Trade Secrets and Secret Trading

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INTRODUCTION

Investment bankers, attorneys, and corporate officers are going to jail in recent years in increasing numbers for violating securities insider trading laws.[1] This has occasioned an outpouring of literature on the policies underlying the law enforcement campaign.[2]

Much of the debate has focused on the mechanics and scope of insider trading, its characterization as a social evil, and whether it actually constitutes a problem in the first place.[3] Controversy also

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1. *See, e.g., Levine Sentence Seen in Line with Insider-Trading Penalties*, N.Y.L.J., Feb. 24, 1987, at 1, col. 3; *Southern District Insider-Trading Defendants Prosecuted Since 1980*, N.Y.L.J., Feb. 24, 1987, at 17; *Trading Places*, TIME, Dec. 28, 1987, at 63 (Boesky sentencing).

2. *See, e.g.*, Lowenfels & Bromberg, *Insider Trading-Arguments In Favor of It and Against*, N.Y.L.J., Mar. 18, 1987, at 1, col. 3; *The SEC v. Wall Street?*, Wall St. J., May 28, 1986, at 34, col. 1; *Boesky the Terrible*, Wall St. J., Nov. 18, 1986, at 32, col. 1; COMM. ON CRIMINAL LAW OF THE ASS'N OF THE BAR OF THE CITY OF NEW YORK, FEDERAL CRIMINAL LIABILITY FOR INSIDER TRADING OF SECURITIES 32 (1986) [hereinafter N.Y.C. BAR REPORT]; Stigler, *Inside Traders and Traitors*, Chicago Tribune, July 7, 1986, § 1, at 9; DePetris & Summit, *The Insider-Trading Panic, Overlooked Elements of Scienter*, N.Y.L.J., Dec. 10, 1986, at 1, col. 3; Wallance, *Insider Trading — Objective Enforcement Standards Needed*, N.Y.L.J., Jan. 20, 1987, at 1, col. 3; Kohn, *Bar Council Panelists Split on SEC Record with Insiders*, N.Y.L.J., Feb. 11, 1987, at 1, col. 3; Leisure & Wilkinson, *Private Rights of Action Based on Insider Trading*, N.Y.L.J., Feb. 18, 1987, at 1, col. 3; Macey, *Too Strict a Crackdown Will Harm Markets*, Wall St. J., May 28, 1986, at 34, col. 4.

3. The articles and works on insider trading are too numerous to cite in toto. The seminal work on the subject is Dean Henry G. Manne's brilliant book, INSIDER TRADING AND THE STOCK MARKET, which argued that insider trading is a most effective method to compensate entrepreneurs. Manne also argued that "investors" who do not trade frequently seldom are harmed by inside information. He further argued that insider trading moved stock prices in the correct direction, and thus, improved the efficiency of stock markets. *See generally* H. MANNE, INSIDER TRADING AND THE STOCK

surrounds the proper definition of insider trading.[4] Finally, disagreement exists over the applicability of the federal securities anti-fraud statutes to insider trading.[5] This Article will advance the concept that insider trading law under Securities and Exchange Commission (SEC) rule 10b-5 is in reality a form of protection of property rights in information. The Article develops the relationships between trade secrets law and rule 10b-5 doctrine, and indeed concludes that the securities law of insider trading may be viewed as a form of trade secrets law.

The Rationale Behind The Rules

There are two basic types of insider trading cases. Each has a separate and distinct fact pattern. In Case I, a corporate officer or director trades in the stock of his corporation without advance disclosure of a material nonpublic piece of information about the corporation, developed or learned in the course of his employment.[6]

MARKET (1966); *see also* Manne, *Insider Trading and the Law Professors*, 23 VAND. L. REV. 547 (1970).

For more recent literature, *see, e.g.*, Carney, *Signaling and Causation in Insider Trading*, 36 CATH. U.L. REV. 863 (1987); Cox, *Insider Trading and Contracting: A Critical Response to the "Chicago School,"* 1986 DUKE L.J. 628; Dooley, *Enforcement of Insider Trading Restrictions*, 66 VA. L. REV. 1 (1980); Carlton & Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857 (1983); Brudney, *Insiders, Outsiders and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322 (1979); Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 SUP. CT. REV. 309 [hereinafter Easterbrook, *Insider Trading*]; Easterbrook, *Insider Trading As An Agency Problem*, in PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 81 (J. Pratt & R. Zeckhauser eds. 1985); Haft, *The Effect of Insider Trading Rules on the Internal Efficiency of the Large Corporation*, 80 MICH. L. REV. 1051 (1982); Kitch, *The Law and Economics of Rights in Valuable Information*, 9 J. LEGAL STUD. 683 (1980); Levmore, *Securities and Secrets: Insider Trading and the Law of Contracts*, 68 VA. L. REV. 117 (1982); Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9 (1984); Macey & Haddock, *Regulation on Demand: The Influence of Special Interest Groups on SEC Enforcement of Insider Trading Rules*, 30 J.L. & ECON. 311 (1987); Scott, *Insider Trading: Rule 10b-5, Disclosure and Corporate Privacy*, 9 J. LEGAL STUD. 801 (1980); Wang, *Trading on Material Non-Public Information on Impersonal Stock Markets: Who is Harmed and Who Can Sue Whom Under SEC Rule 10b-5?*, 54 S. CAL. L. REV. 1217 (1981).

Economists have studied the subject. *See, e.g.*, Lorie & Niederhoffer, *Predictive and Statistical Properties of Insider Trading*, 11 J.L. & ECON. 35 (1968); Jaffe, *Special Information and Insider Trading*, 47 J. BUS. 410 (1974); Givoly & Palmon, *Insider Trading and the Exploitation of Insider Information: Some Empirical Evidence*, 58 J. BUS. 69 (1985); Seyhun, *Insiders' Profits, Costs of Trading and Market Efficiency*, 16 J. FIN. ECON. 189 (1986).

4. *See, e.g.*, sources cited in note 3, *supra*; *see also* Fed. L. Rep. (CCH) ¶ 1261, Nov. 25, 1987, at 122 (describing SEC's letter to Senate Subcommittee on Securities, Nov. 19, 1987, proposing definition of insider trading); *see also infra* note 21.

5. *See infra* note 116.

6. *See, e.g.*, Securities and Exchange Comm'n v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (en banc), *cert. denied*, 404 U.S. 1005 (1971).

This usually triggers an application of rule 10b-5.[7] If a tender offer is involved, it may also constitute a violation of rule 14e-3.[8] As this paper subsequently discusses, there is a considerable body of scholarly debate as to whether shareholders or insiders can most efficiently use or dispose of that information.[9] A typical fact pattern might involve a situation in which officers and geologists of a mineral corporation, through research and scientific work, learn that valuable mineral ore exists in certain Canadian real estate.[10] The corporation plans to acquire real estate through purchase from the present owners. The corporation, needless to say, does not disclose its information to the prospective sellers. Corporate officers and directors in possession of this material inside information purchase shares of common stock on the New York Stock Exchange without advance disclosure of the information. They sell at a profit after the news of the discovery is made public. In construing rule 10b-5, the courts have held that since the insiders have a fiduciary relationship to their corporation's shareholders they owe an affirmative duty to disclose the inside information a reasonable time before trading.[11] However, if a stranger to the corporation, through her own research (and not through tips from the insiders), learned of the geological news, she would be free to trade without disclosure since she lacked any fiduciary relationship to the sellers on the other side of her purchases. As we shall see later, the reference to fiduciary relationship needs explication since the term has acquired a meaning which describes the obligations that arise because of certain underlying policy concerns with property interests in information.[12] Where the facts involve a tender offer, rule 14e-3 will be triggered, which does not require a breach of fiduciary relationship to sustain a civil or criminal action for the trading.[13]

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7. *See generally id.*

8. *See* 17 C.F.R. § 240.14e-3 (1987); *see infra* note 13.

9. *See supra* note 3; *see infra* notes 90-91. *See also Report of the Task Force on Regulation of Insider Trading*, 41 BUS. LAW 223, 227 & n.6 (1985); Carney, *Why Insider Trading Should Be Legal*, INV. DEALERS' DIG., June 2, 1986, at 44; *The SEC v. Wall Street?*, Wall St. J., May 28, 1986, at 34, col. 1.

10. The fact pattern generally parallels that of the *Texas Gulf Sulphur* case. *See Texas Gulf Sulphur*, 401 F.2d 833.

11. *See, e.g.*, Dirks v. Securities and Exchange Comm'n, 463 U.S. 646 (1983); Chiarella v. United States, 445 U.S. 222 (1980).

12. *See* Easterbrook, *Insider Trading*, *supra* note 3, at 317-23.

13. *See* N.Y.C. BAR REPORT, *supra* note 2, at 10 (Dec. 1986).

