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When Is it Wrong to Trade Stocks on the Basis of Non-Public Information?: Public Views of the Morality of Insider Trading

Stuart P. Green
Rutgers School of Law

Matthew B. Kugler
Lehigh University

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WHEN IS IT WRONG TO TRADE STOCKS ON THE BASIS OF NON-PUBLIC INFORMATION? PUBLIC VIEWS OF THE MORALITY OF INSIDER TRADING

*Stuart P. Green and Matthew B. Kugler**

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* Stuart Green is Professor of Law & Justice Nathan L. Jacobs Scholar at Rutgers School of Law-Newark. Matthew Kugler is a post-doctoral fellow in the Department of Psychology at Lehigh University. Thanks to Sam Buell and Robert Wagner for their helpful comments on an earlier draft.

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INTRODUCTION

For most people, the prototypical criminal offense involves an action that is clearly and unambiguously morally blameworthy, such as an unjustified act of violence or taking of property. Yet many crimes, especially so-called white collar crimes, exist in a realm of substantially greater ambiguity. In a previous article, we examined lay intuitions toward a series of white collar offenses—fraud, perjury and false statements, and bribery and gratuities—in an effort to determine how lay people distinguish between criminal fraud and “sharp dealing,” bribery and “horse trading,” perjury and “wiliness on the witness stand,” and the like.¹ In this study, we examine lay views of insider trading.

Our system of securities law prohibits investors from buying or selling stock on the basis of “non-public” information unless such information is first disclosed. Those who engage in insider trading can be prosecuted criminally or subjected to substantial civil sanctions.² Yet, as in the case of the other white collar offenses we have studied, the line between illegal insider trading and mere “savvy investing” can seem elusive. Some even argue that insider trading should not be prohibited at all.³ Even among those who agree that certain “core” cases of insider trading should be illegal, there is likely to be confusion about exactly how to deal with outlying cases and about what factors should distinguish violations that are criminal from those that are civil.

We wanted to know what the general public thinks about various acts of insider trading and related activity. If ordinary people agree with those who advocate for the abolition of insider trading laws, then

1. Stuart P. Green & Matthew B. Kugler, *Public Perceptions of White Collar Crime Culpability: Bribery, Perjury, and Fraud*, 74 LAW & CONTEMP. PROBS. (forthcoming 2012) (manuscript at 1) (on file with authors) [hereinafter Green & Kugler, *Public Perceptions*].

2. See, e.g., Securities Exchange Act of 1934, 15 U.S.C. §§ 78ff, 78u-1 (2010).

3. See, e.g., HENRY MANNE, INSIDER TRADING AND THE STOCK MARKET (1966) (most famously).

those who attempt to enforce such laws will operate at a considerable disadvantage. Offenders will generally not be tarred with moral approbation and potential jurors will wonder whether the pursuit of these actors is worth public resources. If, as we believe is more likely, people do tend to support a prohibition on at least some forms of insider trading, then the limits and priorities they endorse should be of interest to policymakers. As we will explain in Part II, there is reason to believe that it is important for the criminal law to maintain a connection to the moral intuitions of the lay public and, when the law must differ from that intuition, for it to do so deliberately and coherently.

We begin by outlining in broad terms the scope of insider trading law. We then explain why it is important to consider how the views of the lay public contrast with legal practice. We present a brief discussion of the psychological literature on procedural fairness, which is relevant to understanding lay views on insider trading. Finally, we describe three linked empirical studies that examine lay views of insider trading from several different perspectives.

I. GENERAL BACKGROUND ON INSIDER TRADING

Our system of securities law forbids investors from buying or selling stock on the basis of “non-public” information, at least in certain circumstances.⁴ Yet the most successful and celebrated investors are precisely those who have the best access to (and the best ability to interpret) information that is generally unavailable to the casual investor, even if it is not, strictly speaking, “non-public. This dichotomy presents something of a puzzle: where does one draw the line between illegal insider trading and mere savvy investing?

For many years, courts and commentators have struggled to define the proper limits of insider trading.⁵ Much of the confusion rests on a lack of clarity about exactly what harms, if any, insider trading causes and who, if anyone, it wrongs. Some commentators have gone so far as to argue that insider trading should be no crime at all.⁶ Others have sought to limit the scope of its coverage in a variety of ways. One problem is that no statute or rule specifically prohibits insider

4. See 17 C.F.R. § 240.10b5-1 (2011).

5. For academic commentary on this topic, see Richard L. Lippke, *Justice and Insider Trading*, 10 J. APPLIED PHIL. 215 (1993); Jennifer Moore, *What is Really Unethical About Insider Trading?*, 9 J. BUS. ETHICS 171 (1990); Alan Strudler & Eric W. Orts, *Moral Principle in the Law of Insider Trading*, 78 TEX. L. REV. 375 (1999).

6. MANNE, *supra* note 3.

trading. Rather, the offense has developed mainly through a body of judicial interpretations of the anti-fraud provisions of the Securities Exchange Act Section 10(b) and Securities Exchange Act Rule 10b-5, which bar “manipulative or deceptive devices” in connection with securities transactions.⁷

There have been several different and sometimes overlapping theories of what conduct should constitute insider trading. In its broadest form, insider trading law was viewed as prohibiting essentially all trading by those who had access to non-publicly available information, regardless of how those individuals obtained that information. The Securities and Exchange Commission (SEC) and several lower courts—in early cases such as *Securities & Exchange Commission v. Texas Gulf Sulphur Co.* and *In re Cady, Roberts & Co.*—justified such a rule primarily on the basis of the supposed unfairness of unequal access to such information.⁸

The scope of insider trading law under modern case law, however, has been more limited. It focuses less on whether the trader had an unfair informational advantage and more on how he came to have such an advantage in the first place.⁹ Thus, under the so-called “classical” or “traditional” theory of insider trading, trading on material, non-public information is illegal only if the trader is a corporate insider. A corporate insider may be a permanent insider, such as an officer or director, or a temporary insider, such as a lawyer or consultant. The rationale is that by trading on information unavailable to the public, an insider violates his duty to corporate shareholders.¹⁰ For example, in *Chiarella v. United States*, the defendant, an employee at a financial printer responsible for printing deal announcements, deduced the identities of takeover targets and, on the basis of that information, purchased shares before the public announcement led to an increase in the shares’ value.¹¹ In overturning the defendant’s conviction in the trial court, the Supreme Court rejected the view that

7. See Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (2010); 17 C.F.R. § 240.10b-5 (2011).

8. *S.E.C. v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968); *In re Cady, Roberts & Co.*, Exchange Act Release No. 83925, 1961 WL 59902 (Nov. 8, 1961).

9. Cf. Samuel W. Buell, *What is Securities Fraud?*, 61 DUKE L.J. 511, 562-63 (2011) (“Insider trading law aims at a sometimes difficult-to-specify category of unfair, inefficient, or otherwise-undesirable informational advantage. It is good when a trader does research to gain an advantage. It is bad when a corporate insider gains an advantage simply from having seen a document or having sat in a meeting from which she learned about a deal before the public did.”)

10. See *Dirks v. S.E.C.*, 463 U.S. 646, 663 (1983).

11. 445 U.S. 222, 224 (1980).

merely possessing non-public information made his trading illegal.¹² The Court reasoned that for a trade to constitute insider trading, the trader must owe a fiduciary duty to the company's stockholders or derivatively assume the duty of the person who gave him the inside information (the "tipper").¹³ The mere fact that a trader holds an advantage, and that a trade is in some sense "unfair," does not make it fraudulent under the securities laws.¹⁴

Under the complementary "misappropriation theory" of insider trading, a defendant is liable for violating a pre-existing duty to the source of the inside information on which he traded. For example, in *United States v. Carpenter*, the defendant, R. Foster Winans, a columnist for the *Wall Street Journal*, was charged with operating a scheme through which he would trade in stocks that were to be the subject of his forthcoming "Heard on the Street" columns.¹⁵ The Second Circuit held that although Winans owed no duty to the shareholders of the companies in whose stock he had traded (and therefore had not committed insider trading under the classical theory), he did owe a duty to the source of the information, his employer, the *Journal*.¹⁶ Therefore, he had committed insider trading under the misappropriation theory.¹⁷

The Supreme Court's decision in *United States v. O'Hagan* is similar. There, the defendant was charged with trading on the basis of non-public information obtained from his law firm, which represented a client contemplating a tender offer for shares of the Pillsbury Company.¹⁸ Because Pillsbury was not a client of his firm, the defendant was not liable under the classical theory; he had no duty to Pillsbury's shareholders. Instead, the Court held that O'Hagan could be held liable under the misappropriation theory of insider trading for breaching a duty to the source of the information (namely, his firm and its client).¹⁹

12. *See id.* at 235.

13. *See id.* at 228–229, 230 n.12.

14. *See id.* at 232.

15. 791 F.2d 1024, 1026 (2d Cir. 1986), *aff'd on other grounds*, 484 U.S. 19 (1987).

16. *See id.* at 1034.

17. *Id.*

18. 521 U.S. 642, 648 (1997).

19. *See id.* at 650, 652, 659.

II. WHY CITIZENS' INTUITIONS ABOUT MORAL BLAMEWORTHINESS MATTER

The law of insider trading, like much white collar criminal law, makes fine distinctions between conduct that appears to be merely “aggressive business behavior” and conduct that is illegal and potentially criminal.²⁰ We wanted to know whether similar distinctions would appear in lay subjects’ judgments about such conduct.

Citizens’ beliefs about the seriousness of various criminal acts matter for a number of reasons.²¹ Most scholars agree that society’s ability to enforce compliance with the law lies less in the power to impose sanctions than it does in its ability to influence the way people live their daily lives. Generally, people refrain from committing crimes not because they fear sanctions, but because they believe the underlying conduct is morally wrong.²² Thus, law deters by informing citizens that society has decided a certain act is wrong and by persuading them to adopt that view. If the law does not reflect or create a moral aversion among the citizenry, then its deterrent power is substantially lessened. As Paul Robinson and John Darley put it:

The criminal justice system’s power to stigmatize depends on the legal codes having moral credibility in the community. The law needs to have earned a reputation for accurately representing what violations do and do not deserve moral condemnation from the community’s point of view. This reputation will be undercut if liability and punishment rules deviate from a community’s shared intuitions of justice.²³

When the criminal law is viewed as a reliable indicator of what the community regards as wrongful, citizens are more likely to follow its lead in cases that are unclear. When criminal codes deviate from the

20. See Green & Kugler, *Public Perceptions*, *supra* note 1.

21. The discussion in this Section is derived from Stuart P. Green & Matthew B. Kugler, *Community Perceptions of Theft Seriousness: A Challenge to Model Penal Code and English Theft Act Consolidation*, 7 J. EMPIRICAL LEGAL STUD. 511 (2010).

