks in its bundle.[274] Any clever theorist can cobble together various exceptions so as to better fit the received insider trading law. I am skeptical. Both the right to exclude and alienability are central elements of property, not just peripheral or adventitious features. And to bowdlerize property theory so much so as to fit even roughly current insider trading law would be to lose much of the elegance and self-assured simplicity of property theory in the first place.

Second, property theory enthusiasts can become unabashedly normative and challenge the demand for rough doctrinal fit. If the theory is somehow

permission and increased transparency, the majority of investors would still likely condemn insider trading by corporate insiders.

273. One study on public attitudes about insider trading found that where the defendant was a corporate official or employee, there was "essentially no distinction between the classical and misappropriation theories with respect to criminalization, blameworthiness, or punishment." Green & Kugler, *supra* note 147, at 462 (reporting results for (i) executive at acquiring company, (ii) executive at acquired company, and (iii) secretary at acquired company). That sentiment seems well captured by the majority opinion in *O'Hagan*, which concluded that it would "make[] scant sense to hold a lawyer-turned-trader like O'Hagan a Section 10(b) violator if he works for a firm representing the target of a tender offer, but not if he works for a law firm representing the bidder." *O'Hagan*, 521 U.S. at 644.

274. *See* JOSEPH WILLIAM SINGER, ENTITLEMENT: THE PARADOXES OF PROPERTY 9–11 (2000).

terrific—for example, by increasing allocative efficiency in the capital markets—why should we decline it simply because our imperfect world does not align to what the theory suggests?[275] Stated another way, why does doctrinal fit matter to finding a good theory of insider trading law?

The answer ultimately depends on what one seeks from a theory of insider trading law. As stated at the outset, I believe that a good theory should not consist of blank-slate normative policy analysis, unfettered by the law as it has been received. In other words, a good theory needs to rationalize what courts have been implicitly groping toward, thereby bringing coherence to what might otherwise appear to be increasingly disordered opinions. On this view, the need for a theory with good doctrinal fit is clear.[276] And greater coherence should in turn enhance the doctrine's "clarity, stability, and administrability"[277]—pragmatic virtues that are sorely needed in this area of the law. In addition, only a theory with decent doctrinal fit can have any chance at real-world relevance for judges and regulators grappling with hard cases.

B. Unjust Enrichment Theory

1. The Theory Explained

Besides property theory, the other main contender is unjust enrichment. Arguably, the theory has its roots in Chief Justice Burger's dissent in *Chiarella*. Burger maintained that the defendant, Chiarella, should be liable for insider trading because his conduct "quite clearly serves no useful function except his own enrichment at the expense of others."[278] After *Chiarella*, commentators took note of Burger's words and argued that the insider trading prohibition could be grounded on principles of unjust enrichment.[279]

Robert Thompson, an early proponent of the theory, argued that although Rule 10b-5 cases were grounded on both tort and unjust enrichment principles, it made more sense to analyze insider trading cases under unjust

275. For a recent example of the property theory being used to propose the expansion of liability beyond existing parameters, see John C. Coffee, Jr., *Introduction: Mapping the Future of Insider Trading Law: Of Boundaries, Gaps, and Strategies*, 2013 COLUM. BUS. L. REV. 281, 299–305, which proposes a duty not to trade on inadvertent or unauthorized releases of material information.

276. *See* James Weinstein, *Participatory Democracy as the Basis of American Free Speech Doctrine: A Reply*, 97 VA. L. REV. 633, 634 (2011).

277. *Id.*

278. Chiarella v. United States, 445 U.S. 222, 241 (1980) (Burger, J., dissenting).

279. *See, e.g.*, Langevoort, *supra* note 3, at 2; Robert B. Thompson, *The Measure of Recovery Under Rule 10b-5: A Restitution Alternative to Tort Damages*, 37 VAND. L. REV. 349, 391 (1984).

enrichment. Private plaintiffs could not prove reliance in open market insider trading cases in which the identity of the counterparty is usually unknowable.[280] Framing insider trading as a tort, such as fraud, thus runs into a causation problem.

By contrast, "the guiding principle [of unjust enrichment] is to make the defendant give back that which he obtained by invasion of the plaintiff's interest whether or not that gain equals the plaintiff's loss."[281] Hence, under unjust enrichment principles, plaintiffs need not prove losses that were causally connected to the violation but rather may look to the defendant's gain stemming from the alleged violation.[282] On the issue of causation, unjust enrichment does important justificatory work and thus provides a stronger alternative basis of liability than tort or contract[283] in the absence of direct and demonstrable harm to the plaintiff.

Despite this valuable contribution, vital questions remain unanswered. To base liability on unjust enrichment, the court must conclude that the defendant's retention of the benefit is unjust in some way.[284] For cases in which the defendant is required to disgorge profits above and beyond the claimant's provable losses, liability ordinarily requires a further showing that the defendant wrongfully obtained the profits.[285] Insider trading falls in this category because the remedy is exactly such a disgorgement.

But how does one know what counts as wrongful? As stated bluntly by the Restatement (Third) of Restitution and Unjust Enrichment,

> [t]he law of restitution and unjust enrichment requires the surrender of benefits wrongfully obtained, but it does not tell us whether the defendant's conduct is wrongful in a particular case . . . . [T]he

280. *See* Thompson, *supra* note 279, at 391; *supra* Part I.A.1.
281. *Id.* at 393; *see also* RESTATEMENT (SECOND) OF RESTITUTION § 1 (1983).
282. *See* Thompson, *supra* note 279, at 371.
283. *See* 1 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 1 cmt.a (2011) (observing that the 1937 Restatement of Restitution's "central achievement" was the "identification of unjust enrichment as an independent basis of liability in common-law legal systems . . . comparable in this respect to a liability in contract or tort").
284. Perhaps more accurately, the benefit must be deemed "unjustified"—that is, lacking an adequate legal basis. *See id.* § 1 cmt. b (explaining that "[t]he concern of restitution is not, in fact, with unjust enrichment in any such broad sense, but with a narrower set of circumstances giving rise to what might more appropriately be called *unjustified enrichment*," and also noting that "[u]njustified enrichment is enrichment that lacks an adequate legal basis . . . meaning the transfer of a benefit without adequate legal ground").
285. *See id.* § 3 cmt. a ("Liability to disgorge profits is ordinarily limited to cases of what this Restatement calls 'conscious wrongdoing' . . . ."); 3 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51(4) (2011) (providing liability to disgorge profits for the conscious wrongdoer of the defaulting fiduciary).