> [R]ule 14e-3 promulgated by the SEC under the power granted to it by section 14(e) of the Exchange Act to prevent fraud in connection with tender offers, retains the *possession* theory by prohibiting trading by those possessing non-

In Case II, a noncorporate insider filches material nonpublic information affecting the stock of the corporation, sometimes from his employer, and trades on it.[14] Rule 10b-5 or rule 14e-3 may also apply to these facts. A typical example might involve a printer's employee who learns that X corporation eventually may bid for the stock of Y corporation. In violation of the printer's policy, the employee buys stocks of Y and sells at a profit when the bid is formally announced. Since she has no fiduciary duty to the shareholders of Y corporation, she has no rule 10b-5 duty to disclose the information. However, courts have held that since the employee owes a duty to her employer or its client not to trade on information that she acquires in the course of her employment, she has misappropriated information in connection with a purchase or sale of stock; hence she has criminally violated rule 10b-5.[15] If rule 14e-3 applies to the transaction, however, no fiduciary relationship to anyone is required.[16] Thus, if both the printer and client, for their own reasons, consent to the employee's trading, the analysis for a rule 10b-5 violation ends, but not the analysis for a rule 14e-3 violation.

United States v. Chiarella[17] represents a famous example of Case II. In *Chiarella*, the printer's employee decoded material about future takeovers and mergers planned by bidders who were customers of the printer's employer. The bidders delivered the bidding materials to the printer in coded form to preserve the confidentiality of the targets' identities prior to public filing with the SEC. The employee traded on that information. The Supreme Court overturned his criminal conviction, reasoning that because he had no relationship to the target companies he had no fiduciary relationship to its shareholders.[18] Therefore, he had no affirmative obligation to disclose the names of the target corporations before he traded in their stock. However, the Court reserved decision on future cases that specifi-

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> public information of impending tender offers. Section 14(e), however, like § 10(b), is directed at fraud rather than unfairness. This raises doubts about the SEC power under § 14(e) to make a rule that reaches beyond the fiduciary duty theory of *Chiarella.*

Id. (footnotes omitted) (emphasis added).

14. *See, e.g.*, United States v. Carpenter, 791 F.2d 1024 (2d Cir. 1986), *aff'd*, 108 S. Ct. 316 (1987); United States v. Newman, 664 F.2d 12 (2d Cir. 1981), *cert. denied*, 464 U.S. 863 (1983); *see infra* note 21.

15. *See* United States v. Newman, 664 F.2d 12 (2d Cir. 1981). In private civil actions for damages, the standing requirement prevents suits by plaintiff purchasers or sellers of stock since they cannot show that the defendants have a fiduciary duty to them. That standing requirement is not essential in criminal or SEC enforcement cases. *See* Moss v. Morgan Stanley, Inc., 719 F.2d 5 (2d Cir. 1983), *cert. denied sub. nom.* Moss v. Newman, 465 U.S. 1025 (1984).

16. *See* Exchange Act Release No. 17,120, 1980 Fed. Sec. L. Rep. (CCH) ¶ 82,646 (Sept. 4, 1980).

17. 445 U.S. 222 (1980).

18. *Id.* at 224-25, 235-37.

cally charged to a jury that someone in the employee's position had wrongfully misappropriated information belonging to his employer or his employer's customers in connection with stock trading.[19] A number of courts of appeals have approved the misappropriation doctrine.[20] Most recently, the Supreme Court split 4-4 on the question of the viability of the misappropriation doctrine in the case of *Carpenter v. United States*.[21]

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19. *Id.* at 236-37.

20. *See, e.g.*, SEC v. Materia, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053 (1985);

21. 108 S. Ct. 316 (1987). In this decision, Petitioner R. Foster Winans, a Wall Street Journal employee, coauthored the highly regarded Journal column, "Heard on the Street." Because of its reputation, the column had an impact on the prices of securities it discussed. Winans entered into a scheme with stockbrokers who, in exchange for leaks on the contents and timing of the column, would trade in the stocks and share profits with him. The articles did not contain confidential inside information about the corporations discussed therein. The newspaper had a policy, known to Winans, forbidding such use or disuse of the contents and timing of the articles. Winans and petitioner Kenneth Felis were convicted of violating section 10(b) of the Security Exchange Act of 1934 and rule 10b-5 thereunder, as well as the federal mail and wire fraud statutes. The convictions of these two and certain others were affirmed, with some minor exceptions, by the Second Circuit. United States v. Carpenter, 791 F.2d 1024, 1036 (2d Cir. 1986), *cert. granted*, 107 S. Ct. 666 (1987).

The lower courts found that Winans had "knowingly breached a duty of confidentiality by misappropriating prepublication information regarding the timing and contents of the 'Heard' columns . . . ." 108 S. Ct. at 319. The Supreme Court pointed out that "[i]t was this appropriation of confidential information that underlay both the securities laws and mail and wire fraud counts." *Id.*

The Court split 4-4 on the securities laws convictions. Hence, it affirmed the judgment below on those counts. The Court unanimously upheld the mail and wire fraud convictions. *Id.* at 320.

The split vote leaves the final resolution of the misappropriation doctrine in securities laws undecided, awaiting either judicial or legislative resolution. The unanimous vote in favor of the mail and wire fraud convictions was based upon a property analysis, which is similar to the analysis of rule 10b-5 doctrine set forth in this Article.

The Court held that in the wire and mail fraud counts, Winans had fraudulently misappropriated property within the intent of the statutes. *Id.* at 322. Petitioners, citing McNally v. United States, 107 S. Ct. 2875 (1987), had argued that "the Journal's interest in prepublication confidentiality for the 'Heard' columns is no more than an intangible consideration outside the reach of section 1341 . . . ." 108 S. Ct. at 320. The Supreme Court disagreed, ruling that "[c]onfidential business information has long been recognized as property." *Id.*

The Court also discussed the need to prove harm, a matter considered in this Article. The Court ruled that "[p]etitioners cannot successfully contend based on [International News Service v. Associated Press, 284 U.S. 215 (1918)] that a scheme to defraud requires a monetary loss, such as giving the information to a competitor; it is sufficient that the Journal has been deprived of its right to exclusive use of the information, for exclusivity is an important aspect of confidential business information and most private property for that matter." 108 S. Ct. 321.

This last point indicates that the illustrations discussed in the text (*see infra* notes 83-89 and accompanying text) on insider stock trading on trade secrets without corporate

In both types of securities fraud cases, imposition of civil or criminal penalties turns on the use or misuse of confidential information. We can gain a greater understanding of the true nature of securities law in this area if we analyze property concepts in information, particularly those bearing on trade secrets law. This analysis will reveal that insider trading law can properly be regarded, to a considerable degree, as an effort to protect corporate property rights in information.[22] To the extent that is true, the corporation owner of the property right in information (as the owner of any other property right) should be free to decide through usual corporate modes of decision-making whether to keep the property or transfer it to insiders or others.

In the Case II securities transaction, avoiding harm to public trading shareholders is not the rationale for the securities law prohibition, insofar as rule 10b-5 is concerned, since consent by the em-

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consent may involve criminal violation of mail and wire fraud statutes despite lack of proof of monetary harm. Further, the Court's discussion, certainly by strong implication at least, indicates that no monetary harm need be proven for trade secret law violation.

It is also significant that the Court appeared to approve of the controversial duty of loyalty case, Diamond v. Oreamuno, 24 N.Y. 2d 494, 301 N.Y.S.2d 78, 248 N.E.2d 910 (1969), which upheld an insider trading derivative suit on state duty of loyalty grounds in the absence of proof of monetary harm to the corporate issuer (*see infra* note 89 and accompanying text). The Supreme Court stated, citing *Diamond*, "As the New York courts have recognized, 'It is well established, as a general proposition, that a person who acquires special knowledge or information by virtue of a confidential or fiduciary relationship with another is not free to exploit that knowledge or information for his own personal benefit but must account to his principal for any profits derived therefrom.' " 108 S. Ct. at 321.

The failure to resolve the rule 10b-5 misappropriation theory, because of the split vote, will be most significant in civil cases. Individual plaintiffs and the SEC will not have the benefit of a high court resolution. If the U.S. government wishes to prosecute criminally, it now can use the mail and wire fraud statutes for virtually every case of securities fraud.

Finally, it is of note that on November 19, 1987, the SEC transmitted legislation to define and prohibit insider trading. As reported in the Corporate Counsel Weekly, the SEC would include the phrases "misappropriation" and "conversion" in the bill's definition of insider trading violations. Corp. Counsel Weekly (BNA), No. 46, at 2 (Nov. 25, 1987). As reported in the November 25, 1987 CCH Federal Securities Law Reports, the ". . . proposal would prohibit persons from trading or causing trading of, any security while in possession of material nonpublic information when they know or recklessly disregard that the information has been 'obtained wrongfully' or that the trade would constitute a 'wrongful use' of the information. This would occur if the information has been obtained by or its use would constitute (A) theft, bribery, misrepresentation or espionage or (B) conversion, misappropriation, breach of any other fiduciary duty or breach of other relationships." Fed. Sec. Rep. (CCH) ¶ 1261 pt. 1, at 1 & 2 (Nov. 25, 1987). The SEC proposal also includes express private rights of action for "contemporaneous traders and for other persons who are injured by violations . . . ." *Id.* at 2.