22. See, e.g., TOM R. TYLER, *WHY PEOPLE OBEY THE LAW* (1992).

23. Paul H. Robinson & John M. Darley, *Intuitions of Justice: Implications for Criminal Law and Justice Policy*, 81 S. CAL. L. REV. 1, 21 (2007) [hereinafter Robinson & Darley, *Intuitions of Justice*]; see also PAUL H. ROBINSON & JOHN M. DARLEY, *JUSTICE, LIABILITY, AND BLAME: COMMUNITY VIEWS AND THE CRIMINAL LAW* (1995); John M. Darley, et al., *Community Standards for Defining Attempt: Inconsistencies with the Model Penal Code*, 39 AM. BEHAV. SCIENTIST 405, 419 (1996); Paul H. Robinson & John M. Darley, *Testing Competing Theories of Justification*, 76 N.C. L. REV. 1095, 1136 (1998).

norms of the community, citizens may be less likely to cooperate with or acquiesce in the system's demands.²⁴

Maintaining consistency between the law and social norms is important not only in connection with deciding *which* conduct should or should not be criminalized, but also in deciding *how much* to punish for that conduct. If the legal system imposes more or less punishment for certain crimes than citizens believe is deserved, the system seems unfair. It loses its credibility and, ultimately, its effectiveness.

These considerations play out in an especially interesting way when applied to white collar criminal behavior. In contrast to prototypical street crimes for which the primary questions are *how wrong* an act is and what factors may mitigate the wrongfulness, white collar crimes often raise the issue of *whether* an act is wrong at all. When it is not intuitive that certain criminalized conduct is wrong, the potential for discord between community attitudes and legal policy increases substantially, as does the potential for a loss of credibility if the law strays from community norms. Also at stake is what Andrew Ashworth has called the principle of "fair labeling"—the idea that "widely felt distinctions between kinds of offences and degrees of wrongdoing are respected and signaled by the law, and that offences are subdivided and labeled so as to represent fairly the nature and magnitude of the law-breaking."²⁵ If the public endorses a prohibition on insider trading in general, but balks at its application to a particular kind of case, then that, too, would raise issues of legitimacy.

We are not arguing that the criminal law should always follow popular opinion, or that people's moral intuitions are necessarily correct or immune from persuasion. Moreover, we recognize that present attitudes toward insider trading are likely shaped by the fact that it has been criminalized for the last several generations. In formulating an effective and authoritative criminal law, however, it is essential to know what people's intuitions are and where they diverge from current or proposed legal rules. If the public disagrees with a legal practice despite having been exposed to it for many years, that is of particular note because it implies that there is a limit to the flexibility of popular attitudes on that issue.

24. See Elizabeth Mullen & Janice Nadler, *Moral Spillovers: The Effect of Moral Mandate Violations on Deviant Behavior*, 44 J. EXPERIMENTAL SOC. PSYCH. 1239, 1240 (2008); Robinson & Darley, *Intuitions of Justice*, *supra* note 23, at 23; William Stuntz, *Self-Defeating Crimes*, 86 VA. L. REV. 1871, 1872 (2000).

25. James Chalmers & Fiona Leverick, *Fair Labeling in Criminal Law*, 71 MOD. L. REV. 217, 219 (2008) (quoting ANDREW ASHWORTH, PRINCIPLES OF CRIMINAL LAW 88 (4th ed. 2003)).

III. PREVIOUS STUDIES OF COMMUNITY ATTITUDES REGARDING INSIDER TRADING

The earlier literature on community attitudes towards insider trading is quite limited. Meir Statman administered surveys to university students and finance professionals in eight countries: Australia, India, Israel, Italy, the Netherlands, Tunisia, Turkey, and the United States. Subjects read vignettes and were asked to rate the “fairness” of the conduct described there.²⁶ One scenario involved a lawyer at a firm who received confidential information about a client company’s plan to acquire another company. This lawyer traded stock in the about-to-be-acquired (non-client) company on the basis of that confidential information. A second scenario involved a person who overheard a conversation in which top executives at a well-known firm were discussing the company’s surprisingly good sales results and bought stock in the company on the basis of that presumably confidential information. A third scenario involved a trade by a person who relied on his “research and skill” (rather than inside information) in deciding to sell stock.²⁷

Statman found a significant difference in the way the first two scenarios were perceived in different countries and by the two separate groups of subjects (students and finance professionals). For example, in the first scenario, only 5% of finance professionals in the United States and the Netherlands judged the lawyer’s conduct acceptable, followed by Australia and Israel, where 16% of finance professionals judged his behavior acceptable. In Tunisia, Italy, India, and Turkey, a much higher percentage of respondents deemed the lawyer’s conduct acceptable (41%, 43%, 49%, and 56%, respectively).²⁸ Among students, a higher percentage tended to view the lawyer’s conduct as acceptable, with a similar distribution generally observable across countries. For example, 36% of students in the U.S. found the lawyer’s conduct acceptable, compared with 76% in India.²⁹ In the case of the person who overheard the conversation about sales figures, a much higher percentage of subjects viewed his conduct as acceptable, although here the two groups of subjects were flipped: 72% of the financial professionals in the U.S. said his behavior was acceptable, while only 57% of the students said it was acceptable. Similar patterns ap-

26. See Meir Statman, *Is it Fair? Perceptions of Fair Investment Behavior across Countries*, 12 J. INV. CONSULTING 45, 48 (2011).

27. See *id.* at 48–49.

28. See *id.* at 48.

29. See *id.*

peared in the other countries.³⁰ As for the case of the investor who relied merely on skill and knowledge, an extremely high percentage of both students and professionals in all countries viewed his conduct as acceptable.³¹

Statman attributed the difference between the views of financial professionals and university students to differences in their level of familiarity with the law of insider trading. Financial professionals, who were likely more familiar with the law, were more likely to think insider trading behavior was unfair.³² Statman linked differences among subjects in different countries to diverging attitudes about corruption. Subjects from countries with a lower tolerance for corruption, as measured by Transparency International's Corruption Perception Index,³³ were more likely to view insider trading as unfair.³⁴

We think the Statman study offers useful insights into the way the public views some core types of insider trading. From our perspective, however, the study reflects several significant limitations. It did not go beyond core cases of insider trading, into the realm where some of the most interesting moral ambiguities and most perplexing legal issues lie. For example, the study did not ask subjects whether the conduct should be treated as a crime or subject to civil sanctions, nor did it ask about the difference between tipper and tippee liability. It also did not vary the amount of money earned in the trade, and did not distinguish between merely "possessing" and actually "using" confidential information. Although we agree that the concept of unfairness likely plays a significant role in why people view insider trading as blameworthy, we do not think that unfairness exhausts the moral content of insider trading. We think there are other plausible explanations for why insider trading is viewed as wrong, reflected in both the case law and academic literature that need to be considered as well—most especially, breach of duty to the source of the confidential information

IV. POSSIBLE PSYCHOLOGICAL ROOTS OF OPPOSITION TO INSIDER TRADING

As noted above, early insider trading doctrine (in cases like *Cady, Roberts & Co.*, and *Texas Gulf Sulphur*) tended to focus on the idea

30. *See id.* at 49.

31. *See id.*

32. *See id.*

33. *See id.* at 53 tbl. 6.

34. *See id.* at 53.

that a trader who relied on confidential information was benefiting from an “unfair” advantage not held by other traders.³⁵ More modern doctrine, by contrast, has focused on the trader’s breach of duty to the source of the information he used.

There is a great deal of important psychological work on how people perceive and respond to unfairness. This literature may shed some light on the motivations underlying prohibitions on insider trading. First, people are reluctant to “buy in” to a system that they do not perceive as fair or governed by neutral procedures. For example, Tom Tyler’s work on procedural justice has demonstrated that people are more likely to accept and abide by a decision that was reached using fair procedures, even if the decision goes against their interests.³⁶ Specifically in the legal context, this kind of procedural fairness has been shown to matter in a host of real world, high-consequence domains. The satisfaction of civil litigants depends heavily not only on the results of their cases, but also on their perceptions of procedural fairness.³⁷ Similarly, defendants in felony cases perceived the verdicts they received as more legitimate if they thought the procedures used during the trial were fair, independent of whether they were acquitted.³⁸ People who believe that the police employ fair and impartial procedures are more likely to cooperate with law enforcement.³⁹

People are also hostile toward those they perceive as taking unfair advantage of a situation, sometimes even to the point of being willing to accept pain to punish them. Consider the example of the ultimatum game. Two players divide a fixed sum of money (often \$10 or \$20). Player 1 proposes a division and Player 2 must either accept the division, causing it to take immediate effect, or reject the division, causing both players to lose access to the money. No communication is allowed. The game creates a tension within Player 2 between the strictly rational response, to accept any non-zero offer, and the desire to insist on fair treatment. Behavioral data, gathered across decades

35. See *supra* notes 8–13 and accompanying text.

36. See 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).

37. See JOHN THIBAUT & LAURENS WALKER, *PROCEDURAL JUSTICE: A PSYCHOLOGICAL ANALYSIS* 81–85 (1975).

38. See Johnathan D. Casper et al., *Procedural Justice in Felony Cases*, 22 LAW & SOC’Y REV. 483, 503 (1988).

39. See Jason Sunshine & Tom R. Tyler, *The Role of Procedural Justice and Legitimacy in Shaping Public Support for Policing*, 37 LAW & SOC’Y REV. 513, 535 (2003); Tom R. Tyler, *Public Trust and Confidence in Legal Authorities: What Do Majority and Minority Group Members Want from the Law and Legal Institutions?*, 19 BEHAV. SCI. & L. 215, 234 (2001).

by more researchers than can be mentioned, suggests that the fairness motive dominates; players will generally reject any offer that leaves them with less than 30% of the overall pie.⁴⁰ Though this outcome may seem trivial when people are rejecting \$3 to \$4, the same pattern has been observed in cases where larger amounts of money were at stake.⁴¹ Daniel Kahneman and his colleagues have documented a number of additional fairness constraints on economically rational behavior. For instance, not only are people resistant to being treated unfairly, but they will also sacrifice personal gain to avoid benefiting a person who has previously treated a completely unrelated third party badly in a previous ultimatum game.⁴² People also respond negatively to employers who reduce wages in response to a weak labor market, and to stores that raise prices on snow equipment right after a storm; they apparently see it as unfair to take advantage of the changing power dynamic.⁴³

Taking seriously these two sets of findings, we begin to see the genesis of the unfairness rationale for prohibitions on insider trading. For the stock market to work as intended, people must be willing to “buy in,” and, as we know from the procedural justice literature, this willingness can be expected to be contingent on an assurance of fair play. We therefore think it is no accident that Statman found that the countries with the best developed financial sectors also had populaces that strongly supported insider trading laws. Widespread public participation may require this assurance of facial neutrality. Given the inclination to punish those who violate fairness norms, we can also see the impetus for assigning moral condemnation to those who break such rules once the rules are established.

