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Differentiated Perspectives on Insider Trading: The Effect of Paradigm Selection on Policy

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DIFFERENTIATED PERSPECTIVES ON INSIDER TRADING: THE EFFECT OF PARADIGM SELECTION ON POLICY

STEVEN R. SALBU*

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I. INTRODUCTION

During the twentieth century, the practice of trading securities on the basis of inside information has created policy challenges for legislators, judges, and lawyers. Prior to the Great Depression, the practice was infrequently the subject of litigation;¹ since the stock market crash in 1929, statutory attempts to understand the nature of insider trading and to circumscribe spheres of unacceptable behavior have been significant.²

The nature and extent of the prohibition have not remained

¹ Under common law that developed early this century, the trading of securities based on undisclosed inside information was considered fraudulent. The leading case in this regard is *Strong v. Repide*, 213 U.S. 419 (1909).

² The primary statutory sources of this prohibition are contained in the Securities Exchange Act of 1934 (the "1934 Act") and rules promulgated thereunder. 15 U.S.C. § 78 (1988). Most significant in this regard are § 16(b) and rule 10b-5. Section 16(b) states, in part, the following:

For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, or any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months.

Securities Exchange Act of 1934 § 16(b), 15 U.S.C. § 78p(b) (1988). Rule 10b-5 states the following:

It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (1) to employ any device, scheme, or artifice to defraud; (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or (3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1991).

static since their creation under the 1934 Act. The earlier court decisions construing the Act and its rules embodied an expansiveness of interpretation, culminating in *SEC v. Texas Gulf Sulphur Co.*³ *Texas Gulf Sulphur* created the "abstain or disclose" doctrine, which applied to all trades on nonpublic information.⁴ Transactions in securities based on any exclusively held information were considered to be tainted, regardless of the source and ownership of the inside information employed. In reaction to the expansive interpretation of rule 10b-5 under *Texas Gulf Sulphur*, post-1960s decisions tended toward retrenchment, more strictly construing statutory language and intent in an era of contraction.⁵ Likewise, legal scholarship diverges widely in its normative stance regarding regulation of insider trading, with recommendations ranging from complete legalization to stricter and more precisely defined proscription than exists under current law.⁶

While the different policy approaches of courts and legal scholars are elaborately defended in detailed decisions and treatises, the variation can be traced to more basic and general discrepancies in the underlying paradigms that shape policy recommendations. The following analysis examines the dimensions of basic jurisprudence that most significantly affect a proponent's policy perspective on insider trading. It is contended that strict construction of insider trading laws is fundamentally a function of legal positivist and economic-contract paradigms.⁷ Conversely,

³ 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).

⁴ *Id.* at 848.

⁵ For a discussion of this phenomenon, see Steven R. Salbu, *Regulation of Insider Trading in a Global Marketplace: A Uniform Statutory Approach*, 66 TUL. L. REV. 837 (1992).

⁶ Hundreds of articles addressing various elements of this issue exist; the articles generally combine legal analysis with some economic, financial, or ethical examination, or some combination of these. See, e.g., Jerome B. Baesel & Gary R. Stein, *The Value of Information: Inferences from the Profitability of Insider Trading*, 14 J. FIN. & QUANT. ANAL. 553 (1979); Victor Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322 (1979); Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857 (1983); Jonathan R. Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9 (1984); Henry G. Manne, *In Defense of Insider Trading*, 44 HARV. BUS. REV. 113 (1966).

⁷ The phrase "strict construction" is applied liberally here to refer to all efforts to curb the legal curtailment of insider trading practices; it includes literal readings of existing laws, as well as recommendations that these laws be amended to be less confining. The general viewpoint of strict constructionists in regard to insider trading is that its regulation should be minimized either through legislative reform or conservative statutory interpretation. The strict construction approach in its most extreme form will be labelled "zero regulation"

loose construction of these laws is the product of realist, post-realist, and ethical-contract paradigms.⁸ Sections II through IV of this Article describe the three relevant paradigm dichotomies (positivist/post-realist; economic/ethical; contract/property), and explain how insider trading policy perspectives actually reflect basic philosophy and orientation. Section V discusses the impact of the phenomenon described in the proceeding sections.

The recognition of disparities of assumptions and models underlying policy choices allows us to examine the real issues and points of contention.⁹ This process refocuses our attention on the more basic subtextual questions: should the laws of insider trading be approached from positivist or non-positivist assumptions? To what extent should they be examined economically versus ethically, and are they predominantly matters of contract or of property?

II. LEGAL POSITIVIST PARADIGMS, LEGAL REALIST PARADIGMS, AND POST-REALIST PARADIGMS

A. *Legal Positivist Paradigms*

Under the positivist approach to jurisprudence, the significance of law exists in its rule or force.¹⁰ A distinction is made between the function of law, which provides for the social order by command or compulsion, and the function of morality, which encompasses the individual's efforts to establish and embrace an ethical or normative system.¹¹ John Austin's sober analysis of law

herein.

⁸ The term "loose construction" is intended here to reflect the legislative and interpretive characteristics opposite to those contained in the term "strict construction." See *supra* note 7. Loose construction thus entails the liberal application of existing restrictions on insider trading, as well as the reinforcement and elaboration of these laws under a program of statutory reform aimed at eliminating disparities of information availability in the securities markets. Loose construction tends to result in recommendations that will be labelled "significant regulation" herein.

⁹ Little work has been done on the structural analysis of insider trading decisions and jurisprudence. Phillips has suggested that there are six competing currents, which he labels idealism, traditionalism, economic behaviorism, paradigm case analysis, literalism, and textual structuralism. See David M. Phillips, *An Essay: Six Competing Currents of Rule 10b-5 Jurisprudence*, 21 IND. L. REV. 625 (1988).