22. Three exceptionally good earlier analyses of the implications of corporate property interests in insider information are Carlton & Fischel, *supra* note 3; Easterbrook, *Insider Trading*, *supra* note 3; Macey, *supra* note 3.

ployer will vitiate a securities law action.[23] The rule 10b-5 violation turns on the defendant employee's (or agent's) misappropriation of confidential information belonging to the employer (or principal). Clearly, the employer's property right in the information is being protected, not the interest of trading shareholders. However, rule 14e-3 prohibits trading on inside information by the employee tippee, or any other tippee, bearing on tender offers, even where the employer (or principal) voluntarily gives the information to the defendant tippee. In formulating this rule, the SEC departs from a "property theft" theory and instead relies exclusively on a "harm to public traders" theory.

In the Case I transaction, the rationale usually given in applying rule 10b-5 is to protect individual trading shareholders from harm by their fiduciary. The stated theory of the case insofar as rule 10b-5 is concerned turns on the existence of a fiduciary relationship of insider to shareholders and a violation of that relationship by an act of trading without disclosure of the inside information.[24] However, the fiduciary relationship lends itself to a property explanation. The law does not require the insider, in the absence of inside information, to first share his superior investment skill, if he has it, with shareholders before trading with them. The violation of the fiduciary relationship results from the insider using property information belonging to the corporation, his employer, for his own benefit.

Therefore, where the information is initially property of the corpo-

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23. *See infra* notes 90-94 and accompanying text; *see also* N.Y.C. BAR REPORT, *supra* note 2, at 13 ("although it can be argued that the federal securities laws should only protect purchasers or sellers of securities, the SEC and federal prosecutors have pursued novel theories of fiduciary duty and misappropriation that focus on other parties.") (footnote omitted).

24. The SEC promulgated rule 10b-5 in 1942 under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982). 17 C.F.R. § 240.10b-5 (1987). The rule was utilized against insiders very quickly. *See In re* The Purchase and Retirement of Ward La France Truck Corp. Class A and Class B Stocks, 13 S.E.C. 373 (1943). However, until 1961 its application apparently was restricted to failures to disclose in face-to-face transactions between insiders and stockholders. *See* Wilkinson, *The Affirmative Duty to Disclose After* Chiarella *and* Dirks, 10 J. CORP. L. 581, 583-85 (1985). In the famous SEC case *In re* Cady, Roberts Co., the SEC decided in 1961 that rule 10b-5 applied to nondisclosure of material inside information in impersonal transactions in the open market. 40 S.E.C. 907 (1961). In *Texas Gulf Sulphur*, the court stated that the doctrine "is based on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information." 401 F.2d 833, 848 (2d Cir. 1968) (en banc), *cert. denied sub. nom.* Coates v. SEC, 394 U.S. 976 (1969). In *Chiarella*, the Supreme Court made it clear that the duty to disclose was not based upon the mere possession of inside information. The Court held that there must be a relationship of trust between the parties before a duty to disclose can emerge. *See* 445 U.S. 222, 232-33 (1980).

ration, if the corporation has granted or transferred its property right in the information to insiders, it appears difficult for trading shareholders to argue that they have suffered legally cognizable harm because through board or shareholder vote, they have transferred their rights in the information. The wisdom of the corporate decision in that regard will turn on the efficiency of insider trading as a form of compensation to insiders versus the danger that insider trading will prematurely signal the existence of the confidential information to competitors.[25]

Again, rule 14e-3, unlike rule 10b-5, may impose penalties in certain cases involving tender offer information even where the issuer permits the insider or tippee to use the information. That rule obviously is not based upon a notion of property rights in information and the illegality of theft of information.[26]

TRADE SECRETS LAW

An understanding of trade secrets law provides an important key to the understanding of insider trading law. It will support the principal arguments of this Article that (1) rule 10b-5 insider trading law, to a considerable extent, is a subset of trade secrets law; and (2) when inside information is initially property of the corporation, the corporation's management, pursuant to accepted notions of the business judgment rule,[27] should be free to retain or transfer the right to use inside information, as it can any trade secret. Further, an application of trade secrets law to insider trading cases indicates that in certain situations the insider, not the corporate employer, is the rightful initial owner of the information.

In the United States two bodies of law protect business ownership of confidential information from an unauthorized taking. One is patent law.[28] It requires disclosure of the information in return for protection of a limited duration.[29] The other is trade secrets law.[30]

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25. *See infra* note 84 and accompanying text.
26. *See infra* notes 140-155 and accompanying text.
27. *See infra* notes 101-114 and accompanying text.
28. *See infra* notes 32-35 and accompanying text.
29. *See infra* note 35.
30. Firms whose success depends upon the use of secret information run the risk that theft of such data will cause enormous losses. The risks of such loss have been magnified in recent years by the rise of sophisticated industrial espionage and employee mobility. Advanced methods of electronic spying increase the risks of theft. Contributing to the danger is the greater frequency with which key executives switch jobs and take confidential information with them to the new employer.

One authority recently has stated:

> The first half of the 1980's has witnessed a veritable explosion of the misappropriation of trade secrets. Such misappropriation costs American businesses, it has been said, up to 20 billion dollars annually. Even more harmful is that it contravenes the public's interest in encouraging research and innovation by reducing incentives to develop new technology . . . . Consequently, it is of para-

Trade secrets law protects information even where it is not novel enough to enjoy patent protection.[31] The protection lasts for an indefinite duration provided the information remains secret.[32]

Trade secrets law operates to protect information that is corporate property. Sometimes the information may also be protectable by patent law. However, the corporation may choose the trade secret route since the legal protection continues indefinitely so long as the information is kept secret. Patent law requires publication of the information and has a limited duration.[33]

The National Conference of Commissioners on Uniform State Laws stated in connection with the Uniform Trade Secrets Act:[34]

> A valid patent provides a legal monopoly for seventeen years in exchange for public disclosure of an invention. If, however, the courts ultimately decide that the Patent Office improperly issued a patent, an invention will have been disclosed to competitors with no corresponding benefit. In view of the substantial number of patents that are invalidated by the courts, many businesses now elect to protect commercially valuable information through reliance upon the state law of trade secret protection. Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470 (1974), which establishes that neither the Patent Clause of the United States Constitution nor the federal patent laws preempt state trade secret protection for patentable or unpatentable information may well have increased the extent of this reliance.[35]

Trade secrets are information that derive economic value from secrecy. An extremely wide variety of knowledge or information is protectable as a trade secret. The definition includes knowledge of technological processes, as well as nontechnological business information such as pricing, cost codes, and marketing techniques.[36] Under the Uniform Trade Secrets Act, episodic single event information, negative information, and information of potential value are included.[37]

> mount importance for firms . . . to know what rights they have under the law. . . .

Hutter, *Legal Theories and Recent Developments*, in 1986 PROTECTING TRADE SECRETS 13 (Practising Law Institute) (footnotes omitted).

31. *See* Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470 (1974).

32. *See* HOFER, TRADE SECRETS: PROTECTION AND REMEDIES, A-3 (Bureau of Nat'l Affairs 1985).

33. *See infra* note 35 and accompanying text.

34. Subsequent to adoption by the Commissioners on Uniform State Laws (Commissioners) in 1979, versions of the act have been adopted in 19 states. Silberberg & Lardiere, *Eroding Protection of Customer Lists Under the Uniform Trade Secrets Act*, 42 BUS. LAW. 487, 488 (1987).

35. UNIF. TRADE SECRETS ACT, Comm'rs' Prefatory Note, 14 U.L.A. 537 (1980).

36. *See* Hutter, *Trade Secret Law: Theories and Context*, in 1985 PROTECTING TRADE SECRETS 12 (Practising Law Institute).

37. The Uniform Trade Secrets Act (the Act) defines a trade secret as:

> information, including a formula, pattern, compilation, program, device, method, technique, or process that:

Trade secrets cannot be misappropriated[38] by employees or others without the imposition of civil or criminal penalties.[39] Since trade secrets are considered property,[40] they are protected by the fifth amendment of the United States Constitution from unlawful taking by the government.[41] Moreover, a trade secret owner has the power

(i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and
(ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

UNIF. TRADE SECRETS ACT § 1(4), 14 U.L.A. 541, 542 (1985).

At common law, the most often used definition of trade secret was set forth in the 1939 Restatement of Torts. It read in part: "A trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it." RESTATEMENT OF TORTS § 757 comment b, at 5 (1939).

The Commissioners pointed out that the definition of trade secret in the Act contains a reasonable departure from the Restatement of Torts (First) definition which required that a trade secret be "continuously used in one's business." The broader definition in the proposed Act extends protection to a plaintiff who has not yet had an opportunity or acquired the means to put a trade secret to use. The definition includes information that has commercial value from a negative viewpoint, for example the results of lengthy and expensive research which proves that a certain process will *not* work could be of great value to a competitor.

UNIF. TRADE SECRETS ACT, Comm'rs' comment, 14 U.L.A. at 543 (1980).

38. The Commissioners point out that "[f]or liability to exist under this Act, a section 1(4) trade secret must exist and either a person's acquisition of the trade secret, disclosure of the trade secret to others, or use of the trade secret must be improper under section 1(2)." UNIF. TRADE SECRETS ACT, Comm'rs' prefatory note, 14 U.L.A. at 538 (1985). Wrongful taking is defined in this note as misappropriation. *Id.*

"Misappropriation" means:
(i) acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means; or
(ii) disclosure or use of a trade secret of another without express or implied consent by a person who
(A) used improper means to acquire knowledge of the trade secret; or
(B) at the time of disclosure or use, knew or had reason to know that his knowledge of the trade secret was
(I) derived from or through a person who had utilized improper means to acquire it;
(II) acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or
(III) derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limits its use; or
(C) before a material change of his position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.