> contours of the claim in restitution to recover benefits wrongfully obtained will be determined by principles of law outside the scope of this Restatement.[286]

2. Problems With Unjust Enrichment

a. Substantive Vagueness

The central problem with unjust enrichment theory as applied to insider trading is that it is too vague,[287] which has been a common complaint of the doctrine even outside this context.[288] If insider trading profits are unjust because the counterparty's consent has been vitiated through fraud, then we need a theory about why an anonymous stock trade made in silence constitutes fraud.[289] If insider trading profits are unjust because they represent the misappropriation of a firm's financial assets[290] or intellectual property,[291] then we need a theory—like the property theory[292]—that explains why trading on inside information is similar to misappropriation[293] or intellectual property in-

286. 1 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 3 cmt. d (2011).
287. *Cf.* Park, *supra* note 247, at 375–76.
288. *See, e.g.*, 1 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 1 cmt. a (2011) ("The same flexibility means that the concept of unjust enrichment will not, by itself, yield a reliable indication of the nature and scope of the liability imposed by this part of our legal system."); Daniel Friedmann, *Restitution of Benefits Obtained Through the Appropriation of Property or the Commission of a Wrong*, 80 COLUM. L. REV. 504, 504–05 (1980) ("[Unjust enrichment] has on occasion been regarded as too indefinite and vague to be recognized as a general legal principle, with concern expressed that its adoption might undermine legal stability, confuse legal thinking, and jeopardize clear, systematic organization of the law." (footnote omitted)).
289. *See* 2 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 13 cmt. c (2011) ("This Restatement does not describe the substantive law of misrepresentation. Accordingly, it does not state rules to govern such matters as the elements of fraud; [and] the circumstances in which concealment or nondisclosure is treated as assertion . . . .").
290. *See id.* § 41 (providing a basis of liability in restitution when "[a] person . . . obtains a benefit by misappropriating financial assets, or in consequence of their misappropriation by another").
291. *See id.* § 42 (providing a basis of liability in restitution when "[a] person . . . obtains a benefit by misappropriation or infringement of another's legally protected rights in any idea, expression, information, image, or designation").
292. *See, e.g.*, Friedmann, *supra* note 288 (exploring restitutionary claims based on a theory of property).
293. Liability in restitution for misappropriation of financial assets usually involves tangible assets in the form of "cash, instruments, or securities certificates" or intangible assets in the form of "accounts or other payment obligations." 2 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 41 cmt. c (2011). Therefore, a theory based on restitution must explain why inside information is comparable to cash, instruments, securities certificates, or accounts or other payment obligations.

fringement.[294] If insider trading profits are unjust because they were accrued in breach of a fiduciary duty,[295] then we need a theory that specifies what that duty is, to whom it is owed, and how it is breached.[296]

In an early, important effort to provide more specific and substantive content to the unjust enrichment theory, Donald Langevoort briefly suggested that the purpose of *Chiarella*'s fiduciary duty to disclose was to prevent the insider's unjust enrichment: "It neutralizes the insider's informational advantage . . . in order to assure that as a fiduciary he does not profit when a beneficiary is disadvantaged."[297] Filling the vague vessel of unjust enrichment theory with the more concrete substance of breach of fiduciary duty is appealing and cures much of what is problematic about the theory.[298]

But we need further elaboration. For example, what is the rationale for imposing liability on the insider who expects to receive no financial profit in making a tip to a friend? Or what explains the liability of an insider when trading against someone with whom the insider is not already in a fiduciary relationship, such as when the insider is selling rather than buying shares? What about the liability of misappropriation theory defendants who bear no preexisting fiduciary-like relationship to the trading counterparty?[299] Langevoort's invocation of breach of fiduciary duty to define further the unjust enrichment theory helpfully, but only partially, cures the deficiencies of that

294. *See id.* § 42 cmt. b ("The law of restitution does not define the substantive rules of ownership on which a claim for infringement or misappropriation necessarily rests. The rule of this section depends on a body of law that defines the underlying entitlements . . . ."); 1 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 3 (2011).

295. *See* 2 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 43 (2011) (providing a basis of liability in restitution when "[a] person . . . obtains a benefit (a) in breach of a fiduciary duty, (b) in breach of an equivalent duty imposed by a relation of trust and confidence, or (c) in consequence of another's breach of such a duty").

296. *See id.* ("The enumeration and definition of the duties in question, the identification of the persons who owe them and to whom they are owed, the circumstances in which the duties arise, and the acts constituting a breach thereof, are all matters of local law outside the scope of the Restatement.").

297. Langevoort, *supra* note 3, at 19.

298. Importantly, Langevoort seems to suggest that the wrongfulness of insider trading stems more from the fact that the fiduciary has profited at the expense of the beneficiary rather than the fiduciary's lack of candor when dealing with a beneficiary. I agree with this sentiment, which is expressed in the corruption theory's emphasis on the pursuit of self-regarding gain.

299. *See* Park, *supra* note 247, at 374 ("Fiduciary duty does not cover the conduct of outsiders, which *O'Hagan* partly covers through agency law." (citing United States v. O'Hagan, 521 U.S. 642, 654–55 (1997))). In fact, for noninsider defendants, Langevoort suggests that liability not be premised on the breach of a fiduciary duty. Rather, "[a]s a matter of preventing unjust enrichment . . . a duty to disclose is clearly called for when the information advantage derives from unlawful acquisition or use of the information." Langevoort, *supra* note 3, at 52.

theory. No doubt, one could cobble together an unjust enrichment theory with greater elaboration and qualification—for example, by carefully distinguishing between unjust enrichment as a substantive theory and the remedy of restitution—to answer all of the foregoing questions. But then that theory would risk ad hocery and lack parsimony.[300]

In the end, we are left with what the Restatement intimated: Unjust enrichment theory remains largely a shell that must often resort to another body of law to ascertain the wrongfulness of insider trading. For the most part, unjust enrichment functions more as a conclusory label rather than a robust theory that can help decide hard cases of potential insider trading. Of course, one can object that the corruption theory suffers from the same deficiency of vagueness. For instance, as acknowledged above,[301] vagueness is inherent in determining whether a given perquisite is culturally acceptable or not. But such vagueness—which relates to one aspect (cultural view) of one element (self-regarding gain) of the definition of private corruption—is more cabined than the vagueness inherent in determining what is unjust.

b. Poor Doctrinal Fit

(1) Ninja Redux

Unjust enrichment theory also suffers from poor doctrinal fit. Recall the ninja trader hypothetical. Under an unjust enrichment theory, the ninja's theft would surely be deemed wrongful for trespass[302] or for violating criminal laws on breaking and entering.[303] But as detailed above, under *Chiarella* and *O'Hagan*, the ninja is not liable for insider trading because there was no breach of fiduciary duty. The more general point is that unjust enrichment does not *require* a breach of fiduciary-like duty.[304] It is enough that defendant's gain was achieved through a "wrongful interference with legally protected

300. As between two theories that are both normatively plausible and possessing good doctrinal fit, there should be a rebuttable presumption in favor of the simpler theory. *Cf.* Owen D. Jones, *Time-Shifted Rationality and the Law of Law's Leverage: Behavioral Economics Meets Behavioral Biology*, 95 NW. U. L. REV. 1141, 1201 (2001).

301. *See supra* text accompanying note 122.

302. *See* 2 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 40, at 4 (2011) (establishing liability in restitution for trespass, conversion, and other wrongs).

303. *See id.* § 44, at 77 (providing the residual rule for restitution for wrongs).

304. Under the only plausible application of the unjust enrichment theory to insider trading, a breach of fiduciary duty accomplished through trading on material, nonpublic information is sufficient to produce unjust enrichment. But sufficiency does not mean necessity. One can have unjust enrichment without a breach of fiduciary duty, which is my point here.

interests . . . ."[305] This difference guarantees a significant gap between what unjust enrichment theory might recommend and what insider trading law provides.