Although there is no corresponding literature on psychological responses to breaches of obligation, there are a number of studies examining people’s willingness to cheat or cause harm. One factor that plays a substantial role in this area is the directness of the act. Psychologists have shown, across a variety of domains and contexts, that people tend to perceive objects, events, and other people that are far

40. See Colin Camerer & Richard H. Thaler, *Anomalies, Ultimatums, Dictators and Manners*, 9 J. ECON. PERSP. 209, 210 (1995).

41. See Lisa Cameron, *Raising the Stakes in the Ultimatum Game: Experimental Evidence from Indonesia*, 37 ECON. INQUIRY 47, 58 (1999).

42. See Daniel Kahneman et al., *Fairness and the Assumptions of Economics*, 59 J. BUS. S285, S291 (1986).

43. See Daniel Kahneman et al., *Fairness as a Constraint on Profit Seeking: Entitlements in the Market*, 76 AM. ECON. REV. 728, 734 (1986).

away in different ways than those that are close up.⁴⁴ Nina Mazar, On Amir, and Dan Ariely recently demonstrated this phenomenon in a series of studies in the context of dishonesty.⁴⁵ In these studies, the researchers asked their subjects to complete a series of basic math puzzles within a time limit, and they paid the subjects based on the number of problems they solved. Through various means, the participants had the opportunity to cheat, say they had completed more puzzles than was actually the case, and therefore receive greater compensation.⁴⁶ Across all studies, the researchers observed a constant but fairly low level of cheating; those who could cheat tended to get one to two more questions right than those who could not.⁴⁷ Interesting for our purposes was a study that manipulated the mechanism through which participants received compensation. In one version, participants reported the number of questions they answered correctly directly to the person who would pay them. In another version, participants reported the correct number to a separate person who paid them in tokens that participants took across the room to exchange for cash. Though the conditions were morally indistinguishable, cheating was substantially more common in the condition in which tokens were used as an intermediary between the cheating and the unearned gains.⁴⁸

A further demonstration of the power of indirect action comes from the domain of moral psychology. A line of research conducted by Adam Moore and his colleagues has shed new light on the class of moral reasoning dilemmas that the classic Trolley Problem exemplifies.⁴⁹ The classic case involves a runaway trolley heading down a track on which five men are working obliviously. The actor has the option of flipping a switch, causing the trolley to instead go down a track that contains only a single workman. The question for the reader is whether it would be morally acceptable for the actor to flip

44. See generally Yacov Trope & Nira Liberman, *Temporal Construal*, 110 PSYCHOL. REV. 403 (2003).

45. See Nina Mazar et al., *The Dishonesty of Honest People: A Theory of Self-Concept Maintenance*, 44 J. MARKETING RES. 633 (2008).

46. See *id.* at 635.

47. See *id.* at 641.

48. See *id.* at 637–38.

49. See generally Adam B. Moore et al., *In Defense of the Personal/Impersonal Distinction in Moral Psychology Research: Cross-Cultural Validation of the Dual Process Model of Moral Judgment*, 6 JUDGMENT & DECISION MAKING 186 (2011); Adam B. Moore et al., *Who Shalt Not Kill? Individual Differences in Working Memory Capacity, Executive Control, and Moral Judgment*, 19 PSYCHOL. SCI. 549 (2008) [hereinafter Moore et al., *Who Shalt Not Kill?*].

the switch. Moore found that one of the key determinants of the acceptability of such an action was whether the actor would be required to use direct physical force to cause harm, such as pushing a large man in front of the trolley, instead of flipping a switch, as in the classic case.⁵⁰ If the actor needed to push the sacrificed individual off a bridge, shove him through an airlock, or smother him with his hands, the action was much less acceptable than if the actor needed to bring about the exact same effect by pushing a button.⁵¹ This directness factor was substantially more important than some elements that traditionally have philosophical relevance, such as whether the death of the sacrificed person was an intentional means to accomplish the beneficial end or a foreseen, but unintended, consequence.⁵²

How, if at all, are considerations of directness likely to bear on lay judgments of the blameworthiness of insider trading behavior? The answer to this question may turn on the choice between the unfairness/cheating theory and the breach-of-duty-to-the-source-of-information theory. Under the unfairness/cheating approach, the harms and wrongs of insider trading primarily affect other traders in the market—those without access to the confidential information. The harms are fairly indirect in that they are inflicted on a typically unidentified target who may not even be aware that he has been cheated. By contrast, under the breach-of-duty-to-the-source-of-information approach, the harms and wrongs of insider trading typically affect the company for which the insider trader works or from whom he obtained and misappropriated the information. Here, the harms and wrongs of insider trading may be seen as more “direct,” at least in normal cases.

V. EMPIRICAL STUDIES OF PUBLIC VIEWS OF INSIDER TRADING

We conducted three linked studies intended to elicit lay views of insider trading. The first study focused on the extent to which the way a trader obtains inside information affects lay judgments about blameworthiness and punishability. Would our subjects think that traders should be blamed and punished merely for trading on the basis of non-public information, or would they insist that the trader breach a duty to the source of the information or to the shareholders of the company in whose stock he was trading? The second study fo-

50. See Moore et al., *Who Shalt Not Kill?*, *supra* note 48, at 556.

51. See *id.* at 549.

52. See *id.* at 550 (discussing Thomas Aquinas' doctrine of double effect).

cused on lay views regarding a number of narrower, but nevertheless significant, issues in insider trading law. We wanted to see if, and under what circumstances, our subjects would approve of punishing insider trading by means of civil, rather than criminal, sanctions, particularly with respect to differences in the amount of money earned through trading. In addition, we wanted to test our subjects' views on doctrinal issues concerning "use" versus mere "possession" of confidential information and "tipper" versus "tippee" liability. The final study sought to probe the underlying thinking that might inform subjects' views about the blameworthiness of insider trading.

A. Study 1 – Initial Look at Insider Trading

In our initial study, we wished to test whether our subjects would make different judgments about culpability based on the means by which the trader came to acquire non-public information. Would our subjects think that defendants should be punished merely for trading on the basis of an arguably unfair advantage derived from the possession of non-public information (along the lines of *Texas Gulf Sulphur*), or would they insist that the trader breach a pre-existing duty in such trading, whether to shareholders of the firm whose stock they were trading in (as required by *Chiarella*) or to the source of the information (as in *O'Hagan* and *Carpenter*)?

There is also the question whether insider trading liability should apply to those who trade on the basis of inside information when they are neither insiders nor misappropriators. Where such people receive information from one who is an insider or misappropriator (a "tipper"), they are known as "tippees." The Supreme Court has held that a tippee can be liable for insider trading based on a "derivative" breach of duty – that is, a duty that derives from the tipper's breach.⁵³ But the Court has made clear that such tippee liability exists only when (1) the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee, and (2) the tippee knows or should know that there has been a breach.⁵⁴

We were particularly interested in those cases in which the tipper did not intend to benefit the tippee, as where the tippee overhears a conversation that the (inadvertent) tipper thought was private, and then trades on that information. Should such conduct be treated as insider trading? Here, the level of intentionality of the listener may

53. See *Dirks v. SEC*, 463 U.S. 646, 659 (1983).

54. See *id.* at 660.

play an important role: passively overhearing a conversation is substantially less direct than seeking out information as a reporter or dealing with it in the course of one's job as an executive. The SEC has taken the position that a tippee can be liable even where the tipper did not intend to benefit the tippee.⁵⁵ The Supreme Court has not considered the issue, but lower courts have split. At least one lower court decision, *Securities & Exchange Commission v. Musella*, has followed the SEC's position.⁵⁶ Likewise, at least one lower court decision, *Securities & Exchange Commission v. Switzer*, has disagreed.⁵⁷ We investigate these issues more fully in Study 2.

To examine lay perceptions of these questions, we formulated a scenario in which: an individual has non-public information that ABC Corp is about to make a public announcement that it is acquiring a majority share in XYZ Corp. On the basis of this information and without disclosing his knowledge of it, the individual buys stock in XYZ. After the merger has been made public, the individual sells the stock at a price substantially above what he paid for it, thereby earning a handsome profit.

We then presented seven variations of this scenario, each with different facts about who the individual was and how he came to possess the non-public information on which he based his trade.

In three of the variations, the individual trading in XYZ stock was an insider at either the acquiring company or the target company. In one case, the trader, Richards, was a senior executive at the target company, XYZ. This scenario corresponded to the so-called traditional or classical form of insider trading in that the duty Richards presumably violated was to the shareholders of his company. In a second case, the trader, Williams, again worked for the target company in which the stock was bought, but this time as a secretary who handled papers containing confidential information about the merger prior to its public announcement. This case also corresponded to the traditional theory, but Williams was arguably less an "insider" than

55. See J. KELLY STRADER, UNDERSTANDING WHITE COLLAR CRIME 104 (2002).

56. See S.E.C. v. Musella, 578 F. Supp. 425 (S.D.N.Y. 1984), *aff'd*, 898 F.2d 138 (2d Cir. 1990) (holding that a law firm manager who gave material non-public information to defendants who profited from the information was liable for insider trading because he breached a duty of silence to his law firm).