¹⁰ See H.L.A. HART, *THE CONCEPT OF LAW* (1961) (detailed discussion of tenets of legal positivism); see also MALCOLM CLARK, *THE ENTERPRISE OF LAW* 153-56 (1987) (general discussion of tenets of legal positivism).

¹¹ See CLARK, *supra* note 10. Clark notes that positivist approaches were dominated by

identifies the "source" or "author" of command, suggesting that laws are simply policies established by the sovereign in power.¹² Positivism pervades much of the Anglo-American system of common law, particularly in its emphasis on process.¹³ In this sense, the efficacy of the law in the positivist tradition is largely bound to the fairness of its procedures.¹⁴

The relatively pragmatic approach of legal positivists emphasizes the integrity of the legal system and the level of functioning that results. Positivism is modest in declining to identify universal moral imperatives in a heterogeneous world of diverse and divergent cultures. It is a position in jurisprudence potentially congenial to cultural and ethical relativist stances: it insists on no superior substantive approach, thereby evading temptation of ethnocentric dogmatism. Yet, in its contention that law is ultimately pure and detached from the moral and political fray, positivism has resisted appeal to relativist scholars inclined to associate the cultural with the political.

The command theory of law stands in contrast to conceptions of society constrained by natural laws. Legal positivism departs from eighteenth century natural law theory and its incorporation of morality into normative legal frameworks.¹⁵ Whereas natural

the distinction between law and morality for over a hundred years. He observes as well the influence of utilitarianism on positivists, who strove to achieve "the greatest good for the greatest number," while still maintaining that reformation of bad law was the exclusive province of legislative emendation, implying that bad law is nonetheless operative and effective.

¹² John Austin, *Lecture 5, in THE PROVINCE OF JURISPRUDENCE DETERMINED* (1832). Austin's notion that law is derived from command of the sovereign is later criticized by H.L.A. Hart, whose jurisprudence substitutes rules (which are obligatory, implying some extra-coercive legitimacy) for sovereign orders (which are merely coercive). For a discussion of the development of Hart's philosophy, see H.L.A. HART, *ESSAYS IN JURISPRUDENCE AND PHILOSOPHY* (1984).

¹³ The doctrine of *stare decisis* exemplifies the implicit incorporation of positivism within the common law and its procedures. Taken very literally, *stare decisis* requires strict adherence to properly established precedent regardless of the merits of the substantive law being followed. The doctrine as tempered by considerations of fairness and justice in allowing some latitude for altering precedent in case law represents a departure from rigid adherence to legal positivist thinking. See, e.g., *Flagiello v. Pennsylvania Hosp.*, 208 A.2d 193, 205-08 (Pa. 1965) (overruling precedent in interests of "justice" and "reason").

¹⁴ Hart observes, however, that both Austin and Bentham recognized the moral obligation to engage in civil disobedience when the law reaches a "certain degree of iniquity." H.L.A. Hart, *Positivism and the Separation of Law and Morals*, 71 HARV. L. REV. 593, 617 (1958).

¹⁵ For a discussion of natural law, see THOMAS AQUINAS, *SELECTED POLITICAL READINGS* (ed. 1959); JOHN M. FINNIS, *NATURAL LAW AND NATURAL RIGHTS* (1980); THOMAS HOBBS,

law theorists sought to identify empirically the universal rights and responsibilities of all persons to serve as normative judicial guidelines,¹⁶ the positivists demystified the law by denying any spiritual or deistic source. The more modern proponents of the "legal naturalist" position deem the descriptive or value-neutral study of law to be inadequate. In this vein, Lon Fuller resists the positivist notion that "law must be treated as a manifested fact of social authority or power, to be studied for what it is and does, and not for what it is trying to do or become."¹⁷

Positivism is opposed today by rights theorists such as Dworkin, who contends that judges are bound not simply by rule or precedent, but by principle as well.¹⁸ Dworkin distinguishes between political principle, which involves individual rights, and political policy, which concerns the general welfare.¹⁹ In controversial cases, he contends that judicial decision-making should consider the rights that arise from political principle, but not the public interest concerns that are a function of mere political policy.²⁰ Acknowledging what he calls the "political basis of law,"²¹ Dworkin departs from the assumption of legal objectivity implicit in positivist conceptions of law.²² This departure is crucial to the development of legal realism²³ and post-realism,²⁴ in which the political nature of

PHILOSOPHICAL RUDIMENTS CONCERNING GOVERNMENT AND SOCIETY (1651); JEAN JACQUES ROUSSEAU, *THE SOCIAL CONTRACT* (1762).

¹⁶ In regard to economic regulation such as the prohibition of insider trading, the received model of natural law is generally the neoclassical one derived from Adam Smith. See ADAM SMITH, *THE WEALTH OF NATIONS* (1776). Among the normative assumptions contained in the neoclassical approach are the natural superiority of markets unfettered by governmental regulation except as is necessary to support competition; the importance of individual freedom under conditions of readily available information; and the tendency of the invisible hand to regulate price, quantity, and labor costs in any market created under the first two assumptions.

¹⁷ LON L. FULLER, *THE MORALITY OF LAW* 145 (1969).

¹⁸ See RONALD DWORKIN, *TAKING RIGHTS SERIOUSLY* 81-130 (1977). Dworkin contends that legal questions can be categorized as questions of policy and questions of principle; the latter cannot be addressed by mere application of rule under a sustainable and defensible system of ethics. *Id.*

¹⁹ RONALD DWORKIN, *A MATTER OF PRINCIPLE* 11 (1985).

²⁰ *Id.*

²¹ *Id.* at 7.