UNIF. TRADE SECRETS ACT § 1(2), 14 U.L.A. 537, 541-42.

39. *See infra* notes 47-50.

40. In one of the standard treatises on trade secrets, the author states that "[r]ecognition of trade secrets as property is a basic conceptual step from which important aspects of trade secret law are derived. 1 R. MILGRIM, MILIGRIM ON TRADE SECRETS, § 1.01, at 1-2 (1987). The author argues that this view "characterizes as 'property' the bundle of rights of the owner of a trade secret." *Id.* The author concludes, "The right to prevent unauthorized use or disclosure" is one of those rights." *Id.*

41. *See* Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1003-1004 (1984) (a state-

and the right to sell his secret.[42] Trade secrets include material that is not protected by patent, although trade secret protection frequently may extend to arrangements of information that is also protectable by patent law.[43]

Insider trading law turns in part on the concept of material secret information.[44] Any confidential information that may reasonably have an impact upon the price of the stock if known or disclosed will be considered material.[45] Trade secrets probably denominate a category of information that is of narrower scope than securities law notions of material information. But clearly an enormous overlap of the two categories exists.

Trade secrets law is a subset of intellectual property law. In existence are well established doctrines of patent and trademark that protect new forms of information. The reason for the development of trade secrets law appears to be that its flexible definition of protected information and indefinite period of protection have proved best suited to meet the demands of business in a time of rapidly changing technology. The burgeoning computer programs and semiconductor industries are prime examples of businesses that require trade secret protection.[46] Trade secrets law provides the necessary inducement to business to research, innovate, and develop new ideas. The business or individual owner may lease or grant the property right to others as it pleases.

Under certain circumstances an employee who takes his employer's trade secret commits a crime as well as a civil wrong under

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accepted property right in a trade secret would be protected by the fifth amendment takings clause).

42. *See* Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470, 493 (1974).

43. *See supra* note 35 and accompanying text.

44. *See, e.g.*, Chiarella v. United States, 445 U.S. 222 (1980).

45. The duty to disclose under rule 10b-5 arises only if the information is material. *See, e.g.*, *Texas Gulf Sulphur*, 401 F.2d at 848-50; List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965). The test of materiality is broad. In TSC Industries, Inc. v. Northway, the Supreme Court asserted:

> An omitted fact is material if there is a substantial likelihood that a reasonable [investor] would consider it important in [making his or her investment decisions] . . . . Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.

426 U.S. 438, 449 (1976).

46. *See supra* note 30. A number of Supreme Court decisions have restricted the use of patents to computer programs. *Compare* Gottschalk v. Benson, 409 U.S. 63 (1972) (no patent protection) *and* Parker v. Flook, 437 U.S. 584 (1978) (no patent protection) *with* Diamond v. Diehr, 450 U.S. 175 (1981) (giving patent protection).

state law.[47] The question in each state will be whether the general statutes on larceny, embezzlement, and robbery cover trade secret misappropriation. That question raises the issue of whether the term "property" in the general criminal statute encompasses trade secrets.[48] Alternatively, there may be a specific trade secret crime statute in the jurisdiction.[49] Certain federal statutes make theft of trade secrets a crime.[50]

Commercial Bribery Statutes

Commercial bribery statutes also play a role in protecting corporate rights to information. For example, in *Perrin v. United States*,[51] petitioner (among others) was convicted of violating and conspiring to violate the Travel Act,[52] which makes it a federal offense to travel or use a facility in interstate commerce to commit, *inter alia*, "bribery . . . in violation of the laws of the state in which committed."[53] In that case Perrin and others attempted to steal key mineral exploration facts from a Louisiana-located company. They approached Roger Willis, an employee of the company, and asked him to filch the information in return for a percentage of the profits from a corporation which was formed to use the stolen data.[54]

Willis tipped off the FBI. The Supreme Court ultimately held in the case that the term "bribery" in the federal Act included payments to private individuals to influence their actions.[55] The Louisiana statute provided in part that "commercial bribery is the giving . . . of . . . value to any private agent, employee, or fiduciary, without the knowledge and consent of the principal or employer, with the intent to influence such agent's, employee's, or fiduciary's action in relation to the principal's or employer's affairs."[56]

The similarity of the principles that the Court upheld in the *Perrin* case to principles which insider misappropriation of information rules are aimed to protect is apparent. Likewise the trade secret definition of misappropriation (including its reference to tipping concepts)[57] resembles misappropriation doctrine in securities law. The difference, in part, lies in the fact that insider trading, where the

47. 1 R. MILGRIM, *supra* note 40, § 1.10, at 1-62.
48. *Id.*
49. *Id.*
50. *Id.* § 1.10[2], at 1-81. A comprehensive list of federal and state trade secret theft statutes is contained in Epstein, *Criminal Liability for the Misappropriation of Trade Secrets*, *reprinted in* 3 R. MILGRIM, *supra* note 40, app. B-5.
51. 444 U.S. 37 (1979).
52. 18 U.S.C. § 1952 (1976).
53. *Id.*
54. *Perrin*, 444 U.S. at 40.
55. *See id.* at 41-49.
56. LA. REV. STAT. ANN. § 14.73 (West 1974).
57. *See supra* note 38.

corporation does not consent to it, involves the misappropriation of information via one specific means, that of stock trading.

Coase's Theory

Coase's brilliant insight is very relevant at this point: Whether trade secrets or securities law denominated material information is more valuable to the firm and shareholders or more valuable to the management will determine (when transaction costs of negotiation are low) with whom the property right will ultimately rest.[58] Thus, in the absence of legal restraint, shareholders will transfer rights in inside information or trade secrets to managers if they are the higher valuing users. Particularly, if a corporation and its insiders mutually will gain by permitting insiders to trade on inside information, the corporation will transfer its ownership interest in the information to the insiders.

Trade secrets law permits corporate employers to transfer rights in secrets to others pursuant to mutually agreed upon contracts. Further, it is hardly clear whether and when the employer corporation or the employee (in the absence of explicit contracts) initially owns the trade secret.[59] The courts apply various tests that are frequently difficult to apply in a given setting.[60] Hence, trade secrets attorneys counsel their corporate clients to prepare and bargain for detailed contracts from key employees that clarify the employer's ownership rights in confidential information.[61]

In attempting to discover an implicit contract between employer and employee in the absence of explicit agreement, courts appear to balance the interest of the employer in developing innovative technology against the interest of employees in developing merchantable skills that can be marketed at some time in their careers with other employers.[62] Courts appear to discriminate between information disclosed to or learned by an employee in the course of her employment and information developed in whole or in part by the employee which is not connected with her specific job.[63] In the latter category, the employee, in certain circumstances, will be given initial property rights in the information. For example, where the employer has not

58. *See* Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).
59. *See generally* 1 R. MILGRIM, *supra* note 40, § 5.02.
60. *Id.* at 5-15 to 5-63.
61. *Id.* at 5-61.
62. *Id.* at 5-15 to 5-46.
63. *Id.* at 5-18, 5-46 to 5-63.

hired her to invent a specific device, yet the employee develops a valuable technique, the employee is more likely to prevail in litigation about the ownership of the trade secret.[64] With respect to the second category, one leading treatise goes so far as to assert that:

> inventions made by an employee, although made during the hours of employment and with the use of his employer's materials, facilities and personnel, are the employee's property unless by the terms of his employment, *or otherwise*, he agreed to transfer the ownership (as distinguished from the use) of such inventions.[65]

Even in the case of the first category above, courts may sometimes give an ex-employee property rights in information in order to facilitate her job mobility.[66]

Since there is some uncertainty in traditional trade secret law about who has initial ownership, the same legal question may arise in any insider trading case involving trade secrets, and perhaps in any insider trading case involving confidential information.

Inside Trading as Compensation

It has been argued that insiders should be granted rights by corporate employers to trade, as a more efficient form of compensation in lieu of traditional salary or bonus arrangements.[67] This approach arguably motivates insiders to create productive trade secrets that will benefit the corporation as well as the insiders. It may be asserted, however, that corporations (assuming the applicable legal doctrine places initial ownership of trade secrets or confidential information with the corporation) must be prevented by law from voluntarily transferring trade secrets to insiders as a form of compensation.[68] The argument is that the temptation of management to overreach is too great. In addition, the rewards of insider trading are difficult to measure, and corporations, lacking subpoena power, cannot adequately examine insider trading records. Thus, the corporations, it is asserted, seemingly lack ability to regulate, control, or assess the significance of such a compensation scheme.

However, the argument ignores that in certain cases corporate boards may reasonably decide that it is more efficient to award insiders compensation via insider trading rather than by salary or stock options. There is a vast amount of literature on the pros and cons of these arguments.[69] When the decisions are made by independent boards, the liberal business judgment rule applies and the directors

64. *Id.* § 5.02(4)(b), at 5-50.1 to 5-50.2.
65. *Id.* at 5-52 (footnote omitted).
66. *Id.* § 5.02(3).
67. *See supra* note 3 and *infra* note 90.
68. *See* Cox, *supra* note 3, at 653-55.
69. *See supra* note 3 and *infra* note 90.

are not liable for their mistakes provided they make reasonably informed decisions based on an adequate investigation of the facts.[70]

A flat ban would prevent boards from entering into transactions that they believe are more valuable to the corporation than traditional compensation. Thus, the ban would prevent mutually agreed upon transactions that are value increasing (that is, the corporation and the employee each value the result more than a traditional salary arrangement).