One can now see a crucial distinction between both property and unjust enrichment theories on the one hand and corruption theory on the other. The corruption theory takes more seriously the fiduciary duty requirement. This is not by accident. To explain, let us return to *Chiarella* to unpack how and why fiduciary duty became central to insider trading law. The explanation provided above[306] was that the Court embraced a fraud conception and invoked fiduciary duty simply to get around the need for an affirmative misrepresentation, which is generally absent in insider trading. But, as Donald Langevoort has suggested, the appeal to fiduciary duty could have greater significance beyond its utility as a convenient doctrinal tool. Indeed, the corruption theory provides a wholly different interpretation of why the insider trading ban applied to fiduciaries.

Although the category of persons deemed to be fiduciaries is heterogeneous,[307] one common attribute is that, for varying reasons, their beneficiaries are unable to monitor their activities adequately.[308] As a consequence, the law imposes on fiduciaries a special duty of loyalty to act solely in the interest of their beneficiaries with respect to matters connected to the fiduciary relationship.[309] This duty not only decreases agency costs but also prevents "those who hold power in fiduciary interactions from abusing the trust and confidence reposed in them."[310]

This concern about the abuse of trust was intimated in *Chiarella*. In that case, Justice Powell mentioned that requiring a fiduciary duty to disclose or to abstain from trading would "guarantee [] that corporate insiders, who have an obligation to place the shareholder's welfare before their own, will not benefit

305. 2 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 44 cmt. a, at 77 (2011).
306. *See supra* Part I.A.1.
307. The category is so diverse that it may be impossible to identify a uniform set of necessary and sufficient conditions that characterize the category. *See* Kim, *supra* note 98, at 903.
308. *Cf.* Larry E. Ribstein, *Are Partners Fiduciaries?*, 2005 U. ILL. L. REV. 209, 215 (arguing that the "fiduciary's discretion cannot readily be constrained by devices other than fiduciary duties without undermining the owner's objectives in delegating control").
309. *See* 2 RESTATEMENT (THIRD) OF AGENCY § 8.01, at 249 (2006) ("An agent has a fiduciary duty to act loyally for the principal's benefit in all matters connected with the agency relationship."); 1 RESTATEMENT (FIRST) OF TRUSTS § 170, at 431 (1935) (noting that the duty of a trustee is "to administer the trust solely in the interest of the beneficiary").
310. Leonard I. Rotman, *Fiduciary Law's "Holy Grail": Reconciling Theory and Practice in Fiduciary Jurisprudence*, 91 B.U. L. REV. 921, 932 (2011).

personally through fraudulent use of material, nonpublic information."[311] As Adam Pritchard has observed, based on his extensive analysis of Justice Powell's securities law jurisprudence, Powell was especially disturbed by the abuse of trust inherent in an insider's exploitation of inside information.[312]

Powell's concerns resonate with a concern about private corruption, the use of an entrusted position to pursue self-regarding gain. Indeed, the abuse of trust by those who hold power or authority by virtue of their roles is the central concern of the corruption theory. By viewing insider trading as private corruption (as opposed to fraud), the Supreme Court's turn to fiduciaries makes deeper sense. Additionally, the corruption theory explains why insider trading law has extended the relevant duty not just to those who are established fiduciaries but also to those in a "similar relation of trust and confidence"[313]—in other words, those involved in fiduciary-like relationships. After all, corruption can infect entrusted positions beyond that which the common law has identified as strictly fiduciary in nature.[314]

Again, I hasten to add that the alignment between the corruption theory and the received doctrine is not perfect. The duty at the heart of *Chiarella* was the fiduciary duty to disclose.[315] By contrast, the duty at the heart of the corruption theory is the duty not to use one's entrusted position for self-regarding gain. This divergence in the nature of the duty has some unexpected benefits, however.

First, the corruption theory cures a doctrinal anomaly that has long plagued the classical theory. Under the classical theory, the corporate insider

311. Chiarella v. United States, 445 U.S. 222, 230 (1979).

312. *See* Pritchard, *supra* note 111, at 947 ("[Powell's] distaste for the abuse of trust of insider trading led him to read the common law of fraud broadly in *Chiarella* to make room for a prohibition under section 10(b)."); *id.* at 936 n.585 (reporting an excerpt from Powell's notes as confirming that "Powell viewed the principal problem with insider trading as the abuse of trust by the corporate insider"); *id.* at 938 (reporting that Powell described *Texas Gulf Sulphur* insiders as trading "on inside information for personal gain").

313. *Chiarella*, 445 U.S. at 228 (citations omitted).

314. Consider, for example, a family member or friend. Although fiduciary or fiduciary-like obligations have occasionally been imposed on family members, they are not presumptively deemed fiduciaries. *See* Ray J. Grzebielski, *Friends, Family, Fiduciaries: Personal Relationships as a Basis for Insider Trading Violations*, 51 CATH. U. L. REV. 467, 488–89 (2002); D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1415 n.63 (2002); William A. Snider, Note, *Securities Law—All in the Family*—United States v. Chestman: *Finding a Fiduciary or Other Similar Relation of Trust and Confidence Under Rule 10b-5 for Family Members of a Family-Controlled Publicly Traded Corporation*, 16 W. NEW ENG. L. REV. 79, 104–08 (1994).

315. Bainbridge, *supra* note 58, at 1194 ("[T]he Court made clear that liability could be imposed only if the defendant was subject to a duty to disclose prior to trading."). Such a duty only arises if the defendant is already in a fiduciary or fiduciary-like relationship.

is said to owe a fiduciary duty (to disclose or abstain) to the shareholders on the other side of his trades. This will be the case when the insider buys shares (obviously from a current shareholder). But this will not always be the case when the insider sells shares. Unless those investors who purchase the insider's shares already own some of the corporation's shares, they are not current, but rather prospective, shareholders of the corporation. The completion of that very trade with the insider brings the investor into a fiduciary relation with the insider. In other words, before the closing of that trade, those purchasers are mere strangers to the insider. To them, there can be no fiduciary duty.

The *Chiarella* Court's only response to this puzzle was to quote Judge Learned Hand who observed that it would be a "sorry distinction to allow [the insider] to use the advantage of his position to induce the buyer into the position of a beneficiary although he was forbidden to do so once the buyer had become one."[316] Although this distinction may intuitively seem "sorry," it is a distinction long recognized in the common law. Hence, the abandonment of such distinction warrants deeper discussion.

The corruption theory resolves this doctrinal anomaly and explains why the problematic distinction should be abandoned. Because the primary beneficiary of the duty at stake is the principal who entrusted the defendant with his position, the identity of the person on the other side of the defendant's trade does not matter. As long as the defendant used his entrusted position for self-regarding gain by trading in securities, it makes no difference whether he bought from or sold to a party that did or did not already own stock in the firm. To be sure, the officer who inside trades is concomitantly betraying the trust of all the shareholders (as a group) who have placed their trust in the officer; however, such betrayal is not contingent on the presence of a shareholder on the other side of his trade. The betrayal arises simply from the officer's exploitation of his position in a manner inconsistent with its purpose—to serve the corporation.

Second, for similar reasons, the corruption theory resolves another doctrinal anomaly concerning bondholders. Under the classical theory, the primary beneficiary of the duty (to disclose or abstain) is the shareholder on the other side of the insider's trade. Hence, under the classical theory, insider trading in bonds is not actionable. As is well established, the common law does not recognize a fiduciary relationship between corporate insiders and the corporation's bondholders (at least while the corporate issuer remains

316. *Chiarella*, 445 U.S. at 227 n.8 (quoting Gratz v. Claughton, 187 F.2d 46, 49 (2d Cir. 1951)).

solvent).[317] As a result, a corporate insider who uses material, nonpublic information to trade in bonds cannot be said to have breached the requisite fiduciary duty to disclose or abstain.[318] But, as a policy matter, there is no discernible rationale for why the classical theory should distinguish between insider trading in debt and insider trading in equity.