57. S.E.C. v. Switzer, 590 F. Supp. 756 (W.D. Okla. 1984) (holding that defendant had not committed insider trading where he traded on information overheard in the stands at a high school track meet, from a man he knew to be the CEO of a publicly held corporation, since CEO "tipper" had not violated a fiduciary duty to his firm's shareholders).

Richards. In a third case, the trader, Brown, was a senior executive at the acquiring company, ABC, who bought stock in the target company, XYZ. This scenario corresponded to the so-called misappropriation theory in that the duty that Brown presumably violated was to the firm from which he misappropriated the information (ABC), rather than to the shareholders of the company in which Brown had bought shares (XYZ). We predicted that these three scenarios would be judged as most deserving of criminal penalties and that the traders who were senior executives would be judged more harshly than the secretary, partly because high-powered finance professionals are supposed to know the rules concerning insider trading in a way that clerical employees might not be expected to, and partly because they are presumably much better compensated. We did not anticipate any significant difference between people's judgments of the executive who satisfied the traditional theory (Richards) and the executive who satisfied the misappropriation theory (Brown).

In the next two variations, the trader came into the non-public information as a result of his work for a third party. In one case, the trader, Buckley, worked as a "markup man" at a commercial printing company that prints documents for companies involved in mergers, including the merger between ABC and XYZ.⁵⁸ Although the trader was not privy to the information, he deduced it from documents that were being printed in his shop. In the other case, the person doing the trading, Anderson, was an investigative reporter for a major business newspaper. Through his sources, he learned about the impending merger and wrote an article about it. Just before the article was published, and on the basis of the information contained in it, he bought stock in XYZ.⁵⁹ We predicted that the actors in both of these cases would be rated as deserving of criminal sanctions, but less than the traders in the three cases previously described.

In the final two variations, the trader had no connection to either firm. In one case, the trader, Taylor, was described as being in the back of a cab, on his way home after work, when he found a memo marked 'Confidential – Not for Release.' The memo describes the proposed merger. In the other case, the trader, White, trades on information which he happens to overhear at a ball game where several

58. This scenario corresponds closely to *Chiarella v. United States*, 445 U.S. 222 (1980); see *supra* note 11 and accompanying text.

59. This case is analogous to *Carpenter v. United States*, 791 F.2d 1024 (1986); see *supra* note 15 and accompanying text.

employees of ABC are discussing the proposed merger.⁶⁰ In the final two variations, the most tangential cases, unintended tippees trade based on non-public information. They provide a strong test of whether an unfair informational advantage on the part of the trader is a sufficient condition to elicit condemnation.

1. *Study 1 Method*

For this study, we recruited fifty participants from Amazon's Mechanical Turk service. This approach allowed for a diverse sample of adult Americans. Data from two individuals were discarded owing to an abnormally fast completion time (less than half the median) or incorrectly answering a question intended to screen inattentive participants.⁶¹ Of the remaining forty-eight participants (eighteen male, thirty female), the median age was thirty-eight. Of the participants, 58% had college degrees.

The study began with a brief description of its procedure. Participants were told that the study concerned evaluating how people act in social situations. After giving their consent to continue, participants were shown a question, which the instructions told them to bypass rather than answer. Those who recorded an answer were marked as inattentive, as mentioned above. Participants then completed a page of individual difference questions. These included self-rated political orientation, ranging from one (Very Conservative) to seven (Very Liberal); faith in various public institutions such as government, courts, defense attorneys, and the like, ranging from one (Not much faith) to seven (A lot of faith); and eight items from the Competitive World Beliefs scale.⁶²

Following the individual difference measures, participants were given instructions describing the format of the scenarios. Participants were told that they would view a core "story" with multiple possible "endings" and that it was for them to determine which distinctions, if

60. This scenario corresponds closely to *Switzer*, 590 F. Supp. 756; see *supra* note 57 and accompanying text.

61. See generally Daniel Oppenheimer et al., *Instructional Manipulation Checks: Detecting Satisficing to Increase Statistical Power*, 45 J. EXPERIMENTAL SOC. PSYCHOL. 867 (2009) (explaining the use of applicant screening to increase statistical power).

62. See generally Chris G. Sibley & John Duckitt, *Big-Five Personality, Social Worldviews, and Ideological Attitudes: Further Tests of a Dual Process Cognitive-Motivational Model*, 149 J. SOC. PSYCHOL. 545 (2009) (explaining the effect of personality and related dispositions on predictive models).

any, were relevant. All scenarios were presented on the same webpage. The scenarios and their various endings were not labeled.

After each scenario, participants were asked three questions. First, they were asked to rate the moral blameworthiness of the described act on a scale ranging from one (Not at All Blameworthy) to seven (Very Blameworthy). Second, they were asked whether the act should be treated as criminal (Yes/No). Third, they were asked how severely, if at all, the person should be punished on a scale ranging from one (No Punishment) to seven (Severely Punished).

Basic demographics (age, sex, occupation, educational attainment, and state of residence) were collected at the end of the study. Participants were also asked whether they owned stock or had traded stock professionally, whether they had ever bought stock on a tip from a friend or relative, and how much they knew about investing in stocks and bonds.

2. Study 1 Results

As Table 1 shows, the seven scenarios can be grouped loosely into three “bands” of seriousness.⁶³ Because blameworthiness, punishment severity, and the percentage of the sample criminalizing an activity were consistent in nearly every case, those factors are discussed together. In the first band, containing three scenarios, the person doing the trading in XYZ stock was an insider at either the acquiring or target company. These cases elicited substantial punitiveness ratings from our participants. The two most serious cases were those involving executives at the acquiring (83%) or acquired (79%) companies. The secretary at the acquired company was judged to be slightly less blameworthy than the executives, but his conduct was criminalized (77%) and punished to the same degree. Respondents thus made essentially no distinction between the classical and misappropriation theories with respect to criminalization, blameworthiness, or punishment.

63. Data on blameworthiness and punishment severity were analyzed using a repeated-measures ANOVA. Scores varied across condition for both blameworthiness $F(3, 161) = 26.56, p < .001$ and punishment $F(3, 144) = 22.43, p < .001$. Due to a sphericity violation, the Greenhouse-Geisser correction was used in these analyses. Comparison of means for those measures (Table 1) is based on post-hoc tests. The criminalization question had a binary response format. We therefore conducted McNemar's within-subjects chi-square tests on that data (one degree of freedom). Alpha was set at .05 for all analyses.

Table 1 — Ratings of Study 1 Scenarios in Terms of Blameworthiness, Deserved Punishment, and Percentage of the Sample Criminalizing the Activity

	Blameworthiness	Punishment	Percent Crimi- nalizing
Executive at Acquiring Company	5.69 _a (1.64)	4.27 _a (1.81)	83.3% _a
Executive at Acquired Company	5.52 _a (1.74)	4.33 _a (1.74)	79.2% _a
Secretary at Acquired Company	5.13 _b (1.81)	4.02 _a (1.83)	77.1% _a
Markup Man	4.71 _b (1.77)	3.25 _b (1.97)	60.4% _b
Reporter	4.63 _b (1.92)	3.25 _b (1.99)	58.3% _b
Memo Found in Cab	3.81 _c (2.14)	2.54 _c (1.81)	37.5% _c
Remark Overheard at Game	2.94 _d (1.96)	1.98 _d (1.48)	18.8% _d

For each variable, numbers sharing subscripts are not significantly different from each other. Standard deviations are in parentheses. Blameworthiness and punishment scores are on scales ranging from one to seven.

In the next band of seriousness, the trader came into the information as a result of his work for a third party (either a financial printer or a newspaper). Sixty percent of participants sanctioned the markup man, whose case paralleled the facts of *Chiarella*. Fifty-eight percent of respondents sanctioned the reporter, whose case paralleled *Carpenter*. This slight mitigation, as compared to the first three cases, could be the result of several factors. Most obviously, these two traders were operating a step removed from the two companies in question. To the extent that the salient victim of the bad act is the source of the information, this added distance may have led people to mitigate their punishment. Still, a strong majority criminalized the actions of both of these individuals, 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.

In the scenarios making up the final band, the trader had no connection to either firm. Thirty-seven percent of participants sanctioned the cab rider who found and read the confidential memo, and 19% sanctioned the person who overheard a conversation at a baseball game. These two cases, particularly the second, represent a hard test of the pure unfairness rationale for banning insider trading. In

each case we see that a minority do adopt this view, despite a lack of plausible connection or duty between the beneficiary and either firm, but that the majority clearly rejects it. This result lends some credence to a breach of obligation account: in neither case did the recipient of information actively pursue that information, and in the case where the recipient acquired the information truly incidentally, very few people sought to impose punishment.

From a practical perspective, the social cost of “insider” trading by lucky outsiders is likely to be fairly minor. Few people will find themselves in a position to gain such inside information and, if they do, they are unlikely to do so repeatedly. They therefore can cause minor market distortions, but they certainly do not break the system. A corporate insider, on the other hand, could cheat on a regular basis and, if allowed to do so, would ultimately undermine confidence in the fairness of the market.⁶⁴ Perhaps participants were aware, whether explicitly or implicitly, of this difference. Another possibility is that while participants did not approve of trading by these inadvertent insiders, they nevertheless backed away from labeling them as “criminal.” In Study 2, we included a civil punishment option to account for this concern.

Past research has sometimes found differences in punitiveness toward certain kinds of white collar offenders based on the gender, race, or educational attainment of the participant.⁶⁵ In this study, neither gender, stock market experience, nor educational level had an effect.⁶⁶ Given our comparatively small sample size, it is not necessarily safe to assume that such differences do not exist. Rather, we only assume that, if they do exist, the differences are likely not large. The sample was not large enough to test meaningfully for ethnic differences.