Some have argued that the corporate employer cannot know the costs and benefits of a contract awarding inside information to managers.[71] Hence, corporations should be banned from voluntarily entering into such a transaction. The argument is based in part upon the assumption that shareholders will not be able to quantify the benefits, if any, such as a more effective management, presumably resulting from permitting insiders to trade on inside information. This argument demands a higher degree of performance accuracy from managers compensated through inside trading than from more traditional modes of compensation. It is very difficult to quantify with any accuracy the exact relationship between management efficiency and a particular mode of salary or bonus arrangement; however, cash salary or bonus arrangements, as opposed to inside trading, do not make the computation of managerial efficiency any easier. Directors must be free to exercise their judgment and instinct, informed by records of corporate performance. In the last analysis the market will discipline the choice; share prices will be at a higher level if a more efficient compensation package is utilized.[72] Furthermore, the argument that the costs of insider trading compensation cannot be limited or scrutinized by the corporate employer is incorrect. Firms need not enforce contracts on insider trading as compensation with exact precision in order to benefit from permitting insiders to trade. To regulate the process, firms can require an audit of Schedule D of the manager's tax return and can impose sanctions such as liquidated damages and termination of employ-

70. *See* R. HAMILTON, CASES AND MATERIALS ON CORPORATIONS 633-99 (3d ed. 1986).

71. *See* Cox, *supra* note 3, at 649-53.

72. The Efficient Capital Markets Hypothesis establishes, *inter alia*, that all publicly available information about issuers is quickly reflected in stock prices. *See, e.g.*, Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970); Comment, *The Efficient Capital Market Hypothesis, Economic Theory and The Regulation of The Securities Industry*, 29 STAN. L. REV. 1031 (1977).

ment[73] to penalize a manager that violates the terms of the compensation agreement.

TRADE SECRETS LAW AND INSIDER TRADING

This section of the Article will examine the similarities and dissimilarities between insider trading doctrine and trade secrets law. It also will consider the applications of corporate law.

Insider trading law protects a shareholder or corporate interest in information that is "material."[74] Securities law defines "materiality" as protected information, just as the Uniform Trade Secrets Act defines information that is protected under the Act.[75] Accordingly, there must be many occasions when the definition of "material" overlaps with the traditional definitions of a trade secret.

Consider the case of a corporate officer or director who trades on material inside information like the scenario in the *Texas Gulf Sulphur* case mentioned earlier.[76] The corporation lawfully discovered the probable presence of valuable minerals in certain Canadian real estate and secretly bid for the mineral right to the property.[77] That is, it bid without revealing its discoveries to the prospective sellers of the land. Meanwhile, certain insiders or their tippees bought stock and calls without disclosing the geological finds to the traders on the other side of the market. The geological information was clearly a trade secret.[78] The stock trading was held a violation of SEC rule 10b-5.[79] Professor Kronman notes that with reference to the real estate transaction,

> in a litigated case arising out of a related transaction the Ontario High Court of Justice remarked that Texas Gulf Sulphur was only doing what any prudent mining company would have done to acquire property in which it knew a very promising anomaly lay when it purchased property "without causing the prospective vendors to suspect that a discovery had been made."[80]

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73. *See* Carlton & Fischel, *supra* note 3, at 864. Also, federal statutes could require reports on insider trading with civil and criminal penalties; these reports could be used by management to police and tailor insider trading for management compensation purposes.
74. *See supra* note 45.
75. *See supra* notes 36-37 and accompanying text.
76. *See supra* notes 6-10 and accompanying text.
77. *See Texas Gulf Sulphur*, 401 F.2d at 843-47; *see also supra* notes 10-11 and accompanying text.
78. *See* 1 R. MILIGRIM, *supra* note 40, § 6.02(2), at 6-26 (1986).
79. *See supra* note 24.
80. Kronman, *Mistake, Disclosure, Information, and the Law of Contracts*, 7 J. LEGAL STUD. 1, 20 (1978) (quoting from Leitch Gold Mines, Ltd. v. Texas Gulf Sulphur, 1 O.R. 469, 492-93 (1969)). Professor Kronman points out, "In order to encourage the production of such information [mineral research], our legal system generally permits its possessor to take advantage of the ignorance of others by trading without disclosure." Kronman, 7 J. LEGAL STUD. at 21.

If the corporate insiders had used their knowledge of the trade secrets personally to buy up real estate, hence making corporate real estate purchases in the area more expensive, this clearly would have been a violation of trade secrets law.[81] It probably would have served also as a violation of traditional corporate opportunity doctrine.[82] Now consider insider stock trading from the standpoint of the corporation where the corporation did not consent to it in advance. Did the insiders' use of trade secret information in the course of trading constitute a violation of trade secrets law? The argument might turn, in part, on the existence of harm to the corporation.[83] For example, there is the possibility the insider trading signaled the existence of the trade secret to outside competitors. By price movement and traders' talk, the trading may have leaked the inside news to the competition. Professor William Carney, in a recent article, demonstrates that this is a very unlikely scenario; nonetheless, it remains a possibility in a given case.[84] A plaintiff corporation that can prove that inside trading caused it harm by signaling the existence of the trade secret to competitors[85] has a prima facie trade secret case, as well as a shareholders' derivative suit based on duty of loyalty grounds, against the insiders.[86] Furthermore, to the extent there is such signaling, the secrecy of the trade secret may be impaired to the point at which the corporation would lose its property interest in it, since a condition to trade secrecy protection is the presence of reasonable precautions to preserve the secrecy of the information.[87] In *Texas*

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81. *See* 1 R. MILGRIM, *supra* note 40, § 6.02(2), at 6-26, 6-27 (1987).

82. *See* R. HAMILTON, *supra* note 70, at 748-68.

83. *See* R. MILGRIM, *supra* note 40, § 7.07(1), at 7-126 to 7-171 (1987). Plaintiff must prove that (1) it is the owner of a trade secret; (2) defendant wrongfully took the trade secret from plaintiff without plaintiff's authorization; (3) defendant's use of the trade secret is wrongful; and (4) defendant has used or disclosed the trade secret to plaintiff's detriment. *Id.* at 7-126 to 7-134.

84. *See* Carney, *supra* note 3. Professor Carney argues that absent leaks insider trading in and of itself does not cause investors to buy or sell shares in impersonal markets. He points out that in stocks with large numbers of shares outstanding, even institutions are able to transact large blocks without changing the price from the prior trade. *Id.* at 887. *See contra* Givoly & Palmon, *supra* note 3, who argue that their data shows that a large part of the stock market profits of insiders are due to the information disclosed through the trades. But Givoly and Palmon cannot explain why the greater signals of larger trades do not result in larger abnormal returns.

85. *See* Carney, *supra* note 3, at 873-74.

86. *See infra* note 89 and accompanying text. *See also* Macey, *supra* note 3, at 45.

87. Under section 1(4)(ii) of the Uniform Trade Secrets Act, the plaintiff seeking relief must have made "reasonable efforts" to maintain secrecy. The Commissioners state that "reasonable efforts" to preserve secrecy include "advising employees of the existence of a Trade Secret, limiting access to a Trade Secret on a "need to know" basis, and

Gulf Sulphur, harm would be proved if evidence indicated that insider trading tipped potential real estate sellers to the existence of a valuable find in their land for which they should significantly raise their selling price.

If the insider trading did not harm the corporation, or if the trading actually benefited the corporation, then arguably there was no violation of trade secrets law. However, since the Uniform Trade Secrets Act permits recovery for unjust enrichment caused by misappropriation (as well as recovery of loss), it would seem that harm to the corporation is not essential where the defendant, without corporate consent, was enriched by use of the trade secret in stock trading.[88] At least one state court has held that in a case of insider trading without corporate consent, harm resulting from the insider's breach of duty of loyalty need not be proved; only benefit to the insider need be shown.[89]

Voluntary Corporate Action

A number of legal commentators have argued forcefully that insider trading, far from harming the corporation, actually benefits it because the financial rewards from the trading act as an incentive to insiders to innovate and discover trade secrets and other valuable information.[90] Moreover, the trading arguably moves the prices of the stock in the right direction, commensurate to its actual worth, without forcing premature disclosure of the trade secret to the public and

controlling plant access. UNIF. TRADE SECRETS ACT § 1 comment, 14 U.L.A. 541, 543 (1985).

88. *Id.* § 3, 14 U.L.A. 541, 546 (1985). *See also supra* note 21.