Under the corruption theory, however, the primary beneficiary of the duty at stake is the person or entity that entrusted the defendant with the position. If the defendant is a corporate insider, then the corporation is the primary beneficiary of his duty. As a result, it does not matter whether the insider trades in bonds or stocks. So long as he is using an entrusted position to pursue self-regarding gain by trading in securities, he is liable regardless of the type of securities.

Third, the corruption theory helps rationalize the mutation of the fiduciary duty requirements from *Chiarella* to *Dirks*. Recall that in *Dirks*, the Court converted *Chiarella*'s fiduciary duty to disclose to the insider-tipper's fiduciary duty of loyalty and confidentiality not to convey confidential corporate information for an improper purpose. Further, no explanation was ever provided for how the insider-tipper's breach of her duty of loyalty and confidentiality converted back into a breach by the tippee of a duty of disclosure to shareholders. Justice Powell authored both opinions. Perhaps this suggests that it may be too limiting to see the invocation of fiduciary duty as only a convenient solution to the act/omission problem, which was ostensibly chosen in an effort to comply with the text of Section 10(b) as requiring fraud or deceit. Instead, by adopting the corruption theory, one could reconceptualize Justice Powell's invocation of fiduciary duty as a gesture toward responding to a breach of trust, which is captured in various aspects of the fiduciary relationship as well as in the corruption theory.

In sum, under *Chiarella* and *O'Hagan*, the ninja cannot be held liable. Yet both property and unjust enrichment theories would hold otherwise. By contrast, the corruption theory concurs with Supreme Court precedent and finds no insider trading liability. It does so because the corruption theory's demand for an entrusted position overlaps with the law's fiduciary duty requirement. To be clear, it is not an exact overlap. In particular, the corruption theory—while recognizing the importance of a fiduciary duty—clarifies who the primary beneficiary is. The beneficiary is not necessarily the trading counterparty to

317. *See* A. C. Pritchard, O'Melveny & Meyers v. FDIC*: Imputation of Fraud and Optimal Monitoring*, 4 SUP. CT. ECON. REV. 179, 188–89 (1995).

318. To be sure, that corporate insider may nonetheless be held liable under the misappropriation theory.

whom a duty to disclose might be owed. Rather, the beneficiary is whoever has granted the entrusted position.

(2) The Player

Next, consider the player hypothetical. Suppose that Molly, an investment banker, meets a celebrity actor at a cocktail party. Being a fan and thinking herself a bit of a player, she tries to impress him with a juicy stock tip about one of her publicly traded clients. The actor heeds the banker's advice and makes a nice profit. Under unjust enrichment theory, although the court might be able to impose a constructive trust on the actor's profits,[319] the banker herself would not be liable because she was not financially enriched.[320]

By contrast, under *Dirks*, the banker would be liable for the tip. Although the banker is neither an officer nor director of the issuer of the traded securities, she would qualify as a constructive insider of her client. Accordingly, she may not convey confidential corporate information to another for an improper purpose, that is, to benefit personally from the disclosure of information. The *Dirks* Court identified three types of personal benefit: (1) a pecuniary benefit, such as a kickback or other payment through a profit-sharing agreement, (2) a reputational benefit, such as when a corporate officer tips an analyst in anticipation of a favorable report about him or his company, and (3) the benefit that accrues to oneself when making a gift.[321] Here, the player is making a gift to the actor in an effort to impress him. While not a monetary benefit, *Dirks* makes clear that gifts of confidential information that enable the recipient to profit from trades generate liability for the gift giver.

319. *See* RESTATEMENT (FIRST) OF RESTITUTION § 201 (1937) (asserting liability of third persons for gain where fiduciary transfers property to third person or conveys confidential information to third person in violation of fiduciary duty).

320. *See* 1 GEORGE E. PALMER, THE LAW OF RESTITUTION § 1.7, at 41 (1978) ("One essential element of relief for unjust enrichment is of course the enrichment of the defendant . . . ."); 1 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 1 at 7 (2011) ("Restitution is concerned with the receipt of benefits that yield a measurable increase in the recipient's wealth. . . . A saved expenditure or a discharged obligation is no less beneficial to the recipient than a direct transfer."); Thompson, *supra* note 279, at 382 ("Recovery based on unjust enrichment is impossible when the defendant receives no benefit . . . .").

In a narrow set of cases, restitutionary remedies may be granted without a showing of financial benefit, but such cases arguably remain outside the law of unjust enrichment. *See* Andrew Kull, *Rationalizing Restitution*, 83 CALIF. L. REV. 1191, 1200 (1995) (arguing that examples of restitution without enrichment are not restitution at all but, rather, of "surreptitious contract enforcement").

321. *See* Dirks v. SEC, 463 U.S. 646, 663–64 (1982).

A defender of the unjust enrichment theory could respond by saying that I have applied a too literal or cramped rendition of the theory. Even though the actual *doctrine* of unjust enrichment requires financial gain (which is then disgorged), the broader *theory* of unjust enrichment as applied to insider trading could be more capacious and include nonmonetary benefits such as those gained by the player. Although this defense helps fit the theory to the insider trading doctrine on the books, it also untethers the theory from the common law doctrine of unjust enrichment. Given how ambiguous the terms "unjust" and "wrongful" are, doing so further risks creating a theory that is too indeterminate to provide concrete guidance in hard cases.

How does the player fare under the corruption theory? The corruption theory would find her liable. First, as a confidential adviser to her client-company, the player clearly occupied an entrusted position. Second, there is self-regarding gain. The primary beneficiary of the gain in question is not the client or its shareholders but the player's acquaintance with whom she wished to spark a relationship. Accordingly, the gain is improper and would be classified as self-regarding, which encompasses gains to an individual's friends, acquaintances, and relatives. By imparting a trading advantage to cultivate a personal relationship, the player used her entrusted position for self-regarding gain.

Again, one finds comparatively better doctrinal fit with the corruption theory in terms of end results. What is more, the corruption theory continues to help explain various doctrinal puzzles, including the previously mentioned mutation from *Chiarella*'s duty to disclose into *Dirks*'s duty of loyalty and confidentiality.[322] As explained above, the *Dirks* Court conditioned the liability of both the tipper and tippee on the tipper's improper purpose—whether the insider-tipper breached his fiduciary duty not to use confidential corporate information for personal gain—rather than the breach of a fiduciary duty to disclose. Although there were some obvious, practical reasons for this shift,[323] the Court never explicitly defended this change. Instead, it simply cited to a footnote in an SEC administrative opinion asserting that "a purpose of the securities laws was to eliminate the 'use of inside information for personal

322. *See* Part I.A.2.