64. *But see* Robert E. Wagner, *Gordon Gekko to the Rescue?: Insider Trading as a Tool to Combat Accounting Fraud*, 79 U. CIN. L. REV. 973, 1000–05 (2011) (arguing that the assumption that insider trading undermines investor confidence may be unfounded).

65. For a useful summary, see Kristy Holtfreter et al., *Public Perceptions of White-Collar Crime and Punishment*, 36 J. CRIM. JUST. 50, 52 (2008). *See generally* James D. Unnever et al., *Public Support for Getting Tough on Corporate Crime: Racial and Political Divides*, 45 J. RES. CRIME & DELINQ. 163 (2008).

66. For these analyses, we created overall composites of the blameworthiness, punishment severity, and criminality measures by averaging across the seven scenarios. None of the individual difference measures (political orientation, competitive world beliefs, and trust in various social institutions) correlated with these composite scores. We did not examine race due to the size of the sample and limited number of participants from minority groups.

B. Study 2—Criminal vs. Civil Liability, Tipper vs. Tippee Liability, and Other Doctrinal Puzzles in Insider Trading Law

From Study 1, we know that people tend to support prohibitions on at least some forms of insider trading and are willing to punish those who are, in various ways, entrusted with confidential information and abuse it for personal benefit. We also found that people were more reluctant to punish in several cases when an individual acquired information by chance. To shed more light on the distinctions that are important in the law and potentially in lay morality, we conducted a second study that considered nuances within insider trading law. We also introduced a new punishment option: participants in Study 2 could choose between permitting a behavior, criminalizing it, or, new to this study, assigning a civil penalty. This better mirrored the options available in real life cases and allowed us to see whether participants actually wanted to permit certain kinds of insider trading or were simply reluctant to go so far as to criminalize them.

1. New Distinctions Investigated in Study 2

a. “Possessing” vs. “Using” Information

A defendant who is charged with insider trading will sometimes contend that he had planned to purchase or sell the stock regardless of the inside information. For example, business magnate Martha Stewart, in defending against insider trading charges brought against her in connection with the sale of ImClone stock, claimed that she had a standing order with her broker to sell her shares as soon as the price dropped below \$60 per share.⁶⁷ The question thus arises whether the defendant must actually rely on the inside information in deciding whether to trade, or whether mere possession is enough.

The SEC has traditionally taken the position that possession, rather than use, of material nonpublic information is sufficient to trigger liability.⁶⁸ The courts, however, are divided on the issue. The Se-

67. *See* United States v. Stewart, 323 F. Supp. 2d 606, 611 (S.D.N.Y. 2004). As it turned out, the SEC’s investigation produced evidence that Stewart and her broker had fabricated the existence of such a standing order. *See, e.g.,* Constance L. Hays, *Stewart Inquiry Is Said to Focus on Lack of a Sell Order*, N.Y. TIMES (June 28, 2002), <http://www.nytimes.com/2002/06/28/business/stewart-inquiry-is-said-to-focus-on-lack-of-a-sell-order.html>.

68. *See, e.g.,* *In re* Sterling Drug Inc., No. 14675, 1978 SEC LEXIS 1759, at *13–14 (Apr. 18, 1978); *see also* 17 C.F.R. § 240.10b5-1(b) (2011) (triggering liability when a person purchases or sells securities while “aware” of material nonpublic infor-

cond Circuit has followed the SEC's "possession" rule, stating that "material information cannot lie idle in the human brain."⁶⁹ Under this approach, the only way that a defendant who was "aware" of such information could avoid liability is by showing that he engaged in the transaction pursuant to a pre-existing plan, contract, or instruction.⁷⁰ By contrast, the Ninth and Eleventh Circuits have held that proof of use, rather than mere possession, must be shown—the defendant's knowledge of such information must constitute a substantial factor in his decision to purchase or sell the subject securities at a particular price or at a particular time.⁷¹

We wanted to see what our lay subjects would think about this issue. We imagined two contrasting scenarios. Both involved a senior executive at a company buying stock in that company immediately before information was released that was expected to make the stock's value increase. In both cases, the executive was privy to confidential information about the merger prior to its public announcement.

In one scenario, the executive "[used] the information to assess the value of the company and without disclosing his knowledge of it, [bought] stock in XYZ." Subjects were told that the executive "would not have bought the stock if he did not have this information." In the other scenario, subjects were told that, in addition to the inside information, the executive had "access to the same public information about the company as everyone else" and would have bought stock in XYZ even if he had not had the confidential information.

We predicted that our subjects would regard the executive who actually relied on the information in making his decision to buy the stock as more blameworthy than the executive who relied on other information and would have bought the stock anyway. Where the trader actually relied on the information, he used his arguably unfair advantage to gain an upper hand. In that sense, he cheated. In the other scenario, he did not rely on his unfair informational advantage and in that sense cannot be said to have cheated.

mation). See generally MARC I. STEINBERG, UNDERSTANDING SECURITIES LAW 374 (5th ed. 2009).

69. United States v. Teicher, 987 F.2d 112, 120 (2d Cir. 1993).

70. See 17 C.F.R. § 240.10b5-1(c)(1)(A).

71. See United States v. Smith, 155 F.3d 1051, 1069 (9th Cir. 1998); S.E.C. v. Adler, 137 F.3d 1325, 1337 (11th Cir. 1998).

b. Amount of Insider Trader's Profits and Professional Status of Trader

In theory, any actor who commits insider trading, however defined, is potentially subject to criminal penalties.⁷² In practice, however, only a relatively small percentage of insider trading cases lead to criminal charges. Most are treated civilly.⁷³ Two factors that play an important role in determining whether an insider trading case will be pursued criminally by the DOJ or just civilly by the SEC are: (1) how much money the individual earned from the insider trading scheme; and (2) whether the trader was a licensed professional, such as an investment banker, broker, trader, investment adviser, attorney, or accountant.⁷⁴

Probably the most significant factor that determines whether a case will be treated as civil or criminal is the size of the defendant's ill-gotten gains. According to a recent study by the New York State Bar Association, the DOJ is much more likely to prosecute those cases in which the amount of money earned was greater than \$100,000.⁷⁵ Cases involving smaller profits will normally be treated civilly. The same study also shows that licensed professionals are substantially more likely to face criminal prosecution than officers and directors of public companies who conduct insider trading in their companies' stock.⁷⁶

Using the same basic scenario as above (senior executive trades on the basis of inside information), we offered two variations. In one, as a result of the transaction, the executive made a profit of \$25,000. In the other, the executive made a profit of \$250,000. We predicted

72. See 17 C.F.R. § 240.10b-5 (2011).

73. Under the Department of Justice's United States Attorneys' Manual, even if there is evidence to show that a person's conduct constitutes a federal offense, the prosecutor should decline prosecuting if, among other things, there is an "adequate non-criminal alternative to prosecution." 9-27.220: Grounds for Commencing or Declining Prosecution, USAM PRINCIPLES OF FEDERAL PROSECUTION, http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/27mcrm.htm#9-27.220 (last visited Jan. 31, 2012). The AUSA should also decline prosecution if: (1) "No substantial Federal interest would be served by prosecution," or (2) "The person is subject to effective prosecution in another jurisdiction." *Id.*

74. See Securities Subcommittee of the White Collar Criminal Litig. Comm., *Criminal Prosecutorial Discretion in Insider Trading Cases: Let's Look at the Numbers*, N.Y. STATE BAR ASS'N, 3-4, (May 12, 2010), <http://www.nysba.org/Content/ContentFolders4/CommercialandFederalLitigationSection/ComFedReports/CRIMINALPROSECUTORIALDISCRETIONININSIDERTRADINGCASES.pdf>.

75. See *id.* at 13.

76. See *id.* at 9 (explaining that during the relevant time period, DOJ pursued 61% of cases involving licensed professionals and only about 33% of cases involving officers or directors of public companies).

that our subjects would find the executive who obtained a profit of \$250,000 more deserving of punishment than the executive who earned only \$25,000.

In one sense, the difference between the executive who earned \$25,000 and the executive who earned \$250,000 is a matter of “moral luck.” The issue is similar to that which arises in the case of unsuccessful, or partially successful, attempts. Imagine two pickpockets at work in a crowd. Both are equal in terms of skill, determination, and neediness. Yet the “lucky” pickpocket finds a wallet bursting with hundred dollar bills, while the “unlucky” pickpocket finds a wallet that turns out to be empty. Is the unlucky pickpocket any less blameworthy than the lucky one? Should his punishment be any less? People’s intuitions vary widely, and there is a large body of ethics and philosophy of law literature about whether, all else being equal, the unlucky wrongdoer should be punished any less severely than the lucky one.⁷⁷ Previous empirical studies have found that, despite the deep divide among scholars, most lay people believe that the unlucky attempter should in fact be punished less severely than the lucky one.⁷⁸

Of course, everything else here is not necessarily equal. Our scenarios did not explain why one trader earned so much more from his trading than the other. It could be that he traded a much larger number of shares of stock, or perhaps the stocks he invested in were more valuable, or perhaps the swing in price was significantly greater. The study instrument did not say. Instead, we simply focused on the fact that trader 1 was more successful than trader 2, and therefore arguably caused more harm to some unidentified victim or to the market generally.

We also varied the trader’s professional status. In one set of scenarios, the trader was a “top executive” at a large company. In other scenarios, the trader was a secretary at the firm or a markup man at a financial printer. We predicted that, other things being equal, the executive would be judged more harshly than the others, both because he would be expected to have a higher level of familiarity with the

77. See generally, e.g., ANDREW ASHWORTH, *Taking the Consequences*, in ACTION AND VALUE IN CRIMINAL LAW 107 (Stephen Shute et. al. eds., 1993); THOMAS NAGEL, MORTAL QUESTIONS 24 (1979); BERNARD WILLIAMS, *Moral Luck*, in MORAL LUCK 35 (Robert B. Louden ed., 1981); Larry Alexander, *Crime and Culpability*, 5 J. CONTEMP. LEGAL ISSUES 1 (1994); Sanford Kadish, *Foreword: The Criminal Law and the Luck of the Draw*, 84 J. CRIM. L. & CRIMINOLOGY 679 (1994).