²² Dworkin asserts that a controversial case may be supported by competing moral principles, all of which are faithful to the rule book. Thus, because a judge's decision is ultimately based on the principle that he or she believes to be correct, his or her decision in this respect is political. *Id.* at 17.

²³ See *infra* notes 25-30 and accompanying text.

²⁴ See *infra* notes 31-42 and accompanying text.

legislative and judicial behavior is a central assumption.

B. *Legal Realist and Post-Realist Paradigms*

Realism is a broadly inclusive description of legal theory that is skeptical of a naivete ascribed as characteristic of the positivist approach. Where the positivist perceives the law to be a given according to an extant command or rule, the realist examines actual relationships and behavior to determine the underlying structural and systemic dynamics, which are not presumed to be value-neutral. The critical matrix that such examination places over the unquestioning positivism it seeks to supplant entails both the scrutiny of the laws themselves and the examination of the courts and their participants. It is not coincidental that Oliver Wendell Holmes, a pioneering realist, wrote during the late nineteenth century in the context of flourishing social and literary criticism.²⁵

Realists use linguistic and semiotic analysis to examine law beneath its surface.²⁶ They begin with the presumption that language is indeterminate, i.e., capable of an infinite number of interpretations. If language is indeterminate, it follows that the neutral creation of rules by the legislature, and application of these rules by the judiciary, is impossible. This failure of neutrality creates a vacuum in which interpretation becomes imperative and inevitable.²⁷ In the process of interpretation, judges cannot avoid the balancing of interests and the imputation of values to ambiguous circumstances.²⁸ Unlike the legal naturalists, realists do not impute specific normative values to law. Rather, they approach legal decision-

²⁵ The most famous of Holmes's documents that express his early version of legal realism is a speech given at Boston University in 1897. See Oliver Wendell Holmes, *The Path of Law*, 10 HARV. L. REV. 457 (1897).

²⁶ *Id.* at 464. Holmes favored critical analysis of legal documents and court decisions to remove the mystique that laypersons often attributed to law, representing the popular validation of the assumption that the command, edict, or rule of law was in some sense divine and therefore unquestionable.

²⁷ See HAROLD J. BERMAN & WILLIAM R. GREINER, *THE NATURE AND FUNCTIONS OF LAW* 482 (1980). Berman and Greiner speak of the indeterminacy of language as the "active side of legal language." *Id.* The description suggests that attempts to fix language are artificial and spurious.

²⁸ Subsumed within this debate is the further question of how evidence can and should be used, and the degree to which probabilistic evidence has value under presumptions of scientific neutrality versus socio-political influence. For a discussion of issues related to the use of probability in law, see Jonathan J. Koehler & Daniel N. Shaviro, *Veridical Verdicts: Increasing Verdict Accuracy through the Use of Overtly Probabilistic Evidence and Methods*, 75 CORNELL L. REV. 247 (1990).

making sociologically, attempting to understand the political, social, and economic functions served by the actual workings of the legal system as it is observed both on paper and in action.²⁹

While the realists acknowledge the subversion of pure motives and integrity in the application of the law, they do not discard the idealized concepts of purity and integrity. The traditional realist (as opposed to the post-realist) accepts ontology, admitting the existence of truth while observing its manipulation and obfuscation by humans.³⁰ For the realist, the descriptive challenge is to recognize the particular dynamic forces at play in the development of law, and the normative challenge is to remove the layers of debris from the right or the truth hidden below.

Post-realist approaches to jurisprudence, in some ways related to the Critical Legal Studies movement and literary deconstruction, accept the principle of the indeterminacy of language.³¹ Post-realists emphasize the political nature of all efforts at interpretation, assuming not only that "the source of authority *cannot* speak clearly" but also that "if pressed, she would not want to."³² There can be no objectivity of interpreters, and if interpretive communities exist,³³ their consensus is a function of culture or contract and not a manifestation of objective truth.³⁴

²⁹ Jerome Frank has observed that judicial decisions within a single court are internally inconsistent, i.e., that there is wide discrepancy among verdicts and sentences. See JEROME FRANK, *LAW AND THE MODERN MIND* 121 (1970). The phenomenon suggests that judicial activity encompasses more than the rational attempts at consistency as purportedly occur under stare decisis and the positivist view of law. Realism seeks to identify and examine the extra-positivist social dynamic within the law.

³⁰ See Michael S. Moore, *The Interpretive Turn in Modern Theory: A Turn for the Worse?*, 41 *STAN. L. REV.* 871 (1989). (comparing and contrasting realist ontology to what author labels "antirealist" framework).

³¹ See, e.g., Andrew Altman, *Legal Realism, Critical Legal Studies, and Dworkin*, 15 *PHIL. & PUB. AFFAIRS* 205 (1986); Mark Tushnet, *Critical Legal Studies and Constitutional Law: An Essay in Deconstruction*, 36 *STAN. L. REV.* 623 (1984).

³² MARK KELMAN, *A GUIDE TO CRITICAL LEGAL STUDIES* 13 (1987).

³³ See STANLEY FISH, *IS THERE A TEXT IN THIS CLASS?* 14 (1980). Fish states the following:

[I]t is interpretive communities, rather than either the text or the reader, that produce meanings Interpretive communities are made up of those who share interpretive strategies not for reading but for writing texts, for constituting their properties [S]ince the thoughts an individual can think and the mental operations he can perform have their source in some or other interpretive community, he is as much a product of that community (acting as an extension of it) as the meanings it enables him to produce.

Id.

³⁴ See Paul Brest, *Interpretation and Interest*, 34 *STAN. L. REV.* 765 (1982).