323. First, *Chiarella*'s fiduciary duty to disclose, without more, could not support the liability of an insider who tipped, rather than traded on inside information. An insider who discloses information to a third party cannot be said to have breached a duty to disclose. Second, the Court did not want to interfere with the legitimate activities of market analysts, "which the SEC itself recognizes is necessary to the preservation of a healthy market." *Dirks*, 463 U.S. at 658. Conditioning liability on improper purpose enabled the Court to inculpate some tipping without casting the net so wide as to catch most communications to market analysts.

advantage.'"[324] The dissent in *Dirks* was unimpressed and criticized the majority for grafting a "motivational requirement" onto its prior fiduciary duty doctrine without justification. As the dissent pointed out, an affirmative duty to disclose is regularly placed on fiduciaries, regardless of their underlying motives.[325]

The Court's focus on the tipper's motivation suddenly makes sense when one sees insider trading not so much as fraud but as corruption—the use of an entrusted position for self-regarding gain. In deciding whether gain is self-regarding, it clearly matters whether there was an improper purpose underlying the relevant conduct. In other words, it matters whether the individual (in the entrusted position) anticipated direct or indirect personal benefit.[326] And it is not just the accretion of personal wealth that is objectionable. The use of one's entrusted position to benefit family, friends, and acquaintances—nepotism, cronyism, and favoritism—are also commonly viewed as corrupt. This may explain why "personal benefit" in *Dirks* has been defined so broadly to include even psychic benefits that flow to the tipper when making a gift. In the end, the *Dirks* holding can be explained by the Court's final and intuitive judgment that Secrist, the whistleblower, did not engage in corrupt behavior and that, accordingly, Dirks could not have facilitated any corruption.

* * *

Both the property theory and the unjust enrichment theory have substantial deficiencies. Although the property theory is normatively plausible and tells a cogent story of why insider trading is banned (at least in some cases), it diverges substantially from the received doctrine. Unjust enrichment theory also diverges from the law; perhaps worse, its normative plausibility is hard to

324. *Id.* at 662 (citing *In re* Cady, Roberts & Co., 40 S.E.C. 907, 912 n.15 (1961)). Elsewhere, citing to the same opinion and the same footnote, the Court noted that "[a] significant purpose of the Exchange Act was to eliminate the idea that the use of inside information for personal advantage was a normal emolument of corporate office." *Id.* at 653 n.10 (quoting *In re Cady, Roberts & Co.*, 40 S.E.C. at 912 n.15). The *Cady, Roberts* observation had some common law support in some jurisdictions, but as Stephen Bainbridge has argued, that support "proves an unusually thin rope upon which to hang the draconian penalties for violating the federal insider trading prohibition." Bainbridge, *supra* note 58, at 1218–19.

325. *Dirks*, 463 U.S. at 674 (Blackmun, J., dissenting). According to the dissent, under *Chiarella*, a breach occurs simply from the failure to disclose, irrespective of whether the fiduciary sought to acquire a personal benefit. By further limiting liability with its motivational requirement, the majority seemed to be countenancing many instances of shareholder disadvantage. As the dissent argued, "It makes no difference to the shareholder whether the corporate insider gained or intended to gain personally from the transaction; the shareholder still has lost because of the insider's misuse of nonpublic information." *Id.*

326. For how the corruption theory might approach mens rea issues, see *supra* note 142.

evaluate given the indeterminacy of what counts as unjust. In comparison, the corruption theory fits the key contours of the received doctrine better than either property theory or unjust enrichment theory. But the alignment is not perfect, nor should it be. The divergence demonstrates that the corruption theory is not simply a circular restatement of doctrine. Even better, the divergence points to fruitful areas for doctrinal reform.

IV. IMPLICATIONS FOR INSIDER TRADING LAW

This Article has proposed a theory of insider trading as private corruption. The theory provides plausible answers to normative skeptics who have long challenged the ban on insider trading. It also fits the doctrine more closely than the two leading contender theories. But what are the implications for this theory in real-world cases that have either divided the courts or have been flagged by commentators as controversial?[327] For instance, does it have anything definite or insightful to say about the centrality of fiduciary duty or the centrality of fraud? More concretely, how would it decide *Dorozhko*, *Cuban*, and *Rocklage*?

A. Centrality of Fiduciary Duty

1. Deceptive Theft: *Dorozhko*

Recall the hacker-trader case, *Dorozhko*. Under the corruption theory, Dorozhko would not be liable for insider trading, although he would be liable for hacking under other law.[328] This result should not be surprising, as the hacker closely resembles the ninja. Let us start with the definition of corruption. Although the hacker's gain was personal and improper and thus potentially classifiable as self-regarding, he used no entrusted position to obtain it. Rather, he acquired the information by hacking, which is a form of a trespass. Like the ninja, the hacker illicitly employed superior skills and technologies in pursuit of an informational advantage. His actions were criminal, but not corrupt.

Although the definition of corruption provides a clear answer, *Dorozhko* presents a novel and difficult case for many readers. To deepen the analysis, it

327. Due to space constraints, this Article does not engage the debates relating to the state of mind required for insider trading violations. For a recent discussion that takes positions that are largely consistent with the corruption theory, see Langevoort, *supra* note 109, at 435–58. *See also supra* note 142.

328. *See supra* note 15.

might be helpful to go beyond the primary question of asking whether the act fits the formal analytic definition of corruption to a secondary exploration of whether the act generates those costs tightly associated with corruption: temptation, distraction, and legitimacy costs. I make this suggestion for two reasons. First, it reflects how our minds actually think through categories whenever we are confronted with the question of whether some instance (such as hack-and-trade) belongs to a larger set (private corruption).[329] Second, because consequences always matter, it is reasonable to seek out some reflective equilibrium between the formal analytic definition and a cost analysis. For example, if a securities trade genuinely poses a hard question in terms of fitting the definition of private corruption, it should matter whether that trade risks substantial temptation, distraction, or legitimacy costs. If it does, one should be more comfortable seeing it as corruption, and vice versa. In this way, the theory is meant to be pragmatically applied.

Even though the hacking-and-trading does not fit the definition of corruption, does it raise corruption costs seriously enough to reconsider the initial judgment? Because he betrayed no entrusted position, there are no obvious temptation or distraction costs. But what about legitimacy costs? Although the hacker's advantage was unfair, he garnered it not through privilege or special connections but through the much rarer combination of superior technologies, risk-taking, and criminal bravado. Hence, the hacker's conduct, though universally condemned and proscribed by other law, is unlikely to be perceived as being systemic in a way that might raise serious legitimacy costs to the securities markets. In the end, most investors will not see the hacker's actions as evidence that the entire system is rigged.

It is conceivable that hacking-and-trading could become so prevalent that law-abiding citizens would come to abandon the securities markets. But to the extent that this can be viewed as de-legitimation, it would be driven not

329. In determining whether a new instance belongs to a category, it is helpful to compare the attributes of the instance to those of the category prototype. *See* Sung Hui Kim, *Lawyer Exceptionalism in the Gatekeeping Wars*, 63 SMU L. REV. 73, 96 n.152 (2010) (defining "prototype" as the "cognitively 'best example' of the category," which contains "a set of attributes, abstracted from experience, that reflect the 'central tendency' of the category members"). My analytic definition of corruption (use of an entrusted position for self-regarding gain) distills in formal terms which attributes are associated with the central tendency of corrupt acts. Also, in determining category membership, it is helpful to consider theories about the causal relationship of an attribute to a category and the purpose of the category. *Id.* By performing a functional analysis of whether the new instance generates temptation, distraction, or legitimacy costs, I am asking whether the instance fulfills the perceived purpose of the category and confirms the conventional theories underlying the category.

so much by disgust with private corruption but by frustration at the incompetence of computer security. This distinction highlights an important point. While private corruption almost always entails legitimacy costs, the converse is not true: Legitimacy costs do not stem only from corruption.[330] To be clear, under the corruption theory, the goal is not to engage immediately in some open-ended search for legitimacy costs; rather, the primary question is whether a trade based on material, nonpublic information amounts to corruption.