78. See PAUL H. ROBINSON & JOHN M. DARLEY, JUSTICE, LIABILITY, AND BLAME: COMMUNITY VIEWS AND THE CRIMINAL LAW 186–88 (1996).

law, and because his compensation, absent the insider trading, would presumably be higher.

c. Tipper vs. Tippee Liability

Most of the cases we have looked at so far have involved persons with inside information who themselves trade on the basis of such information. But what about cases in which an insider gives nonpublic information to another individual, and it is the second individual who does the trading? How should the liability of the “tipper” (the person who discloses material, nonpublic information to another individual) compare to the liability of the “tippee” (the person who trades on the basis of the information received from the tipper)? Other things being equal, should the tipper be regarded as more, less, or equally blameworthy to the tippee?

The courts have said that the tippee’s liability is “derivative” of the tipper’s. Thus, if the tipper is not liable (say, because he had no duty of confidentiality to the source of information), then the tippee also would not be liable.⁷⁹ This does not necessarily mean that the tipper will be subject to more serious punishment than the tippee, though as a practical matter tippers do seem to face a higher risk of criminal prosecution than do tippees or sole actors. For example, in the New York Bar study cited above, 58% of the SEC defendants selected by the DOJ for prosecution were tippers, whereas 36% were tippees, and 6% were sole actors who did not tip anyone.⁸⁰

But why should the tippee’s liability be thought of as derivative of the tipper’s? It is the tippee, after all, who actually engages in trading. Perhaps it would be more accurate to say that the *tipper’s* liability is derivative of the *tippee’s*—that the tipper is in some sense an accomplice or aider and abettor of the tippee’s conduct. Under this approach, the tipper is like the actor who provides a gun to the would-be killer, but does not use it himself.

There are really two questions at issue here. The first is: which kind of liability is conceptually more basic—the tipper’s or tippee’s? The answer to this question turns on the deeper question of why insider trading is wrong to begin with. If one believes (as Green has argued) that the basic wrong of insider trading lies in the fact that the insider uses an unfair advantage against other traders and thereby

79. See *Dirks v. SEC*, 463 U.S. 646, 662 (1983); *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 237 (2d Cir. 1974).

80. See *Criminal Prosecutorial Discretion in Insider Trading Cases: Let’s Look at the Numbers*, *supra* note 74, at 3.

“cheats” them, then it would seem that it is the tippee who commits the more basic wrong, and that the tipper’s liability is derivative. If, on the other hand, one believes (as does a majority of the Supreme Court) that the basic wrong in insider trading is the misappropriation of information, then it would seem that the more basic wrong is committed by the tipper, and that the tippee’s liability is the derivative one.

The second question is whether any of this should make a difference in practice. Regardless of which form of liability is conceptually more basic, we might simply decide that the two should be treated as equally worthy of punishment. This is what has generally occurred with accomplice liability in criminal law, where the same punishment typically applies to both the offender who gives support and the offender who directly causes the harm.⁸¹

For present purposes, we cannot hope to resolve either of these issues. Instead, we are simply interested in knowing how our lay subjects would judge the question of relative blameworthiness. All else being equal, who do they believe is more deserving of punishment: the tipper who gives confidential information to another individual, or the tippee who receives the information and trades on the basis of it? Or do they think they should be treated as equivalent?

An additional question related to the liability of the tipper is whether he must obtain any personal benefit from making the tip. Traditionally, under the classical theory, a defendant who is prosecuted for insider trading will incur liability only if he “personally benefited” from the tip.⁸² The leading case is *Dirks v. Securities & Exchange Commission*.⁸³ In *Dirks*, Secrist, a former employee of Equity Funding American (EFA), revealed to an investment analyst, Dirks,

81. Though Green has argued here as well, contrary to the prevailing view, that this outcome is a mistake and that accomplices ordinarily ought to be punished less severely than principals. See STUART P. GREEN, LYING, CHEATING, AND STEALING: A MORAL THEORY OF WHITE-COLLAR CRIME (2006). See generally Joshua Dressler, *Reassessing the Theoretical Understandings of Accomplice Liability: New Solutions to an Old Problem*, 37 HASTINGS L.J. 91 (1985).

82. If the defendant is prosecuted under the misappropriation theory, however, some district courts have explicitly held that the personal benefit test is inapplicable. See *S.E.C. v. Willis*, 777 F. Supp. 1165, 1172 n.7 (S.D.N.Y. 1991); *S.E.C. v. Musella*, 748 F. Supp. 1028, 1038 & n.4 (S.D.N.Y. 1989). On the other hand, a number of courts have held that proof of personal benefit is a required element to prove tipper/tippee liability under the misappropriation theory. The most significant opinion is the Eleventh Circuit’s opinion in *S.E.C. v. Yun*, 327 F.3d 1263, 1279 (11th Cir. 2003).

83. 463 U.S. 646.

that EFA was being fraudulently managed, a fact that constituted material, nonpublic information. Apparently, Secrist's sole motivation in revealing this information to Dirks was to reveal the fraud. Dirks, in turn, revealed this information to a number of people, including his own clients, who thereafter sold their shares in EFA.⁸⁴ The Supreme Court held that Dirks was not liable for insider trading, finding that, absent personal benefit to Secrist as a result of the tip to Dirks, Secrist had not breached his fiduciary duty to the shareholders.⁸⁵ The Court also identified three types of personal benefit that a tipper may receive from making a tip: (1) a pecuniary benefit (such as a kickback or profit-sharing arrangement); (2) a reputational benefit (such as when a corporate officer provides information to an analyst in hopes that the analyst will report about him favorably); and (3) a benefit from making a gift.⁸⁶

To test our subjects' views on these issues, we gave them several scenarios involving both tippers and tippees and asked them to judge their relative blameworthiness. In each of these scenarios, we contrasted the blameworthiness and punishment meted out to the tipper with that assigned to the tippee, and both to the baseline case of an executive trading on his own inside information for his own benefit. In one tipper/tippee scenario, the executive did not himself trade on inside information, but passed the information on to a professional stock analyst whom he knew casually and with whom he hoped to do business in the future. The executive hoped to impress the analyst with his access to inside information. The analyst then bought stock based on the inside information. This was the tip-for-gain case. In a contrasting scenario, an insider at a company revealed confidential information to a business reporter with the intent of exposing fraudulent business practices and protecting shareholders from (in this case) a bad merger. No personal benefit, except perhaps reputational, would accrue to the "tipper" in this case—paralleling the *Dirks* case. The reporter then traded on the information, making a substantial profit.

We predicted that, other things being equal, our subjects would view the person who actually uses the confidential information to buy stock (the tippee) as more blameworthy than the person who merely divulges the information and does not use it (the tipper). This would reflect our view that the principal wrong in insider trading comes

84. *See id.* at 649.

85. *See id.* at 666–67.

86. *See id.* at 663–64.

from a sole trader or tippee using an unfair advantage vis-à-vis other investors, and that the tipper is merely an accomplice in this act. This would be especially clear if the tipper's motive was innocent; being the unwitting accomplice to another's insider trading should attract relatively little punishment.

d. Existence of Confidential Relationship

As noted above, the misappropriation theory of insider trading applies only when stock is traded on the basis of "material nonpublic information misappropriated in breach of a duty of trust or confidence."⁸⁷ To find out when our subjects would find a breach of the duty of trust or confidence, we constructed two scenarios. In one case, an executive leaked information to his brother with the intent of impressing him (as in the tip-for-gain case). The brother then traded on the information, making a handsome profit. This was, more or less, the scenario contemplated by SEC Rule 10b5-2, which imposed liability where the disclosing person and the recipient have a familial relationship, even in the absence of some other duty of confidentiality.⁸⁸

We also thought it was worth posing a case in which a confidential relationship arises out of a different sort of association. We had in mind a class of cases in which a government employee has advanced notice of still-confidential information that would affect the value of a given stock—for example, information about whether a drug is about to be approved for general distribution; whether a judge is going to rule for the plaintiff or the defendant; whether a legislator will vote yes or no on proposed legislation. People who have access to such information as government employees may arguably have an even higher level of duty to maintain confidences than those in private business.⁸⁹ We therefore constructed a scenario in which an official at the Food and Drug Administration (FDA) had advance knowledge that a drug is about to be approved. The official buys stock in the drug company prior to the announcement and later sells it, making a handsome profit.

87. 17 C.F.R. § 240.10b5-2(a) (2011).

88. *See id.* § 240.10b5-2(b)(3).

89. In our previous work on bribery and gratuities, we found that government officials were held to higher standards than corporate officials. *See Green & Kugler, Public Perceptions, supra* note 1 (manuscript at 22).

2. *Study 2 Method*

Once again, we solicited participants for this study from Amazon's Mechanical Turk service. Because of the greater number of scenarios in this study, we recruited 101 subjects. Data from three individuals were discarded owing to an abnormally fast completion time (less than half the median) or incorrectly answering a question intended to screen inattentive participants. Of the remaining ninety-eight participants (forty-four male, fifty-four female), the median age was twenty-eight. Of the participants, 53% had college degrees.

The procedure for the second insider trading study mirrored that of the first with several important exceptions. First, this study—owing to the greater number of scenarios—split the various scenarios across web pages. As a result, the participants could not easily view all of the cases before beginning to respond, but it was possible for participants to move backward and forward through the survey and modify their answers, if they so desired. This format did, however, raise the possibility of order effects. To address this concern, we created two orders and contrasted them in analysis.

To review, we employed a substantial number of scenarios in this study. As described above, we had a pair of scenarios contrasting an insider who used information as the basis for his trade with one who possessed the information, but would have made the stock purchase even without it; a pair contrasting large and small gains, three sets of tippers and tippees; and one government official trading in advance of a regulatory decision. We also reused the memo-found-in cab and remark-heard-at-ballgame scenarios to see if the civil punishment option altered responses.

We also made a substantial change to one of the answer choices. We maintained the blameworthiness and punishment severity questions without modification, but the criminality question was replaced with one asking whether the conduct described should be permitted, treated civilly, or punished criminally. We added a special instruction screen at the beginning of the study to explain the distinction between civil and criminal penalties and asked subjects to describe the distinction in their own words.