The deconstruction of legal texts is the post-realist method of identifying the dynamic forces that shape the law.³⁵ Whereas the realist views interpretation as the identification of extant meanings, the post-realist admits to no "true interpretation" independent of the forces of linguistic communities.³⁶ From a viewpoint since labelled the "institutional" approach,³⁷ Stanley Fish suggests that institutions in general and professional bureaucracies in particular are sources of epistemology.³⁸ Fish echoes the older institutional school of sociological thought which seeks to expose organizational policy as the subversive utilization of power and control in the configuration of a social reality.³⁹

Post-realists depart from realists in their denial of realist ontology: no objective truth exists apart from our individual minds or our social conventions.⁴⁰ For the post-realist, all efforts to discover reality objectively⁴¹ are naive in their presumption that an actor can shed convention and thereby gain neutrality. The postulate that social reality is invariably invented renders the scientific model for identifying truth futile in any event, since there is no truth to glean apart from what other humans have created. The application of political and sociological power models to these post-realist assumptions suggests that good faith and impartial ef-

³⁵ Deconstruction has been described as the revelation, analysis, and disassembling of texts. See BARBARA HERRNSTEIN SMITH, *CONTINGENCIES OF VALUE: ALTERNATIVE PERSPECTIVES FOR CRITICAL THEORY* 207 n.41 (1988).

³⁶ See Moore, *supra* note 30, at 949.

³⁷ See David Luban, *Fish v. Fish or, Some Realism About Idealism*, 7 *CARDOZO L. REV.* 693, 693 (1986) (comparing Fish's themes of interpretive communities and institutionalism).

³⁸ Stanley Fish, *Anti-Professionalism*, 7 *CARDOZO L. REV.* 645 (1986).

³⁹ See CHARLES PERROW, *COMPLEX ORGANIZATIONS: A CRITICAL ESSAY* 174-99 (1979) (discussing sociological institutional school).

⁴⁰ See Moore, *supra* note 30, at 880-81.

⁴¹ Particularly in regard to economics, American policy is often based on assumptions that are considered to be the objectively perceived manifestation of natural law. Critical analysis of these assumptions suggests that the purported laws are actually political and social constructs. While they may work and work well, critics contend that it is a fallacy to view them as inherently superior and culturally neutral. Thomas McCraw states that

[e]conomists' habitual argument in favor of free trade . . . expresses much more than an autonomous economic principle. It carries with it a whole congeries of other doctrines and policies without which it makes no sense either as an ideology or a freestanding element of statecraft. It implies anti-colonialism, national self-determination, consumer sovereignty, and political individualism.

Thomas K. McCraw, *Schumpeter Ascending*, 60 *AM. SCHOLAR* 371, 387 (1991). Though neither Schumpeter nor McCraw's treatment of Schumpeter would be properly categorized as critical analysis, McCraw's statement captures the spirit behind realist and post-realist approaches.

forts at objective interpretation are rare. Consciously or otherwise, the positivist judicial function of neutral interpretation of laws is naive and impossible under post-realist assumptions.⁴²

C. *Legal Positivism, Legal Realism, and Post-Realism Applied to Insider Trading*

Because the taxonomies that have been presented are to a degree arbitrary and artificial, they are imperfect both in their fit with any particular theorist and in their true cohesiveness and purity as ontological or epistemological approaches. Since they are idealized types that can be applied to real theory and policy only crudely, it is best to discuss their effect on insider trading perspectives along a continuum that captures their generic thrusts. The positivist end of the continuum can be characterized as acritical, conservative, and classically constraining. The post-realist extreme is critical, non-conservative, and relationally liberating. These characteristics can be visually represented as follows:

LEGAL POSITIVISM	POST-REALISM
[-----]	
CHARACTERISTICS	
acritical	critical
conservative	non-conservative
classically constraining	relationally liberating

Each idealized dichotomy is described below, along with the contention that each of the positivist characteristics tends to support zero regulation of insider trading, while their post-realist opposites tend to support significant regulation.

1. Acritical v. Critical Approaches

Legal positivism is acritical in its conception of the law as the manifestation of existing power or authority. In this orientation it tends toward the descriptive rather than the normative. Post-real-

⁴² The inevitable failure of intendedly neutral interpretive schemes under post-realism has implications for the economic models of jurisprudence discussed in Sections III and IV. Herrnstein Smith has observed that the metaphors of economic theory, which appear in social-exchange theory, decision science, and game theory, are reductions of questionable legitimacy. See HERRNSTEIN SMITH, *supra* note 35, at 115. The economic approach toward jurisprudence, in its reliance on an array of typical economic assumptions, embraces strong and usually unstated philosophical and potentially political presumptions.

ism, in its effort to dissect the law and uncover dynamics and underlying motives, is more analytical, more critical, and unabashedly normative in its prescriptions. Post-realist scrutiny identifies political and social gamesmanship and evaluates the quality of resulting policy.

The most recent cases regarding insider trading have restricted the application of rule 10b-5. The decisions are based on a "close reading" of the regulatory language and the technical requirements of fraud. Among these recent developments are the requirement of proof of scienter,⁴³ the introduction of the theory of misappropriation⁴⁴ in civil claims, and the limitation of derivative tippee liability to instances of tipper malfeasance.⁴⁵ The shift away from the significant regulation approach of *Texas Gulf Sulphur* reflects a swing toward a purportedly acritical reading of rule 10b-5 which the post-realist or deconstructionist will typically reject as inevitably biased,⁴⁶ and potentially dangerous with its insistent proclamation of neutrality. Critical, post-realist assessment ordinarily rejects the zero regulation alternative and recommends a reinstatement of significant regulation, justifying an expansive reading of rule 10b-5 by evoking the ethical models discussed in Section III.