To summarize, under the primary definitional analysis, hacking-and-trading does not fit the definition of corruption. A secondary analysis employing corruption's signature costs does not give a strong reason to revise this initial judgment. Accordingly, under the corruption theory, the Second Circuit's opinion in *Dorozhko* goes too far in classifying hacking-and-trading as a violation of federal insider trading laws.[331] The district court's opinion was correct.[332]

2. Mere Agreement of Confidentiality: *Cuban*

The requirement of a fiduciary-like duty has been tested in another controversial case, *SEC v. Cuban*.[333] According to SEC allegations, in 2004, the CEO of Mamma.com contacted Mark Cuban, who held 6.3 percent of

330. For example, if high-frequency trading (HFT) comes to dominate the securities markets so much that ordinary investors feel that they are systematically disadvantaged, then perhaps it is fair to say that HFT has inflicted serious legitimacy costs. This does not mean, however, that HFT amounts to private corruption or, for that matter, to a violation of federal insider trading law.

331. The Second Circuit seems to have acknowledged that it was recognizing a new form of insider trading that is not based on existing precedents. *See Dorozhko II*, 574 F.3d 42, 45 (2d Cir. 2009) (noting that the SEC's claim is "not based on either of the two generally accepted theories of insider trading"). While courts may have the power to expand the definition of what counts as insider trading by creating new theories of liability, there should be some theoretical coherence between the newly-minted rules and established case law. Here, I argue only that hacking-and-trading does not fit my definition of corruption; hence, if courts are to find liability for hacking-and-trading, they should do so using doctrines other than insider trading.

332. To put my theory's results into context, it is useful to note that a majority of commentators believe that current insider trading law does not cover hacking-and-trading cases, but most believe that it should. *See, e.g.*, LANGEVOORT, *supra* note 92, § 6:14, at 6-51 to 6-52 (noting that *Dorozhko* poses the question of whether a new approach to insider trading ought to be recognized but opining that profiting from stolen information "plainly threatens market integrity"); Nagy, *supra* note 270, at 1249–57 (doubting that securities trading by the computer hacker would violate Section 10(b)); Robert A. Prentice, *The Internet and Its Challenges for the Future of Insider Trading Regulation*, 12 HARV. J.L. & TECH. 263, 296–98 (1999) (arguing that "from a traditional point of view" hacking-and-trading is not covered by insider trading laws but advancing policy reasons for finding liability).

333. *See* text accompanying notes 67–74.

Mamma.com's outstanding shares,[334] to invite him to participate in a forthcoming PIPE financing.[335] After first obtaining Cuban's promise to keep such information confidential, the CEO disclosed the details of the proposed transaction. Cuban immediately protested on the ground that the financing would dilute the value of his existing shares. He added: "Well, now I'm screwed. I can't sell."[336] But sell he did, dumping all of his shares before the PIPE deal was publicly announced and avoiding a loss of more than $750,000.[337]

In 2008, the SEC brought a civil enforcement action against Cuban, alleging that he was under a "duty of trust or confidence" arising from the oral agreement of confidentiality that he reached with the CEO.[338] The SEC was relying on the controversial Rule 10b-5-2(b)(1) adopted in 2000.[339] As discussed above, the Fifth Circuit reversed the trial court's dismissal and explicitly declined to determine the rule's validity. On remand, the SEC survived a motion for summary judgment but ultimately lost the trial, as the jury held in Cuban's favor.[340]

What does the corruption theory have to say about *Cuban*? The primary analysis starts with the definition. Although his gain was personal and thus potentially classifiable as self-regarding, he did not make use of any entrusted position to obtain it. According to the SEC, Cuban did promise confidentiality and, as the Fifth Circuit suggested, might have implicitly promised not to trade on the information.[341] But such promises, if made, were made in the context of an arms-length relationship. Cuban owned only 6 percent of Mamma's stock, making him a minority shareholder with a significant (but not controlling) interest in the company. He had no power to appoint directors and no special influence over Mamma's strategic agenda. In particular,

334. Complaint at 3, SEC v. Cuban, 634 F. Supp. 2d 713 (N.D. Tex. 2009) (No. 08 Civ. 2050-D).
335. A PIPE (private investment in public equity) transaction is a private placement followed shortly by a registered offering that enables PIPE investors to resell their shares to the public.
336. Complaint, *supra* note 334, at 4.
337. *Id.* at 5–6. To be clear, these facts portray the SEC's version, not Mark Cuban's.
338. *Id.* at 6.
339. 17 C.F.R. § 240.10b-5-2(b)(1) (2000).
340. On remand, Cuban made a motion for summary judgment in the district court. On March 5, 2013, the district court denied the motion, noting that the issue of whether Cuban was entitled to summary judgment was a "close one." SEC v. Cuban, No. 08 Civ. 2050-D, 2013 WL 791405, at *1 (N.D. Tex. Mar. 5, 2013). The trial was set for Monday, September 30, 2013. On October 16, 2013, the trial jury found in favor of Cuban. *See* Ben Protess & Lauren D'Avolio, *Jury Rules for Mark Cuban in Setback for S.E.C.*, DEALBOOK (Oct. 16, 2013, 4:14 PM). http://dealbook.nytimes.com/2013/10/16/mark-cuban-cleared-of-insider-trading/?nl=business&emc=edit_dlbkam_20131017.
341. *Cuban II*, 620 F.3d 551, 557 (5th Cir. 2010) ("It is at least plausible that each of the parties understood, if only implicitly, that . . . Cuban could not use the information for his own personal benefit.").

the company had decided on the PIPE financing without consulting Cuban in advance. Without more, Cuban's minority stake is not enough to confer an entrusted position—one that is imbued with the social norms of fidelity.[342]

Still, *Cuban* might be a hard case.[343] Accordingly, it makes sense to engage in the secondary analysis, to see, for example, if very high temptation, distraction, and legitimacy costs suggest a different result. Given that Cuban held no formal or informal responsibilities at Mamma.com deriving from his status as a minority shareholder, it is hard to identify any temptation or distraction costs. But what about legitimacy costs? Legitimacy costs arise when public investors see the conduct in question as playing the part of a rigged game. On the one hand, Cuban's loss avoidance was a sure thing because declines in share price predictably follow public announcements about PIPE financings. This might create a sense of unfairness. On the other hand, if we take Cuban's words at face value, he did not seek the information and was not being tipped off by a friendly CEO trying to do him a favor. Instead, Cuban was being hit up for more money as a potential investor. Seen in this light, the information was thrust on him because of his raw wealth, rather than because of any entrusted position. Accordingly, there should be no overwhelming concern about legitimacy costs—or so the jury must have concluded when they held in favor of Cuban.