Finally, we made two small methodological changes. As noted above, the individual differences measured in Study 1 failed to affect the scenario judgments. We therefore removed many of the attitudinal items, retaining only the overall ratings of political orientation and demographics (including stock-related questions). Also, as we split the scenarios across multiple study screens, we modified our sce-

narios so that they “stood alone” more effectively; the scenarios were all freestanding rather than being endings to a common story.

Table 2. Ratings of Study 2 Scenarios in Terms of Blameworthiness, Deserved Punishment, and Preferred Response.

Scenario	Blameworthiness	Punishment	Action should be:		Punished Criminally
			Permissible	Given	
			Civil	Penalty	
Would Not Have Bought Without Information	5.55 (1.77)	4.53 (1.68)	12%	51%	38%
Would Have Bought Anyway	3.39 (2.14)	2.90 (1.85)	43%	39%	18%
Gain of \$25,000	5.34 (1.79)	4.07 (1.70)	12%	54%	34%
Gain of \$250,000	5.46 (1.85)	4.67 (1.78)	12%	43%	45%
Memo Found in Cab	3.53 (2.14)	2.59 (1.95)	54%	32%	14%
Overheard at Ballgame	2.52 (1.93)	1.93 (1.57)	73%	21%	6%
Employee of FDA	5.16 (1.84)	4.39 (1.77)	14%	44%	43%
Tipper/Tippee Cases					
Pair 1	5.10 (1.82)	4.09 (1.74)	14%	57%	29%
Executive Tipped for Gain	5.35 (1.76)	4.53 (1.82)	14%	47%	39%
Analyst Tipped for Gain	3.03 (2.09)	2.44 (1.72)	54%	38%	7%
Pair 2	5.81 (1.57)	4.80 (1.80)	11%	47%	43%
Executive Tipped with Good Motive	5.10 (1.81)	4.18 (1.79)	14%	56%	31%
Reporter Tipped by Tippee with Good Motive	4.78 (2.07)	4.02 (1.86)	22%	48%	30%
Pair 3					
Family Tippee					
Family Tipped					

Standard deviations are in parentheses. Blameworthiness and punishment scores are on scales ranging from 1-7.

3. Study 2 Results

Responses to the scenarios did not differ across the two scenario orders; for example, participants gave the same ratings to the scenarios contrasting high versus low amount gained whether they preceded or followed the “would have bought anyway” cases, and the same ratings to the “tip for gain” case regardless of whether it was the first or last of the tip cases. This allowed us to combine participants across orders in all subsequent analyses. The design of this study was centered on a series of planned contrasts (between tippers and tippees, large and small gains, would or would not have bought anyway, et cetera). We therefore employed a somewhat different analysis strategy and report only those contrasts rather than a comprehensive analysis.⁹⁰ We also compare the scenarios within a pair to the case in which a classic insider makes a stock purchase based on inside information that he otherwise would not have made. This case reflected a prototypical example of insider trading and could serve as a baseline.

a. Liability for Direct Buyers

For our first contrast, we compared the cases in which the insider possessed inside information, but did not rely on it—and thus would have made the stock purchase anyway—with the case in which the insider would not have otherwise purchased the stock. The data show that lay people can and do draw a distinction here: when the insider would have made the stock purchase anyway, he was blamed significantly less and people wished to punish him significantly less severely. When evaluating how the case should be resolved, people selected harsher channels (criminal over civil, civil over no punishment) when evaluating the actor who used the information as a basis for trading.⁹¹ When the actor would have bought anyway, a substantial minority thought that the conduct was entirely permissible (43%) and most of the remainder would have opted for a civil penalty. When the executive would not have otherwise purchased the stock, in contrast, only

90. For the blameworthiness and punishment severity questions, we used within-subjects t-tests. Our analysis approach in this study differs in that we report only the planned contrasts and therefore are less likely to have a multiple comparison issue. The question asking whether the conduct should be permitted, treated civilly, or punished criminally was coded for each set of paired scenarios to reflect whether one scenario was to be treated with more, equally, or less serious means than the other. The more and less serious options were then contrasted using a McNemar test, as before.

91. Blameworthiness $t = 10.14$, $p < 0.001$; punishment severity $t = 9.55$, $p < 0.001$; preferred treatment method $\chi^2(1, N = 94) = 40.14$, $p < 0.001$.

12% of participants thought his conduct was permissible and a full 38% thought it merited criminal treatment.

The two scenarios which varied the size of the gain were rated as equally blameworthy, but they were punished differently. When evaluating the actor who made the larger gain, participants assigned greater punishment and were more likely to prefer criminal sanctions (45%) than when evaluating the actor who made a smaller gain (34% for criminal sanctions).⁹² These differences, though small, show that participants were willing to prioritize when meting out punishment even while seeing blameworthiness as constant.

The confidential-memo-found-in-cab and remark-overheard-at-ballgame cases presented traders who came into insider information accidentally, rather than within the context of a previously existing duty. The trader who reads the confidential memo left behind in a cab is blamed and punished less than the actor in the control would-not-otherwise-have-made-the-trade case, and participants were much more likely to judge his conduct as permissible.⁹³ Interestingly, the trader in the ballgame case was blamed and punished even less than the trader in the cab case.⁹⁴ As we speculated in Study 1, this may be because the person finding the memo in the cab took some direct action to acquire the information and was at least made aware, by the label on the memo, that the information was confidential. The addition of a civil penalty option may have had some effect on results, as the permissible/not criminal option was down 10% in this study as compared to Study 1.

Finally, the FDA case presented an interesting wrinkle on insider trading. The FDA official may have a duty of confidentiality to his employer (the government) or a derivative duty as part of an agency entrusted to review trade secrets, but he does not have a direct duty to the company in question. In that sense, this scenario is closely analogous to the *Carpenter* case. But participants still viewed the official as acting inappropriately. He was blamed as much, punished as severely, and subject to criminal punishment as often as the actor in the would-not-otherwise-have-made-the-trade case.⁹⁵

92. Blameworthiness $t = 1.22$, *ns.*; punishment severity $t = 6.75$, $p < 0.001$; preferred treatment method $^2(1, N = 91) = 5.56$, $p < 0.05$.

93. Blameworthiness $t = 7.48$, $p < 0.001$; punishment severity $t = 8.63$, $p < 0.001$; preferred treatment method $^2(1, N = 94) = 37.93$, $p < 0.001$.

94. Blameworthiness $t = 6.56$, $p < 0.001$; punishment severity $t = 11.61$, $p < 0.001$; preferred treatment method $^2(1, N = 92) = 20.01$, $p < 0.001$.

95. Blameworthiness $t = 1.52$, *ns.*; punishment severity $t = 0.85$, *ns.*; preferred treatment method $^2(1, N = 94) = .22$, *ns.*

b. Tipper/Tippee Liability

Reactions to the tippers and tippees in our scenarios depended greatly on the circumstances of the tip. When the executive tipped the analyst for personal gain, participants blamed the executive approximately the same amount as the analyst, and punished him slightly less. This judgment, however, had no impact on whether participants believed the conduct should be treated civilly or criminally.⁹⁶ As in the small and large gain cases, this may reflect punishment priorities. The analyst's purchase of the stock is seen as being as blameworthy, deserving of punishment, and worth pursuing criminally or civilly, as was the defendant in the would-have bought-the-stock-anyway executive case.⁹⁷ The tippee received no liability discount.

An executive tipping a reporter to expose a bad deal produces a very different set of reactions. Participants blamed and punished the reporter as much as in the would-not-otherwise-have-made-the-trade case and were as likely to punish him civilly and criminally.⁹⁸ Participants blamed and punished the executive tipping for apparently altruistic reasons far less, however. The participants were also much less likely to subject this executive to sanctions than the reporter or the executive in the would-not-otherwise-have-made-the-trade case. Of the participants, 54% thought that the executive's conduct in tipping for altruistic reasons should be permissible, and only 7% thought it should be subject to criminal sanctions.⁹⁹

The case involving a tip obtained from a relative was again distinct, if only slightly. Participants blamed and punished both the tipper and the tippee less than the executive in the would-not-otherwise-have-made-the-trade case, but only the tippee was less likely to be dealt with civilly or criminally, and that difference was small. The tipper and tippee in this case were treated equivalently.¹⁰⁰

96. Blameworthiness $t = 1.82$, $p = 0.07$; punishment severity $t = 2.99$, $p < 0.004$; preferred treatment method $^2(1, N = 95) = 2.33$, *ns*.

97. Blameworthiness $t = 0.79$, *ns*; punishment severity $t = 0.08$, *ns*; preferred treatment method $^2(1, N = 93) = 0.10$, *ns*.

98. Blameworthiness $t = 1.71$, *ns*; punishment severity $t = 1.25$, *ns*; preferred treatment method $^2(1, N = 92) = .023$, *ns*.

99. As compared to the reporter: blameworthiness $t = 11.17$, $p < 0.001$; punishment severity $t = 10.07$, $p < 0.001$; preferred treatment method $^2(1, N = 94) = 44.72$, $p < .001$. As compared to the executive who would not have traded but for the nonpublic information: blameworthiness $t = 9.96$, $p < 0.001$; punishment severity $t = 11.40$, $p < 0.001$; preferred treatment method $^2(1, N = 94) = 43.75$, $p < .001$.

100. Family tipper compared to would-not-otherwise-have-made-the-trade executive: blameworthiness $t = 2.43$, $p = 0.02$; punishment severity $t = 2.08$, $p = 0.04$; preferred treatment method $^2(1, N = 93) = 2.68$, *ns*. Family tippee compared to would-

C. Study 3—Subjects' Underlying Reasoning

In our final study, we wanted to further explore the motivations underlying lay condemnation of insider trading. As previously discussed, one theory holds that insider trading is wrong because it is “cheating.”¹⁰¹ It is not merely that one party has an advantage over another, but also that the advantaged party has acquired his advantage in a way that violates the accepted rules of the game. Though the magnitude of the advantage that the various actors hold has generally been held constant—to the extent that gains have been specified, they have not varied across most scenarios—participants still draw substantial distinctions between cases, apparently based on the degree of moral violation involved in obtaining the information. Those who are trusted explicitly with inside information are punished much more than those who acquire it by chance, for example. Here, we wished to go further in two ways. First, we wanted to assess lay reactions to a case in which a person acquires a substantial advantage in a way that does not involve cheating. Second, we wished to ask participants to rate the kinds of wrongs they believed were being committed. When people criminalize the conduct of an executive trading in the stock of his own company, are they doing so because they feel it is unfair to other investors, because it is a breach of obligation to the company, or for some other reason?