89. *See, e.g.*, Diamond v. Oreamuno, 24 N.Y.2d 494, 496, 301 N.Y.S.2d 78, 80, 248 N.E.2d 910, 912 (1969) (possible harm to the firm's reputation for integrity; however, the court asserted that an allegation of damages "has never been considered to be an essential requirement for a cause of action founded on a breach of fiduciary duty."). In *Diamond*, two officers of the issuer sold stock on inside negative news. The case involved a derivative suit to compel defendant to account for their profits. It was not a rule 10b-5 case. This argument has been turned down by two other courts that have faced the issue. *See* Freeman v. Decio, 584 F.2d 186 (7th Cir. 1978); Schein v. Chasen, 313 So.2d 739 (Fla. 1975). However, the Supreme Court seems to have looked on *Diamond* approvingly. *See* Carpenter v. United States, 108 S. Ct. 316, 321 (1987); *see also supra* note 21.

90. Managers have incentives to divert more of the income stream generated by the firm's assets to themselves than they initially agreed upon . . . . Thus, both managers and shareholders have incentives to reach agreements ex ante that limit divergent behavior by managers . . . . [Incentive] contracts that provide for periodic renegotiation ex post based on (imperfectly) observed effect and output are alternatives to contracts that ex ante tie the compensation to output. Such renegotiations are . . . costly.

> Insider trading may present a solution to this cost-of-renegotiation dilemma. The unique advantage of insider trading is that it allows a manager to alter his compensation package in renegotiation . . . . This in turn increases the manager's incentive to acquire and develop valuable information . . . .

Carlton & Fischel, *supra* note 3, at 869-71.

competitors.[91] Additionally, it has been argued that the trading usually causes no harm to sellers on the other side.[92] These arguments bear directly on whether there should be a voluntary corporate decision to permit insider trading where the corporation owns that information. That decision involves an evaluation of the wisdom and consequences of allowing insiders to trade on inside secret information as a form of compensation.

If the board and/or shareholders explicitly or implicitly consent to the insider's use of the material information, then the *Chiarella* case requirement of a violation of a fiduciary duty is eliminated, and with it, the rule 10b-5 violation.[93] Since *Chiarella* required breach of a fiduciary duty, consent by the corporation to whom the duty is owed ends the violation.[94] Phrased in property terms, the *Chiarella* requirement of a fiduciary duty stands for the conclusion that where the corporation owns the confidential information, and has not licensed its use in insider trading by the management defendant, the insider may not trade on it. Hence, granting the property right to the insider ends the violation.[95] Likewise, consent of the board and/or shareholders (whichever is appropriate corporate action in the circumstances) will eliminate the possibility of a trade secret violation.

As mentioned above, there are certain circumstances in which a trade secret is held by the courts to be property of the employee, not of the employer.[96] In such a case it would be impossible for the corporation or any plaintiff to argue successfully that the employee violated her fiduciary duty in trading on information since it belonged to her and not the corporate employer. Hence, the fiduciary duties of rule 10b-5 established in *Chiarella*[97] would not be applicable in that

91. Sometimes corporations have good business reasons to keep information secret. The *Texas Gulf Sulphur* case is such an example. *See supra* notes 6, 10 & 80, and accompanying text. However, if insiders trade, the share prices will move closer to where they would have been if there had been full disclosure. How much the price moves will depend upon how much "noise" masks the insider trades from outsiders. *See* Plott & Sunder, *Efficiency of Experimental Security Markets with Insider Information: An Application of Rational-Expectations Models*, 90 J. POL. ECON. 663 (1982) (utilization of simulation model to demonstrate that markets adjust rapidly to insider information).

92. *See generally* H. MANNE, *supra* note 3; Carney, *supra* note 3.

93. For a different treatment under rule 14e-3, see *infra* notes 140-55 and accompanying text.

94. *See, e.g.*, Macey, *supra* note 3; and Fischel, *Insider Trading and Investment Analysis: An Economic Analysis of* Dirks v. Securities and Exchange Commission, 13 HOFSTRA L. REV. 127, 136 (1984).

95. For discussion of rule 14e-3, see *infra* notes 140-155 and accompanying text.

96. *See supra* notes 59-66 and accompanying text.

97. *See supra* note 24.

case.

The corporate consent to insider trading in Case I, where the corporation initially owns the information, would involve the judgment that insider trading constitutes a form of efficient management compensation.[98] The trade secret or other valuable information is corporate property which the corporation may grant to the insider to utilize in trading. But there is an accepted model for the authorization of the payment. It is usually in the form of board of directors' action authorizing specific payments to senior management.[99]

Assume that the board of directors of a publicly held corporation adopted such a resolution. Immediately such a resolution would resolve the use of corporate information *qua* property problem. Clearly, within the usual limits of duties of loyalty and care, the corporation can dispense corporate property as a form of management compensation. Under traditional corporate law, if the compensation is established by a committee composed exclusively of independent, nonmanagement directors, the business judgment rule would be applicable.[100]

Business Judgment Doctrine

The test of business judgment rule turns on whether the board, in good faith and after adequate investigation of the facts, believes that the form of compensation improves rather than perversely distorts management's incentives to maximize corporate profits.[101] The board need not be correct in its judgment.

Theoretical arguments of considerable plausibility on both sides of the debate have been exhaustively set forth in the literature.[102] The author is not aware of any conclusive empirical proof one way or the other. Clearly now, when insider trading is a violation of law, it would be difficult to find empirical proof of the efficacy of insider trading as a form of management compensation. However, given the theoretical plausibility of insider trading as an efficient mode of compensation, it appears that a board's decision to implement such a regime would be able to pass muster under the permissive business judgment rule test.[103]

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98. *See supra* note 90 and accompanying text.

99. *See, e.g.*, H. HENN, TEACHING MATERIALS ON CORPORATIONS 530-31 (2d ed. 1986).

100. *See* AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 5.03 & Commentary (Tentative Draft No. 5) (1986).

101. *See, e.g.*, Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

102. For example, contrast the arguments against using insider trading to compensate management in Cox, *supra* note 3, at 649-55, with the arguments in favor in Carlton & Fischel, *supra* note 3, at 869-72, 876-78.

103. *See* Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

The board decision would turn on a deliberate balancing between the corporate need to protect and insulate inside information and the potential benefits to be gained in allowing an insider's use of it for compensation. The latter premise recognizes that insider trading does not constitute a dangerous form of signaling the existence of trade secrets to competitors.[104] Additionally, the board would evaluate the various arguments that have been presented in the seminal work of Dean Henry Manne and the scholars who have debated his positions pro and con through the years.[105] For example, the board would weigh the danger that inside information would be used by managers who did not create the information against the incentives for innovation by creative managers.[106] The board would also consider the possibility that such a scheme would permit managers to sell on bad news as well as buy on good news.[107] Other downside factors the board would consider include the possibility that managers would delay disclosure of information in order to benefit from the secrecy,[108] and the difficulties of policing insider trading and obtaining accurate reports from managers on the extent of their trades.[109] Finally, the board would consider the arguments that insider trading is a more sensitive tool for awarding management compensation than after the fact contract renegotiations or salary adjust-

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104. *See supra* note 84 and accompanying text.

105. *See supra* note 3.

106. Professor Anthony Kronman has suggested that regulation of insider trading may be rationalized by "the idea that inside information is more likely to be casually discovered rather than deliberately produced." Kronman, *supra* note 80, at 34.

However, worthwhile information must be created before it can be accidentally acquired. A ban on insider trading might chill the production of valuable information.

107. *See, e.g.*, Schotland, *Unsafe at Any Price: A Reply to Manne, Insider Trading and the Stock Market*, 53 VA. L. REV. 1425, 1440-42 (1967).

The danger is that, therefore, managers will be indifferent about being efficient or incompetent. However, managers work in teams and, therefore, must convince each other to do bad things. Each manager will be interested in her long run reputation; hence, managers will not be keen on working with others to decrease the value of the firm.

108. *See, e.g.*, Mendelson, *The Economics of Insider Trading Reconsidered*, 117 U. PA. L. REV. 470, 489 (1969). *Compare* Dooley, *supra* note 3, at 34, who found after investigation of cases that insider trading did not postpone the public disclosure of information. Also, insider trading may sometimes speed up disclosure because the potentiality of gain is based upon the information being disclosed. An additional danger lies in the fact that investors in the stock market, by selling short, can capture profits on any predictable swing in the price of stocks. Therefore, an investor who knows that the market price of a stock will decline can reap the same type of profit from trading on that information as might be had from trading on a stock rising in value. The potential exists for management to create drops in the stock price just so that insiders can trade on that information.

109. *See supra* note 73.

ments at the end of each year.[110] The important point is that the argument would be debated in the context of the relatively liberal and permissive business judgment rule,[111] not the rigid criminal statutes such as section 10(b) of the 1934 Exchange Act.[112] Under traditional corporate law, the business judgment test would apply provided the insider trading mode of compensation was set by an independent committee of nonmanagement directors.[113]

In every rule 10b-5 case of insider trading (Case I) the premise is that the corporate employer previously had decided not to release the information immediately. Presumably a good business reason for the secrecy exists.[114] If the corporate employer, in its business judgment, felt that immediate disclosure was advisable, it would so disclose and the price of the stock would move rapidly to its correct equilibrium level. Hence, the corporate employer, when authorizing insider trading, must have decided that signaling will not compromise the secrecy.

Misappropriation Doctrine

The second major scenario in so-called insider trading under rule 10b-5 involves the misappropriation doctrine, or Case II.[115] In that form rule 10b-5 is applied to the use by a corporate outsider of secret information filched from his employer or another. The information bears on the stock price of another corporation.