To be sure, many readers will doubt the plausibility of the reported facts and find it more plausible that the CEO knowingly tipped off Cuban in an

342. This raises the question of whether shareholders holding greater stakes than Cuban are deemed to occupy entrusted positions and could thus be potentially liable for insider trading under the corruption theory. A shareholder who exercises some de facto control over corporate affairs—through its ability to appoint or remove directors by virtue of its share ownership—may occupy an entrusted position. Similar judicial analyses can be found in cases targeting public corruption. *See, e.g.*, United States v. Margiotta, 688 F.2d 108, 123–25 (2d Cir. 1982) (holding that, for purposes of the federal mail fraud statute, the jury could properly find that the defendant owed a fiduciary duty to the electorate under New York law where defendant, though not a public official, had "de facto control over the processes of government and is relied upon by others in the rendering of essential governmental decisions"); United States v. Del Toro, 513 F.2d 656, 663–64 (2d Cir. 1974) (finding conspiracy to defraud the United States in connection with the performance of its lawful government functions, in violation of 18 U.S.C. § 371, regardless of the fact that the defendant was not a public official); Oil & Gas Ventures-First 1958 Fund Ltd. v. Kung, 250 F. Supp. 744, 749 (S.D.N.Y. 1966) (concluding that domination of a legal entity may confer a fiduciary duty, regardless of whether the defendant was an officer or director of the entity); *see also* LANGEVOORT, *supra* note 92, § 3:4, at 3–6 (noting that a "noncontrolling shareholder . . . is not deemed to be a fiduciary [under insider trading law] unless he took on some additional role that itself could be treated as fiduciary").

343. *Compare* Appellate Amicus Brief, *supra* note 74 (opposing liability), *with* Hazen, *supra* note 4, at 903–12 (supporting liability).

effort to save Cuban from significant investment losses. After all, Cuban seems like the type of investor who is well positioned to return favors. If these were the actual facts, the CEO's conduct would amount to the use of *his* entrusted position for self-regarding gain, triggering liability under the corruption theory. But neither the SEC nor the courts have alleged this to be the story.[344] Moreover, a full and fair reading of the facts suggests that there was no improper tipping going on.[345]

In sum, although Cuban may have breached his oral promise to the CEO, that is not the same as the betrayal of an entrusted position. More generally, breaking a promise is not always, or even often, corrupt.[346] Under the corruption theory, Cuban should not be liable for insider trading. And under that theory, the SEC's controversial Rule 10b-5-2(b)(1) goes too far in classifying ordinary breaches of promises, without more, as generating insider trading liability.[347]

B. Centrality of Fraud

Under the misappropriation theory, disclosure (to the source of information) of one's intention to use that information to trade forecloses liability by negating the deception element.[348] So, for example, if James O'Hagan had

344. *See Cuban II*, 620 F.3d at 557 n.38 (entertaining tipper/tippee scenario but disclaiming the suggestion that "any such improprieties occurred").

345. If the CEO did actually tip Cuban in an effort to confer a favor on Cuban, it seems unlikely that the CEO would thereafter report back to the board chairman that Cuban acknowledged that he could not sell his shares until after the PIPE announcement, as doing so significantly complicates Cuban's defense. *See* Complaint, *supra* note 334, at 4–5.

346. This is not to say that an explicit promise of confidentiality cannot be used to support the finding of an entrusted position. Entrusted positions and contractual relationships are not mutually exclusive.

347. *Cuban I*, 634 F. Supp. 2d 713, 730–31 (N.D. Tex. 2009). To be clear, this Article does not engage the administrative law debate over whether the SEC exceeded its statutory authority in promulgating Rule 10b-5-2(b)(1). For a recent discussion, see Steve J. Cleveland, *Resurrecting Deference to the Securities and Exchange Commission: Mark Cuban and Trading on Inside Information*, 65 FLA. L. REV. 73 (2013).

348. United States v. O'Hagan, 521 U.S. 642, 655 (1997) ("[I]f the fiduciary discloses to the source that he plans to trade on the nonpublic information, there is no 'deceptive device' and thus no § 10(b) violation . . . ."). Some commentators believe that mere disclosure of one's intention to trade also forecloses liability under the classical theory. *Compare* Prakash, *supra* note 5, at 1491, *with* Painter et al., *supra* note 101, at 180. But this transposition of one feature of the misappropriation theory to the classical theory when the two theories provide distinguishable bases of liability requires further justification, especially in light of substantial doctrinal support to the contrary under the classical theory. *See supra* note 265 (summarizing doctrine suggesting that full disclosure of the information itself is needed to foreclose liability under the classical theory).

brazenly notified his law firm of his intention to trade on material, nonpublic information, he could not have been held liable under the misappropriation theory.[349] This doctrinally odd result makes no policy sense.[350] But given the unlikelihood of this type of scenario, the issue remained purely academic—at least until 2006.

In *SEC v. Rocklage*,[351] the chairman and CEO of Cubist Pharmaceutical shared with his wife nonpublic information about the recent failure of one of the company's clinical drug trials.[352] Emphasizing the confidential nature of the information, he also told her that once the results were announced, the company's share price would plummet.[353] Unbeknownst to the CEO, the wife had a standing agreement with her brother to pass on any negative information that she would learn from her husband.[354] In a curious twist, before tipping her brother, she informed her husband, the CEO, of her plan to do so.[355] Upon receiving the information, her brother and his friend liquidated their holdings of Cubist stock and avoided significant losses. The SEC brought an action against the CEO's wife, as well her two downstream tippees—her brother and his friend.

In affirming the district court's denial of the defendants' motion to dismiss, the First Circuit Court of Appeals struggled with the fact that the wife disclosed her intention to tip her brother. The court got around this fact by identifying not one but two different deceptions: the deceptive acquisition of the information and the subsequent deceptive tip leading to the trades. The court noted that although the wife's disclosure to her husband perhaps negated the deception involving the tip, it did not negate or cure her deceptive acquisition of the information.[356] In other words, the court interpreted *O'Hagan* as requiring that any disclosure insulating against insider trading liability must take place before the deceptive activity. By characterizing the wife's conduct as involving multiple deceptive steps, the court effectively eliminated the nondisclosure element of insider trading liability under the misappropriation theory.

349. *See* Nagy, *supra* note 270, at 1256–59; Painter et al., *supra* note 101, at 180.
350. *See, e.g.*, Joseph McLaughlin, 'O'Hagan': *Some Answers, More Questions*, N.Y. L.J., July 1, 1997, at 1 (calling *O'Hagan*'s "full disclosure to the source exception" a "foul ball"); Nagy, *supra* note 270, at 1257–58.
351. 470 F.3d 1, 3 (1st Cir. 2006); *see supra* text accompanying notes 80–82.
352. *Rocklage*, 470 F.3d at 1, 3.
353. *Id.* at 4.
354. *Id.* at 3–4.
355. *Id.* at 4.
356. *Id.* at 8.

In its attempt to arrive at a palatable result, the First Circuit strained Supreme Court precedent. After all, one could easily have characterized the very facts of *O'Hagan* as involving multiple deceptive acts, not all of which could be undone by the mere disclosure of O'Hagan's intention to trade. The principal task here, however, is not to comment generally on the soundness of *Rocklage*. Instead, it is to test whether the corruption theory has something interesting to say about this case of the "brazen fiduciary."[357]

The primary analysis, again, starts with the definition of private corruption. The gain (in the form of avoidance of losses) that accrued to the brother and his friend was personal. Financial gains accruing to one's family members or friends—and not just to the individual who used her entrusted position to pursue the gain—potentially count as self-regarding. But did the wife use any entrusted position to achieve the gain in question? That is the hard question.