2. Conservative v. Non-Conservative Approaches

I use the term "conservative" and its ideological opposite in the pure and technically apolitical sense.⁴⁷ For this reason the phrase "non-conservative" is used instead of the more typical label "liberal," which may connote intent to distinguish on a political

⁴³ *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 201 (1976).

⁴⁴ *See infra* note 100.

⁴⁵ *Dirks v. SEC*, 463 U.S. 646, 660 (1983).

⁴⁶ In this regard, Barbara Herrnstein Smith states that when someone or some group of people insist(s) on the objective necessity or propriety of their own social, political, or moral judgments and actions, and deny the *contingency* of the conditions and perspectives from which those judgments and actions proceed, it must be—and always is—a move to assign dominant status to the *particular* conditions and perspectives that happen to be relevant to or favored by that person, group or class.

HERRNSTEIN SMITH, *supra* note 35, at 181.

⁴⁷ Whether conservative and non-conservative approaches can ever be evaluated in the "technically apolitical sense" would probably be contested by the very positivists and post-realists under consideration here. Whereas the positivist would probably tend to give substantial credence to the discussion of pure idealized types, the post-realist would uncover the inevitable political underpinnings of these purportedly neutral doctrinal types.

basis and may lead to confusion between the classically liberal and the more modern use of the term.⁴⁸ The conservative is oriented toward stasis in general, and the conservation and preservation of individual rights and freedoms in particular. The non-conservative favors change, potentially including the expenditure of individual freedoms in service of the greater good. The conservative approach is interpretively restrained and intendedly objective, whereas the non-conservative approach is interpretively activist and admittedly non-objective. The maintenance of stasis is consistent with the positivist's generally conservative approach to regulation. Stability in the law requires consistency of interpretation, and consistency is best assured by the positivist's "literal" interpretation. The era of retrenchment from the broad reading of rule 10b-5 in cases like *Texas Gulf Sulphur* reflects this conservative orientation in favor of literal, close readings and the resolution of ambiguity so as to preserve or conserve individual freedoms.

The non-conservative's receptiveness to change that enhances social well-being is combined with a skepticism regarding both the accuracy of and the motives behind ostensibly literal interpretations. For the non-conservative, there is no objectively identifiable interpretation, and any purported efforts to discover one will be tainted by a politically motivated subtext. From the standpoint of these assumptions, a reading of rule 10b-5 can and should be dynamic, seeking that resolution which best addresses the problems, not only as they were perceived in 1934 but also as they have developed and exist today. This open-text approach to statutory interpretation gives wide berth to legal and ethical analysis. Scholarship that recommends expansive reading and the revitalization of the significant regulation position reflects the inherently non-conservative nature of the post-realist orientation.

3. Classically Constraining v. Relationally Liberating Approaches

Classification of jurisprudence as "classical" or "relational" is an extension of Ian Macneil's typology of contracts.⁴⁹ The classical view of contract favors discreteness⁵⁰ and presentiation.⁵¹ The rela-

⁴⁸ Classical liberalism is similar to what I am labelling conservatism in its inclination to maximize individual freedoms and minimize social and regulatory impingement.

⁴⁹ See Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 Nw. U. L. REV. 854 (1978) (detailed discussion of contract types).

⁵⁰ "Discreteness" refers to the isolation of individual transactions. A discrete contract

tional perspective sacrifices some of the order, stability, and predictability gained by the relatively rigid classical approach and instead seeks the continued effective service of the developing and changing relationship between the contracting parties.⁵² While classical contract reduces risk and enhances the predictability of legal applications, relational contract is more responsive to the idiosyncratic development of a particular consensual relationship.

The positivist approach to insider trading is to view both the transactional contract⁵³ and the social contract⁵⁴ from a classical perspective. In order to presentiate the rights and duties of buyer and seller, the classically inclined legal positivist creates and supports unambiguous rules. The recent confinement of rule 10b-5 to classic cases of fraud is the product of ostensibly close and literal interpretation of that common-law doctrine. The idea is to read the law precisely as it is, rather than as it should be, with the positivist and classical implications of consistency and order.

The post-realist addresses the transactional contract as well as the social contract from a relational viewpoint.⁵⁵ The expansion era cases epitomized by *Texas Gulf Sulphur* reflect the open-textured interpretive stance of both the post-realists and the relationalists. Social consensus supports the expansive application of norms of fairness and equality in the securities market, and the nature of these norms evolves and develops within communities.⁵⁶ The post-

in its ideal form refers to one specific exchange. *See id.* at 856-57.

⁵¹ "Presentiation" refers to the effectiveness of a contract in stabilizing the expectations of parties into the future. A highly presentiated contract clearly specifies the precise obligations of each party through completion, and provides predictable remedies in the event of breach. *See id.* at 863.

⁵² *See id.* at 895.

⁵³ The "transaction contract" refers to the contract of sale that exists between the buyer and the seller of the securities in question.

⁵⁴ The "social contract" refers to the conditions and terms of widely held norms regarding behavior in securities market exchange.

⁵⁵ *See* Steven R. Salbu, *Joint Venture Contracts as Strategic Tools*, 25 *IND. L. REV.* 397 (1991). The relational approach to contracts

recognizes that although contract terms are finite and circumscribed, the disputes which arise between parties usually do not conform to these pre-existing confines. Instead, they develop within a natural context of organic change and development. As a result, disputes are often immune to any effective quick fix solely on the language of the contract document. Negotiation and mediation, considering both the document and the continuously unraveling pattern of relationships between the parties, may be the most effective mode of resolution.

Id. at 407.