The Case II misappropriation cases frequently involve situations in which a third party bribes the employee to steal employer-owned information about another corporation.[116] The cases resemble commer-

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110. *See supra* note 90.

111. There is enormous literature on the duty of care and the business judgment rule. *See, e.g.*, 39 BUS. LAW. 1461-1559 (1984), 40 BUS. LAW 1373-1455 (1985) (includes reference to much of the older literature). *See also* Veasey & Manning, *Codified Standard — Safe Harbor or Uncharted Reef?*, 35 BUS. LAW. 919 (1980); Arsht & Hinsey, *Codified Standard — Same Harbor But Charted Channel: A Response*, 35 BUS. LAW. 947 (1980).

112. *See supra* note 24.

113. *See supra* note 100 and accompanying text.

114. In many cases, for example, important information should be hidden from competitors. Insider trading may thus permit firms to indirectly communicate information with a lesser risk of compromising its competitive position. *See supra* note 91.

115. *See, e.g.*, United States v. Newman, 664 F.2d 12 (2d Cir. 1981), *cert. denied*, 464 U.S. 863 (1983). Other cases have involved assumptions of confidentiality between corporations and their lawyers, SEC v. Musella, 578 F. Supp. 425, 439 (S.D.N.Y. 1984), and between a father and his son, United States v. Reed, 601 F. Supp. 685, 690 (S.D.N.Y. 1985); *see also supra* note 21.

116. *Boesky Apparently Reaped at Least $203 Million in Illicit Profits with Levine's Inside Information*, Wall St. J., Nov. 24, 1986, at 2, col. 2; *see also* N.Y.C. BAR REPORT, *supra* note 2, at 5-7:

> The present statutory basis for both civil and criminal insider trading liability, the Securities and [sic] Exchange Act of 1934, does not directly address trading on non-public information — and proscription of such trading is depen-

cial bribery and trade secret cases in which third parties work in conspiracy with an employee to steal and use trade secrets of the employer.[117] Indeed, they are indistinguishable from trade secret and commercial bribery cases. Certainly if a case brought on a trading misappropriation theory involves harm to the employer, a traditional trade secret violation may be involved.[118] For example, if the employee of an investment banker, in return for payment by a third party, steals material information in the possession of the employer regarding a stock trading transaction, which harms the employer or its client, a traditional trade secret or commercial bribery cause of action necessarily exists.

If, on the other hand, the employer explicitly or implicitly grants permission to the employee to use the information in connection with a stock trade, under rule 10b-5 and the *Chiarella* doctrine, there is no securities violation. The employer's permission obviates any misappropriation. There is no trade secret violation since employers may license third parties to use trade secrets so long as the licensee maintains the confidentiality of the trade secret.[119] (The rule 14e-3 case is addressed below). However, since the Case II trade, with or without employer permission, involves the potential to harm the public trader, it is clear that the misappropriation doctrine is not related to harm to public traders.[120]

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dent on SEC rulemaking under the Act's general anti-fraud provisions and judicial application of those anti-fraud rules and rules on insider trading. While this may be an acceptable manner in which to impose civil liability for insider trading — although even that is open to question — we believe it is a wholly inappropriate basis for imposing criminal liability . . . .

The legislative history of the Securities and [sic] Exchange Act of 1934 suggests that Congress intended to eliminate trading on inside information by corporate insiders . . . . The statute, however, contains only one provision — § 16 — specifically aimed at insider trading, and it prohibits only short-swing transactions by a limited class of insiders (*See* 15 U.S.C. § 78p. 1982) . . . [R]ecovery under § 16 does not depend on proof of actual abuse of inside information.

The limited scope of § 16 as a weapon against insider trading raises questions about what Congress in 1934 actually intended to do about trading on insider information. The SEC, however, has long abhorred the practice of insider trading, and it found a different section of the Exchange Act — § 10(b) . . . .

Under the authority granted by 10(b), the SEC created Rule 10b-5 in 1942.

117. *See supra* notes 51-56 and accompanying text.

118. *See supra* notes 83-86 and accompanying text.

119. 2 R. MILGRIM, *supra* note 40, § 9.03(2), at 9-70 (1986).

120. There is considerable evidence that insider trading does not cause harm to public traders, but we assume here for the sake of argument that it does. *See generally* Carney, *supra* note 84.

Contracts to Protect Trade Secrets

The literature on trade secrets law makes it clear that because of uncertainty about who owns the information, there is widespread (although not unanimous) use of express contracts to protect trade secrets.[121] For example, one survey showed that of eighty-six companies surveyed, eighty-three used some form of express agreement.[122] Many of these agreements protect so called "confidential information." For example, one form of agreement suggested in the leading treatise on trade secret law stated, *inter alia*: "Except as required in my duties to Company, I will never, directly, indirectly, or otherwise use, disseminate, disclose, lecture upon or publish articles concerning any CONFIDENTIAL INFORMATION."[123] The term is defined in the contract to mean:

> [I]nformation disclosed to me or known by me as a consequence of or through my employment by Company (including information conceived, originated, discovered or developed by me), . . . not generally known in the relevant trade of [sic] industry, about Company's products, processes and services, including information relating to research, development, INVENTIONS, manufacture, purchasing, and engineering.[124]

Obviously this is a very broad definition that closely parallels the securities law concept of materiality.

A fair reading of trade secrets law and the language of these contracts is that corporations do not consent to the use of inside information in stock trading where there is some significant risk of signaling the secret to the public or the competition. Of course, since Professor Carney, as discussed earlier,[125] has demonstrated the unlikely frequency of such a risk, the contractual prohibitions may not apply to insider trading unless they are interpreted (as they might be) as forbidding employee benefit from the use of the information even where such use does not monetarily harm the corporate employer.[126]

Differences from Trade Secrets

There is an important respect in which trade secrets law and insider trading differ. Even if we assume for the sake of argument that shareholders or boards of directors, or employers in the misappropriation scenario, consent to the use of an insider trading compensation scheme, there is still the question of the impact on public stock trad-

121. 1 R. MILGRIM, *supra* note 40, § 3.02, at 3.9.
122. *Id.*
123. 3 R. MILGRIM, *supra* note 40, app. C, at C-11.
124. *Id.* app. C, at C-8.
125. *See supra* note 84 and accompanying text.
126. *See supra* notes 88-89 and accompanying text; *see also supra* note 21.

ers.[127] Consider the facts of insider trading Case I involving a corporate director or officer.[128] Assume the board of directors explicitly or implicitly has approved use of inside information in stock trading as a form of presumably efficient management compensation. Assume the decision was made by a compensation committee of outside or independent directors.[129] The argument may still be made that despite the board's decision, the trading harms the public traders in the market place and/or is unfair to them.[130] The issue has always been the difficulty of finding causation. Public traders buy or sell for reasons unrelated to the insider's trades. Since they are not dealing face to face, but in the open marketplace where no privity of contract exists between them, there is great difficulty in finding that the insider caused any harm to (that is, prompted the trades of) the public traders.[131] Some have argued that causation exists because disclosure would have compelled the public to act differently. But that argument assumes the very question at issue, namely, whether a duty to disclose exists.[132]

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127. *See, e.g.*, Brudney, *supra* note 3, at 343-46.

128. *See supra* notes 6-13 and accompanying text.

129. *See* AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 100, § 503 & comments; Wolfson, *The Theoretical and Empirical Failings of the American Law Institute's Principles of Corporate Governance*, in THE AMERICAN LAW INSTITUTE AND CORPORATE GOVERNANCE (1987).

130. This question was first analyzed at length in a coherent fashion by Henry Manne. *See* H. MANNE, *supra* note 3, at 107-09.

131. The task is to prove that the entry of trades by insiders actually induced outsiders to buy or sell. *See, e.g.*, Reynolds v. Texas Gulf Sulphur, 309 F. Supp. 548 (D. Utah 1970), *aff'd as modified*, 446 F.2d 90 (10th Cir.), *cert. denied*, 404 U.S. 1004 (1971) (court implicitly held that since trading by insiders did not induce trades by outsiders, no causation was shown).

132. *See* Manne, *Insider Trading and the Law Professors*, 23 VAND. L. REV. 547, 551-53 (1970).

The Sixth Circuit stated that:

> The flaw in this logic we conclude, is that it assumes the very injury which it then declares compensable. It does so by presupposing that the duty to disclose is absolute, and the plaintiff is injured when the information is denied him. The duty to disclose, however, is not an absolute one, but an alternative one, that of either disclosing or abstaining from trading. We conceive it to be the act of trading which essentially constitutes the violation of Rule 10b-5, for it is this which brings the illicit benefit to the insider, and it is this conduct which impairs the integrity of the market and which is the target of the rule. If the insider does not trade, he has an absolute right to keep material information secret. *SEC v. Texas Gulf Sulphur Co., supra* at 848. Investors must be prepared to accept the risk of trading in an open market without complete or always accurate information. Defendant's trading did not alter plaintiffs' expectations when they sold their stock, and in no way influenced plaintiffs' trading decision.