The wife—Mrs. Rocklage—held no professional role that might be referred to as an entrusted position vis-à-vis the source of the information, the husband. She, however, was married to the source—Mr. Rocklage—and thus can be said to have occupied a position of trust and confidence characterized by reliance without recourse. Though not presumptively fiduciary under the common law, the marital relationship is one in which communal norms, as opposed to market norms, ordinarily apply. Further, Mr. Rocklage's confidential disclosure of information to his wife, though perhaps unwise, seems generally consistent with the purposes of Mrs. Rocklage's role as marital partner and confidante. When Mrs. Rocklage used her role to financially enrich her brother (and his friend), she violated the trust of her husband in a way that seemed deeply inconsistent with the communal norms of their relationship. In conclusion, she used her entrusted position for self-regarding gain.

Mrs. Rocklage's notice to her husband does not matter to the outcome because nondisclosure is not an element under the corruption theory. This result should not be surprising because the corruption theory rejects the centrality of fraud. Although corrupt acts tend to occur covertly and duplicitously, the fact that they happen more transparently does not change the fact that the gain in question seems inconsistent with the role of spouse and confidante.

Again, given that this is a hard case, one should also perform a secondary analysis by focusing on corruption costs. Because Mrs. Rocklage had no official responsibilities deriving from her status as a spouse, her actions incurred neither temptation nor distraction costs. But what about legitimacy costs? According to the reported facts of the case, the CEO innocently confided in

357. Nagy, *supra* note 270, at 1256.

his wife, who in turn took advantage of their confidential relationship in order to help her brother. The brother's substantial financial benefit was garnered through special connections of the sort tightly associated with public corruption—family connections. Given the similarity of such conduct to classic nepotism, the advantage seems especially unfair, systemic, and potentially erosive of legitimacy. Most corporate insiders have family members in whom they confide. Accordingly, this type of trading, if permitted, would presumably become widespread and systematic.

To be sure, many readers will find the reported facts to be implausible. Why would the CEO convey such sensitive information to his spouse while at the same time informing her that stock prices would crash? Why would the wife willingly betray her husband's confidence by tipping her brother and—just beforehand—tell her husband that she plans on doing so? Those inclined to betray the confidences of a life partner rarely give advance notice. Finally, the fact that the wife allegedly performed the specific act that would immunize her and her tippees from liability under *O'Hagan* compounds the story's unbelievability, especially because she is presumably not an expert on insider trading law.

Indeed, one might suspect that the CEO willingly tipped off the family and that they together concocted their post hoc explanation only after consultation with legal counsel. On these more plausible facts, the CEO's conduct would amount to the use of his entrusted position for self-regarding gain, triggering liability under the corruption theory. These are not, however, the facts as reported. But the suspicion that naturally comes to mind provides greater reason to be anxious about legitimacy costs.

In sum, Mrs. Rocklage's actions fall within my definition of corruption; moreover, a cost analysis suggests substantial legitimacy harms, which cut in favor of liability for this brazen fiduciary. Incidentally, this analysis takes a position in an ongoing debate in modern insider trading law—whether family relationships constitute the requisite relationship of trust and confidence under the misappropriation theory. Back in 1985, in *United States v. Reed*,[358] the district court for the Southern District of New York found sufficient evidence of a fiduciary relationship between a father and a son. By 1991, however, the Second Circuit held in *United States v. Chestman*[359] that marriage alone was not enough to create a relationship of trust and confidence for purposes of the misappropriation theory and that something more—a demonstration of a

358. 601 F. Supp. 685 (S.D.N.Y. 1985).
359. 947 F.2d 551 (2d Cir. 1991).

conferral of discretionary authority and resulting influence and dependence—was necessary.[360] The debate continued when, in 2000, the SEC promulgated Rule 10b-5-2, which provided—among other things—that family relationships could give rise to the requisite duty under the misappropriation theory.[361] The corruption theory provides an affirmative answer to the question presented.

* * *

The corruption theory provides relatively concrete answers in hard cases. In *Dorozhko* and *Cuban*, the corruption theory finds no insider trading liability due to the absence of an entrusted position. This focus on entrusted position means that the corruption theory more or less affirms the centrality of fiduciary (or fiduciary-like) duty.[362] By contrast, in *Rocklage*, the corruption theory finds Mrs. Rocklage liable for tipping regardless of her notice to the source, her husband. This reveals how the corruption theory rejects the centrality of fraud. Although fraud may be used to execute acts of corruption, that is not always the case, as in *Rocklage*. This last result could be viewed as a deficiency of the theory. But, as this Article has demonstrated, insider trading law has already been so unhitched from the common law of fraud that it makes no sense to "perpetuate the fiction . . . that insider trading is securities fraud."[363]

CONCLUSION

Imagine that a federal government agency, responsible for policing parts of the economy, issued a report warning the public about a threat to the national welfare that could do billions of dollars of damage and undermine the fundamental health and vitality of the economy. To complicate this scenario, imagine further a dissenting view, released by a sophisticated think tank, which declares that this is hysteria and that, to the contrary, the so-called threat is an eco-

360. *Id.* at 568.

361. 4 ALAN R. BROMBERG ET AL., BROMBERG AND LOWENFELS ON SECURITIES FRAUD & COMMODITIES FRAUD § 6:493 (2d ed. 2013).

362. To be clear, the corruption theory is not straitjacketed by fiduciary duty, as "entrusted position" is presumably more flexible than "fiduciary position."

363. Bainbridge, *supra* note 161, at 98; Langevoort, *supra* note 109, at 440 ("[Insider trading] is not really fraud, even though we've chosen to call it fraud in order to preserve and embellish the useful message of investor protection."). Because corrupt behavior offends collective norms, duplicity is often involved. *See* Kim, *supra* note 117, at 181–83. Still, duplicity is not logically necessary to corruption, as persons may be engaged in corrupt behavior openly and shamelessly. As a practical matter, however, covertness and duplicity are often necessary in order to successfully generate the self-regarding gain.

nomic boon. Now, further suppose that the principal legal tools with which to respond are terse, vague statutes and regulations drafted over seventy years ago. Is it possible that such dated text could respond adequately to this modern dilemma?

This is not fiction. It is instead the challenge posed by modern insider trading law, which confronts a steady stream of novel scenarios raised by the likes of hackers, ninjas, superstar CEOs, players, and brazen fiduciaries. We have relied on the judiciary to adapt the law forward, with each case, through acts of interpretation, extension, and innovation. But without an adequate theory of what is wrong with insider trading, that common-law-like development has reached a crisis, with circuits on the cusp of explicit disagreement and some courts initiating a soft rebellion against what appeared to be doctrinal orthodoxy. And the economic stakes are only getting hundreds of millions of dollars higher.

We thus desperately need a theory of insider trading law that makes sense of the law that has developed and that guides the law forward. The theory must respect at least the core features of the received doctrine as well as answer the sophisticated skeptics. Property theory and unjust enrichment theory, introduced almost three decades ago, are not quite up to the task. But viewing insider trading as private corruption, which reconnects the doctrinal dots in a novel and intuitive way, reveals an implicit order that was previously submerged. It is not perfect—no legal theory can be—but it is better than what we already have. Finally, it provides relatively concrete guidance in hard cases going forward, which is precisely what the courts and the SEC need.