⁵⁶ The application of relational contracting to the social contract is an extension of Macneil's original conception, which focuses on individual rather than social contract. The

realist interpretation of rule 10b-5 reflects the law's incorporation of change. It is admittedly normative, viewing the significant-regulation position as a means of mitigating abuse of power and information by insiders. For the post-realist, consistency between current interpretation and the language and legislative history of the rule are both impossible and irrelevant. This perspective is relational in its preference for timeliness and effectuality of interpretation over internal consistency.

III. ECONOMIC PARADIGMS AND ETHICAL PARADIGMS

Conflicting policy approaches toward insider trading often represent a fundamental disagreement regarding a more basic issue in jurisprudence: should the law be shaped using economic models, ethical models, or some hybrid? Economic models emphasize efficiency and optimal allocation of resources.⁵⁷ Given these criteria, it is possible to justify insider trading and any concomitant disparity of market opportunity. Ethical paradigms, which vary widely in their application of criteria to assess insider trading, often result in criticism of the practice based on arguments of fairness, distributive justice, human rights, and even social utility.⁵⁸

A. *Economic Paradigms of Jurisprudence*⁵⁹

The dominant economic model of jurisprudence has developed under the rubric of "law and economics."⁶⁰ Stated broadly, the movement recommends that laws and decisions under laws be con-

typology has value at the social as well as the individual level of analysis as a gauge of the flexibility with which a society believes its normative structure should be imbued. See generally *supra* note 49 and accompanying text.

⁵⁷ See Steven R. Salbu, *A Legal and Economic Analysis of Insider Trading: Establishing an Appropriate Sphere of Regulation*, 8 BUS. PROF. ETHICS J. 3 (1990).

⁵⁸ For a general discussion applying some of these concepts to insider trading, see Steven R. Salbu, *The Misappropriation Theory of Insider Trading: A Legal, Economic and Ethical Analysis*, 15 HARV. J.L. & PUB. POL'Y 223 (1992).

⁵⁹ The "economic paradigms" discussed herein refer specifically to those grounded in neoclassical economic theory, which have been the driving force behind the movement to deregulate insider trading. I do not mean to suggest that these are the only existing economic approaches, or that they represent the correct version of economic analysis. They are labelled "economic paradigms" for simplicity of reference and in contrast to the "ethical paradigms," which tend to result in different determinations of desirable public policy.

⁶⁰ See generally Richard A. Posner, *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*, 8 HOFSTRA L. REV. 487 (1980) (discussing tenets of law and economics theory).

figured to optimize the efficient use of scarce resources.⁶¹ Because social wealth as understood by both economists and some utilitarian philosophers is a proxy for satisfaction of composite utility preference functions,⁶² overall maximization of wealth is viewed as a legitimate and even ethical normative function of a legal system.⁶³

In regard to insider trading, the relevant economic models of law concern contract and property, which themselves comprise a paradigm choice and are therefore treated further in this regard in section IV. For the purposes of the economic versus ethical paradigm distinction presently under consideration, it is important to understand how legal economists view contract and property law.

In their quest for aggregate economic efficiency in fashioning the law, economists seek solutions that mitigate transaction costs.⁶⁴ The work of Coase⁶⁵ and Williamson⁶⁶ suggests that economic relationships are consummated with variations in the associated imple-

⁶¹ See ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS* 4 (1988).

⁶² See generally Frank I. Michelman, *Norms and Normativity in the Economic Theory of Law*, 62 MINN. L. REV. 1015 (1978) (discussing relationship between social wealth and social welfare).

⁶³ Thus, Posner states, "[T]he wealth of society is the aggregate satisfaction of those preferences (the only ones that have ethical weight in a system of wealth maximization) that are backed up by money, that is, that are registered in a market." RICHARD A. POSNER, *THE ECONOMICS OF JUSTICE* 61 (1983).

⁶⁴ The philosophical foundation behind the economic approach to law dates at least back to Hobbes, who conceived the function of law as it relates to property as the mitigation of failures in private cooperation. Hobbes believed that disagreement, contention, and litigation diminish the economic efficiency, and therefore the overall social effectiveness, of the legal system. For a discussion of these ideas, see THOMAS HOBBS, *LEVIATHAN* (1651).

⁶⁵ See Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960); see also Robert Cooter, *The Cost of Coase*, 11 J. LEGAL STUD. 1 (1982) (arguing that Coase's examples about underlying generalizations following from familiar economic assumptions are misleading); Elizabeth Hoffman & Matthew L. Spitzer, *The Coase Theorem: Some Experimental Tests*, 25 J.L. & ECON. 73 (1982) (documenting experimental results that support Coase's proposition). The Coase Theorem has been formulated as follows: "If there are no obstacles to exchanging legal entitlements, they will be allocated efficiently by private agreement, so the initial allocation by the courts does not influence the efficiency of the final allocation." COOTER & ULEN, *supra* note 61, at 101 n.11.