Friedrich v. Bradford, 542 F.2d 307, 318, (6th Cir. 1976), *cert. denied*, 429 U.S. 1053

Critics of insider trading have attempted to prove the likelihood that by moving the price of the stock, insider trading causes public traders to sell or buy; hence, the critics find causation. For example, they argue that the insider trade causes the price to rise which leads some public traders to sell earlier than they otherwise would.[133] Thus, public traders lose the profit they would have captured if they had held and sold after the inside news was disclosed. These arguments appear to be irrelevant, however, once we assume that a board or a board and shareholder body, through accepted corporate procedure, has approved insider trading and confidential information. It appears extremely difficult for public shareholders to cry legal "foul" as a result of such approved trading. They have approved (or bargained for) the transfer of rights in the information they once collectively owned through their corporate vehicle, to the insiders. In return for the transfer, they require the insiders to take less in direct compensation.[134] Critics of the practice must then prove that insider trading is so pernicious to society and all parties involved that boards or shareholders should not be permitted to make these informed voluntary decisions.[135]

The same holds true for the misappropriation violations of Case II, but with certain differences. Assume that the employer and client in *Chiarella* explicitly permitted Chiarella to trade on the secret information, which was the client's intent to buy up target corporation stock. Perhaps the employer and client had decided that Chiarella's trades would facilitate the client's bidding strategy by placing target stock in friendly hands.[136] The target shareholders have no property right in the information that arose out of the client's or tender offeror's takeover plan. Further, the tender offeror's consent satisfies the assumption of Chief Justice Burger's dissent in *Chiarella* that a wrongful taking or misappropriation is required.[137]

A requirement for Chiarella and the bidders to disclose the information before trading would chill tender offerors' incentives to research target companies and create the information that the tender offerors hold in confidence. This argument is in accord with trade secret law, which allows businesses to create, keep secret, and license confidential information to inspire innovation and research. At the opposite end of the spectrum is a "market egalitarian" approach that would require virtually all property rights in information to be

(1977).

133. *See supra* note 84 and accompanying text.

134. *See* Haddock & Macey, *A Coasian Model of Insider Trading*, 80 Nw. U.L. Rev. 1449 (1986).

135. *See supra* notes 71-73 and accompanying text.

136. *See Chiarella*, 445 U.S. at 234; *see infra* notes 140-54 and accompanying text.

137. *See supra* notes 23-24, 118-19 and accompanying text.

shared equally with everyone no matter how lawful the information's original acquisition.[138]

The target shareholders could argue that unlike Case I, they have not consented to, nor bargained for, the transaction with the party who has the inside information. The answer then will turn on the "market egalitarian" duty, if any, to disclose in the absence of any traditional fiduciary relationship between the bidders, their tippees, and the target shareholders. The general response to this proposition in American law has been negative, since to impose such a duty would chill the incentives to discover, create, or innovate new ideas or information.[139]

Rule 14e-3

Rule 14e-3[140] abandons the theft of information approach of court-construed rule 10b-5. The rule provides that any tippee who receives information about an impending or actual tender offer from the bidder or target companies or their officers, and trades on that information is subject to civil or criminal prosecution.[141] This holds true even where the tender offeror or target voluntarily informs the tippee in hope (but without agreement) that he or she will trade on that information.[142] The rule was promulgated after the *Chiarella* holding and in effect reverses it insofar as tipping with respect to tender offers is concerned. The SEC justified the rule on the basis of preventing unfair disparities in information.[143] Hence, with respect to information regarding tender offers, the SEC has adopted the "market egalitarian" view mentioned above. Therefore, where a hostile tender offeror believes that it can best succeed by tipping an arbitrageur, it is forbidden from doing so.[144] Practically speaking, a

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138. The SEC never has adopted this extreme view in rule 10b-5 cases. *See, e.g., Chiarella*, 445 U.S. 222.

139. *See supra* note 80 and accompanying text.

140. 17 C.F.R. 240.14e-3 (1986). *See* Exchange Act Release No. 17,120, 1980 Fed. Sec. L. Rep. (CCH) ¶ 82,646 (Sept. 4, 1980) [hereinafter Rule 14e-3 Release].

The SEC stated that "the Commission . . . continues to have serious concerns about trading by persons in *possession* of material, nonpublic information relating to a tender offer. This practice results in *unfair disparities* in market information and market disruption." Rule 14e-3 Release at 83,457 (footnotes omitted) (emphasis added).

141. *See* 17 C.F.R. 240.14e-3 (1986).

142. "If an offering person *tells* another persons that the offering person will make a tender offer which information is nonpublic, the other person has acquired material, nonpublic information directly from the offering person and has a duty under Rule 14e-3(a)." Rule 14e-3 Release at 83,459.

143. *See supra* note 140.

144. *See* Jensen, *Don't Freeze The Arbs Out*, Wall St. J., Dec. 3, 1986, at 26, col.

tender offeror might prefer multiple smaller purchases, by arbitrageurs and other bidders, due to the less significant impact upon the price of the stock than buying in volume alone.[145] The rule prohibits this even though the tender offeror has, in effect, licensed the trade secret or other valuable information for use by the arbitrageur. Of course, other statutory provisions apply; after a purchaser obtains five percent of the shares of the target corporation, section 13(d) requires public disclosure within ten days of the purchases.[146] The 13(d) "window" permits the purchaser to exceed the five percent figure during the ten day waiting period. Also, if a person's purchases actually constitute a tender offer, it must immediately be disclosed through a public filing with the SEC.[147] Absent the last two conditions, a corporation currently may buy up to five percent of the target stock and more during the "window" secretly. Also, a group concept applies so that different individuals who buy in concert may together count toward the five percent threshold which triggers the public filing requirement.[148]

The SEC has reasoned that the rule protects shareholders of the target corporation from disparities in information.[149] Put somewhat differently, the practical effect of the rule operates to award target shareholders with a property interest in the information developed by the prospective tender offeror, that is, its own plan to ultimately tender an offer. This property award by operation of regulation deprives the tender offeror of the ability to sell or transfer its interest in the information to others who may trade on it.

If courts, the SEC, or Congress should, in interpreting rule 10b-5, prevent corporations by board or shareholder action from transferring rights in inside information to managers, the result would be similar in concept to the result reached by rule 14e-3. In a Case I transaction such consent flows from the affected (or trading) shareholders through the modality of board and shareholder decision. Therefore, judicial or congressional action would mean that such a voluntary informed decision must not be permitted due to the terrible consequences. Since rule 14e-3 forbids voluntary tipping in certain cases by issuers, that rule reaches such a conclusion in the areas regulated by it.[150]

4. Arbitrageurs are professional dealers who buy stock of impending or actual target companies in the hope that they will make a profit when and if the takeover bid succeeds and they sell out to the successful bidder.

145. *See* Carney, *supra* note 3, at 892-93.

146. *See* Securities Exchange Act of 1934, § 13(d), 15 U.S.C. 78m(d)(3), as amended by Act of July 29, 1968, Pub. L. No. 90439, 82 Stat. 455.

147. *Id.* § 14(d), 15 U.S.C. § 78n(d).

148. *Id.* § 13(d)(3), 15 U.S.C. § 78m(d)(3).

149. *See supra* note 140.

150. *See supra* note 13.

In the 14e-3 transaction, the bidder lawfully, not by illegal misappropriation, develops information — its intent to bid and the signal that bid conveys about future possibilities of its management if it succeeds — yet the rule assigns to others, the shareholders of the target, rights to that information. This is merely another way of describing a market egalitarian approach to information: that rights to information must be shared equally by all who may be affected by the information. The 14e-3 approach may, in the end, harm bidders and target shareholders. The rule prevents bidders from tipping risk arbitrageurs and hence facilitating the success of their bids. Thus, the rule may chill the incentive of bidders to make tender offers by increasing, *ex ante*, the cost of bidding.[151] Second, the chilling effect may hurt target shareholders by decreasing the disciplinary threat of tender offers on incumbent management.[152] Incumbent management may be freer to be lazy or inefficient.[153] Also, the chilling effect may decrease the number of mergers which produce synergistic cost savings or efficiency resulting from the marriage of different businesses.[154] On the other hand, sections 14(d), 13(d), the group concept and the proposed new market sweep rules[155] may create much of the same chill effect even without rule 14e-3. It is difficult to measure without careful empirical testing the extent of the incremental impact of rule 14e-3. In sum, rule 14e-3 may be the cause of more harm than good. While insuring that all investors have equal access to information may appear to some to be a worthwhile goal, this rule clearly goes too far.

CONCLUSION

This Article has endeavored to advance the concept of insider trading law under rule 10b-5 as an effort to protect property rights in important information. It has attempted to do that by exploring the relationships between concepts of trade secrets law and insider trading doctrine. Indeed, rule 10b-5 securities law on insider trading may be viewed as a form of trade secrets law. The Article also has shown how traditional business judgment doctrine can support corpo-

151. *See* Jensen, *supra* note 144, at 26, col. 4.
152. *See* Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1169-74 (1981). The contrasting arguments on this issue are developed in R. GILSON, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS (1986).
153. *See* Easterbrook & Fischel, *supra* note 152, at 1175.
154. *Id.*
155. *See* Exchange Act Release No. 24,976, 52 Fed. Reg. 37,473 (Oct. 7, 1987).

rate decisions to use inside information as a form of executive compensation.