We therefore employed four variants of our traditional merger scenario. For each variant, we asked a more extensive series of questions than in the previous studies. First, we asked the participants to rate the extent to which the actor in the scenario was wronging the acquiring company, the acquired company, and other investors. Based on the blameworthiness ratings in the previous studies, we had reason to believe that participants thought that some party was being wronged, but we did not know which party. We then asked about the extent to which the actor had an unfair advantage, was breaching a duty to the acquiring company, or was breaching a duty to the acquired company. Most theories of insider trading turn on breach of duty, and we thought it would be interesting to see whether lay participants drew distinctions in this area. Finally, we asked about the

not-otherwise-have-made-the-trade executive: blameworthiness $t = 4.21$, $p < 0.001$; punishment severity $t = 3.76$, $p < 0.001$; preferred treatment method ² (1, N = 94) = 10.01, $p < .001$. Family tipper compared to family tippee: blameworthiness $t = 1.84$, $p = 0.07$; punishment severity $t = 1.08$, *ns*; preferred treatment method ² (1, N = 95) = 1.16, *ns*.

101. See GREEN, *supra* note 80.

extent to which the actor was causing harm. All of these questions were answered on seven-point scales ranging from one (Not at all) to seven (Very much). We took three of the scenarios from previous studies: the CEOs of both the acquired and acquiring companies and the ballgame case. For each of these, we specified in the question whether the actor had a relationship to the company in question.

We also added a novel case in which an investment analyst with no connection to either firm was able to predict the merger using sophisticated and expensive computer software. This case allows us to assess how participants feel about actors who acquire substantial and quasi-exclusive informational advantages, but do so within the generally accepted rules.

1. Study 3 Method

We recruited 132 subjects for this study, once more drawing our pool from Amazon's Mechanical Turk service. Data from six individuals were discarded due to an abnormally fast completion time (less than half the median) or incorrectly answering a question intended to screen inattentive participants. Of the remaining 126 participants (forty-four male, eighty-two female), the median age was thirty-seven. Of the participants, 41% had college degrees.

The procedure for this study varied slightly from those of the previous two. Given the expanded list of dependent measures for each scenario, it was necessary to present each one in isolation. The small number of scenarios allowed for use of a Latin square ordering system, and four orders were created, allowing each scenario to be presented first in one instance. These orders were contrasted in analysis and no differences emerged.

As in Study 2, the criminalization question included a civil punishment option.

2. Study 3 Results

Table 3 shows that the broad patterns of the blameworthiness, criminality, and punishment severity measures on the three repeated scenarios were the same as in Study 2: the ballgame case was seen as distinct from the two executive cases, which in turn did not differ.¹⁰²

102. ANOVA statistics for this comparison are presented in the table. On the categorical criminality data, the person overhearing at the ballgame was treated more leniently than the executive of the acquiring company, $F(1, N = 120) = 73.80, p < .001$, or the executive of the acquired company, $F(1, N = 121) = 72.63, p < .001$.

The savvy investor scenario was seen as less deserving of punishment than even the ballgame case, with the overwhelming majority of participants stating that the investor's conduct should be permissible.¹⁰³

The novel dependent measures were interesting for the differences they did not show. Across scenarios, these measures tracked the blameworthiness and punishment severity measures. The two CEO cases, attracting the highest blameworthiness ratings, were also rated as wronging the other investors and the shareholders of each company to the greatest extent, being the most unfair, violating the most obligations, and causing the most harm. Interesting for our purposes, however, was the lack of distinction between these measures. If one party was seen as being wronged, all three parties were. If an obligation to one company was breached, the obligation to the other company was also breached. If obligations were breached, conduct was viewed as unfair, and vice versa.¹⁰⁴ In fact, the only noticeable variation from this pattern involved the two CEOs. The acts of the CEO of the acquiring company were judged more wrongful and blameworthy than the acts of the other CEO. This difference is small, however, and may not be meaningful.

One might have expected that the CEO of the acquiring company would be seen as having, and therefore breaching, a duty to his own company, but not to the other company, and likewise for the CEO of the acquired company. Also, the person overhearing details of the merger at a ballgame might be expected to have a duty to the acquiring company because he heard the information from that company's employees, but not to the acquired company. Instead we find a near complete lack of discrimination. The traders are either doing something that is morally permissible (the savvy investor), morally grey (the ballgame), or morally wrong (the CEOs). Distinguishing who was being wronged, and how, was apparently less possible or less important in the minds of our participants. This result is not necessarily surprising. People often have substantial difficulty reporting the ra-

103. ANOVA statistics for this comparison are presented in the table. On the categorical criminality data, the savvy investor was treated more leniently than the executive of the acquiring company, $\chi^2(1, N = 121) = 89.06, p < .001$, the executive of the acquired company, $\chi^2(1, N = 122) = 86.43, p < .001$, or the person overhearing at the ballgame $\chi^2(1, N = 122) = 16.33, p < .001$.

104. The correlations between all of the dependent measures were quite high, with all of the novel measures correlating at least .50 with each of the three primary outcomes.

tionales for intuitive judgments.¹⁰⁵ In fact, it is arguably more common for people to form moral judgments based on intuitive feelings and only later create rules to justify their decisions than to have rules and form judgments based on their application.¹⁰⁶ It is possible that, in this case, participants were well aware of the conclusion they wished to draw—that some of the conduct described was cheating and that that was wrong—and simply chose every explanation supporting that result.

105. See Richard E. Nisbett & Timothy D. Wilson, *Telling More Than We Can Know: Verbal Reports on Mental Processes*, 84 PSYCHOL. REV. 231, 232 (1977).

106. See Jonathan Haidt, *The Emotional Dog and Its Rational Tail: A Social Intuitionist Approach to Moral Judgment*, 108 PSYCHOL. REV. 814, 814 (2001).

Table 3. Ratings of Study 3 Scenarios

	Savvy Investor	Ballgame	CEO Acquiring	CEO Acquired	
Blameworthiness	1.89 _a (1.61)	3.08 _b (1.86)	5.51 _c (1.86)	5.45 _c (1.87)	$F(2, 258) = 177.82 p < .001$
Punishment	1.47 _a (1.21)	2.10 _b (1.50)	4.59 _c (1.88)	4.59 _c (1.90)	$F(2, 227) = 175.41 p < .001$
Wrong Investors	1.88 _a (1.54)	3.02 _b (1.89)	5.13 _c (1.52)	5.06 _c (1.50)	$F(2, 295) = 164.52 p < .001$
Wrong Acquiring	1.69 _a (1.34)	2.79 _b (1.75)	4.89 _c (1.69)	4.49 _b (1.76)	$F(2, 312) = 137.21 p < .001$
Wrong Acquired	1.78 _a (1.49)	2.76 _b (1.82)	4.86 _c (1.62)	4.69 _a (1.71)	$F(2, 315) = 141.73 p < .001$
Unfair Advantage	2.58 _a (1.87)	4.11 _b (2.10)	5.85 _c (1.25)	5.67 _a (1.33)	$F(2, 277) = 137.59 p < .001$
Obligation Acquiring	1.74 _a (1.51)	2.78 _b (1.93)	5.68 _c (1.42)	5.07 _b (1.80)	$F(2, 308) = 190.53 p < .001$
Obligation Acquired	1.76 _a (1.52)	2.75 _b (1.90)	5.23 _c (1.73)	5.47 _c (1.63)	$F(2, 322) = 186.01 p < .001$
Caused Harm	2.10 _a (1.59)	2.97 _b (1.77)	5.10 _c (1.53)	5.06 _a (1.54)	$F(2, 286) = 149.29 p < .001$

Criminalization Results

Permissible	83%	60%	12%	12%
Given Civil Penalty	11%	33%	44%	44%
Punished Criminally	3%	4%	40%	41%

Standard deviations are in parentheses. Blameworthiness and punishment scores are on scales ranging from 1-7. Degrees of freedom for the ANOVAs modified with a Greenhouse-Geisser correction due to sphericity violations.

CONCLUSION

Our findings suggest a high degree of correlation, across several domains, between lay attitudes concerning insider trading and current law and practice.

In the view of our subjects, merely trading on the basis of an informational advantage not held by other traders does not make such trading blameworthy or deserving of punishment. For example, when a trader relied on non-confidential information obtained through his own research and skill, our subjects judged his conduct to be without blame, even if the information was not generally available to the public. Our subjects were only a bit more critical of the trader's behavior when he relied on (confidential) information obtained through chance (as when the information was overheard at a ball game or discovered in the back of a taxi). It was only when the trader obtained the confidential information in some presumably illicit manner, such as by appropriating it from his employer or client, that our subjects regarded it as clearly worthy of prohibition and censure.

Lay views also tracked current law and practice with respect to a number of narrower doctrinal and practice issues. For example, our subjects agreed with current practice at the SEC and DOJ that only insider trading resulting in a large amount of ill-gotten gains should result in criminal sanctions, while those trades resulting in comparatively small gains should be treated civilly. On the issue of tipper and tippee liability, the views of the lay public were also mostly congruent with current law. For example, if the tipper had selfish motives in giving information to a tippee, subjects deemed his conduct blameworthy. But if his motives were altruistic, the subjects did not blame him.

There is also another area in which we found a striking congruence between lay views and the law. As noted at the outset, courts, regulators, and commentators, while largely condemning insider trading, have struggled to define exactly who is wronged or harmed by such conduct, and have struggled to determine whether the answer to that question varies from case to case. In any given case, is the victim of insider trading the trader on the other end of the transaction? Is it the trading public at large? Is it the employer or other principal from whom confidential information is misappropriated? Although our subjects seemed to have strong intuitions that insider trading is wrong, they were unable to isolate the victim in one case from the victim in another. In an interesting turn, we think this result suggests that professionals and the lay public are united in their confusion over the rationale for prohibiting insider trading.