⁶⁶ See OLIVER E. WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* (1975); Oliver E. Williamson, *Transaction Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233 (1979); Oliver E. Williamson, *The Vertical Integration of Production: Market Failures Considerations*, 61 AM. ECON. REV. 112 (1971). Williamson's work builds on the basic tenets of Coase, suggesting that markets and organizational structures are and should be shaped in order to minimize transaction costs. Market activity, supported by contractual arrangements, is affected by laws that tend either to increase or decrease transaction costs. The failure of markets and contracts therein can be reduced by minimizing costs of compliance and creating incentives to cooperate amicably.

mentation and compliance costs. These costs are referred to as transaction costs, and they are incurred in quieting title to property and in negotiating, creating, and adjudicating contracts through which property is disposed. Cooter and Ulen's normative theory of property recommends structuring the law "to remove the impediments to private agreements" in furtherance of the basic efficiency orientation of the law and economics school.⁶⁷

In this spirit, the economic theory of contract and property has developed to reduce three general types of transaction costs⁶⁸ that tend to obstruct cooperation and thereby reduce social wealth: communication costs,⁶⁹ monitoring costs,⁷⁰ and strategic costs.⁷¹ If the function of law is to maximize social wealth, and social wealth is diminished in legal transactions predominantly through the assessment of these three fundamental classes of transaction costs, then both the substance of general laws and the disposition of individual cases thereunder should be guided by the utilitarian effort to create policies and decisions that minimize the costs. Abstract legal desiderata such as justice are considered as fallout, given the net utility maximization of such a system which creates the greatest aggregate good.⁷²

Economic analysis is conducive to the zero-regulation position on insider trading. Regulation is considered both a source of unjustifiable transaction costs and an impediment to the efficient dispersement of information. Rules that prohibit insider trading

⁶⁷ See COOTER & ULEN, *supra* note 61, at 101.

⁶⁸ This classification scheme was created by Cooter and Ulen. *See id.*

⁶⁹ Communication costs are an important component of overall transaction costs because clarity of expression of rights in property and contract should reduce disagreement costs and the associated expense of resolution. *See id.* at 100.

⁷⁰ To the extent that voluntary compliance is uncertain, parties to transactions must monitor them, increasing overall transaction costs, particularly under systems of surveillance that are elaborate or close in degree of scrutiny. To the extent that the law can encourage voluntary compliance, transaction costs are reduced. *See id.*

⁷¹ Strategic costs are incurred predominantly during the bargaining stage, at which negotiation may be enhanced for any individual party through the assessment of the other party's motives and predicted behavior. Because lawyers and investigative agents may be used for this purpose, and because of time and financial opportunity costs incurred thereby, strategy is an important component of overall transaction cost structure. *See id.* at 101.

⁷² Thus, the transaction cost reduction approach to jurisprudence is considered by law and economics proponents to be morally grounded. *See POSNER, supra* note 63, at 60-76. Advocates of this school would likely contest the configuration of the paradigm at issue here—economic versus ethical—contending that they have incorporated the ethical within economics by defining the latter in terms of social utility. The defense of the economic/ethical paradigm is contained in the critical literature which generally attacks the assumptions and value systems of a "social wealth" conception of justice.

thereby charge unnecessary and unproductive costs on securities transactions, reducing the aggregate social wealth by which the efficacy of the law is measured. An economic orientation also effects the way in which contractual analysis is approached.⁷³

Critics of the economic view of law question its fundamental assumptions; Dworkin notes that the view fails unless the bare increase of social wealth necessitates an increase in moral value.⁷⁴ The equation between wealth and value, predicated upon the relationship between individual economic utility and its aggregation into a net social utilitarian optimum, potentially breaks down; social financial wealth may not represent optimal net social utility because preference functions contain elements that cannot be translated into dollars. Dworkin notes that wealth maximization under the economic view of jurisprudence might not coincide with utility preferences in which equitable or humane distribution of assets is a highly ranked concern.⁷⁵

Posner demonstrates in his discussion of numerous specialized areas of the law the great extent to which the law and economics perspective is currently (if tacitly) incorporated within Anglo-American common law.⁷⁶ The entrenchment of an economic orientation, strengthened by the widely held belief that neoclassical eco-

⁷³ See *infra* notes 94-127.

⁷⁴ See DWORKIN, *supra* note 19, at 242. Dworkin states that the law and economics model

holds that if society changes so that there is more wealth than that change is in itself, at least pro tanto, an improvement in value, even if there is no other change that is also an improvement in value, and even if the change is in other ways a fall in value. The present question is not whether a society that follows the economic analysis of law will produce changes that are improvements in wealth with nothing else to recommend them. The question is whether such a change would be an improvement in value. That is a question of moral philosophy, in its broadest sense, not of how economic analysis works in practice. If the answer to my question is no—a bare improvement in social wealth is not an improvement in value—the claim that social wealth is a component of value fails, and the normative claim of economic analysis needs other support.

Id.

⁷⁵ See *id.* at 245. To illustrate this point, imagine a world containing one immensely wealthy person whose net worth exceeds all the wealth of the world as we know it now. In this fictional world, all of the billions of other people are starving. While net wealth is greater in the imaginary world than in the real one, no one (including the tycoon) would be likely to acknowledge greater utility as a function of the change.

⁷⁶ See POSNER, *supra* note 63. Posner's book does not only suggest that optimal allocation of scarce resources be the driving force behind the law; it demonstrates as well the great extent to which the common law's development has been based historically on an economic value system.

nomics is itself based on natural and immutable laws,⁷⁷ has created a cultural bias toward the application of economic metaphors in Western problem-solving.⁷⁸ It is from these critical positions that the strongest arguments favoring non-economic models of morality emerge. They tend to share a broad-based belief that goals other than maximization of social wealth are normatively valid and must therefore be accounted for in a legitimate ethical system.

B. *Ethical Paradigms of Jurisprudence*

Ethical paradigms are broadly defined here to include all models of jurisprudence that require some analysis beyond the efficient allocation of scarce resources aimed at maximizing net social wealth. This inclusive classification provides an ideal type antithetical to the law and economics approach.

The varieties of ethical systems against which we can examine the practice of insider trading have been described in detail in prior works, therefore they will be discussed only briefly here.⁷⁹ The current examination will instead focus on the ways in which judicial or scholarly association with a paradigm, economic or ethical, drives the ultimate philosophy on insider trading.

Non-economic moral systems⁸⁰ most commonly focus on fairness of practices and procedures,⁸¹ equality of treatment and op-

⁷⁷ See SMITH, *supra* note 16. Adam Smith's economic philosophy fits within the context of the Enlightenment era in which it developed: Smith claimed, through empirical observation, to have discovered natural laws of property, human nature, and exchange, according to which the wealth of nations would be maximized. His natural law of markets, considered to be cosmic in its universal application rather than a culturally workable economic choice, is consistent with Posner's presupposition that social wealth is a moral concept.

⁷⁸ The post-realist approach to economic models is critical of the belief that neoclassical theory is the objectively superior, scientifically indicated choice. Applying deconstructive analysis and anthropological methodology, critics suggest that neoclassicism merely fits remarkably well within the power structure, extant incentive systems, and overall Western orientation created through historic imperialism. The very assumption that the primary goal of economic policy should be efficiency rather than, for example, equality, suggests that what we consider natural may in fact be cultural. For a discussion of some of these issues, see MARSHALL SAHLINS, *STONE AGE ECONOMICS* (1972); HAROLD K. SCHNEIDER, *ECONOMIC MAN: THE ANTHROPOLOGY OF ECONOMICS* (1974); Karl Polanyi, *Our Obsolete Market Mentality*, 3 COMMENTARY 109 (1947).

⁷⁹ See Salbu, *supra* note 58.

⁸⁰ For these purposes, I define a non-economic moral system as one which considers issues other than the allocation of scarce resources to maximize net social wealth. Under this definition, a non-economic moral system may contain an economic component, and may consider in part the efficient utilization of the factors of production. A system is non-economic in its recognition of non-economic considerations.

⁸¹ Fairness and equality are related ethical concepts that overlap substantially in the

portunity,⁸² and the prescribed distribution of wealth.⁸³ These qualities are often discussed and evaluated under a chosen normative decision framework, which falls somewhere between teleological⁸⁴ and deontological⁸⁵ ideal types.

Fairness of market transactions and the obligation to disclose unknown or unavailable information have been debated for centuries by both philosophers⁸⁶ and lawyers.⁸⁷ The legal and moral

area of insider trading. Fairness is generically defined by philosophers as "equal treatment of equal cases," or "like treatment of like cases." For a discussion of these elements as they relate to insider trading, see Patricia Hogue Werhane, *The Ethics of Insider Trading*, 8 J. BUS. ETHICS 841 (1989).

⁸² *Id.*

⁸³ Representative of the spectrum of theories of distributive justice are the works of John Rawls and Robert Nozick. For Rawls, once individual liberty is maximized consistent with the basic liberties of others, "social and economic inequalities are to be arranged so that they are both (a) reasonably expected to be to everyone's advantage, and (b) attached to positions and offices open to all." John Rawls, *Justice as Fairness*, in W. HOFFMAN & J. MOORE, *BUSINESS ETHICS: READINGS AND CASES IN CORPORATE MORALITY* 37 (2d ed. 1990). Nozick's theory of distribution is based on the basic premise that the state should refrain from the exercise of illegitimate coercion, including that which redistributes the natural rights in property which are obtained by the mixing of labor with the other economic factors. See ROBERT NOZICK, *ANARCHY, STATE AND UTOPIA* (1974).

⁸⁴ Teleological frameworks focus on consequences of actions rather than intention. The utilitarian model as formulated by Bentham, Mill, and others evaluates ethical choices by seeking to derive the greatest good for the greatest number. See JEREMY BENTHAM, *AN INTRODUCTION TO THE PRINCIPLES OF MORALS AND LEGISLATION* 11 n.a (J. H. Burns & H.L.A. Hart eds., 1982). Bentham's emphasis on what he calls the "greatest happiness principle" provides overlap between the teleological approach to ethics and the ostensibly moral dimension of the law and economics school. John Stuart Mill's version of utilitarianism has been noted to be less supportive of the law and economics movement, as it rejects Bentham's hedonic calculus when in derogation of righteousness or justice. See James V. DeLong, *Defending Cost-Benefit Analysis: Two Replies to Steven Kelman*, 15 REGULATION 103 (1981).

⁸⁵ Deontology is based on the idea of universalism in formulating righteous and just decisions. See IMMANUEL KANT, *THE CRITIQUE OF PRACTICAL REASON* (Lewis White Beck trans., 1956) (1788); IMMANUEL KANT, *FOUNDATIONS FOR A METAPHYSIC OF MORALS* (Lewis White Beck trans., 1969) (1785). Kant's "categorical imperative" is a rule of behavior that the ethical decision-maker would be willing to have applied universally, consistently, and without exception. As compared with teleological approaches, deontology emphasizes the integrity and independent moral status of the means themselves, rather than focusing exclusively on the consequences of behavior.

⁸⁶ See Gary Lawson, *The Ethics of Insider Trading*, 11 HARV. J.L. & PUB. POL'Y 727, 737-46 (1988) (discussing philosophical approaches to information equality). Lawson discusses the question as addressed by Aquinas, Cicero, and Diogenes. See THOMAS AQUINAS, *SUMMA THEOLOGICA* pt. II-II, q. 77, art. 3 (Fathers of the English Dominican Province trans., 1947); MARCUS CICERO, *DE OFFICIIS* bk. III (Walter Miller trans., 1968).

⁸⁷ The issue of non-disclosure in contract law falls within the doctrine of fraud, which is defined under common law as a material misrepresentation of fact upon which the victim relies to his or her detriment. See RESTATEMENT (SECOND) OF CONTRACTS § 164(1) (1979). In regard to insider trading, the question of fraud concerns the conditions under which misrep-

dimensions of disclosure vary according to modulation of circumstance; thus both philosophy and law address disparity of information that is publicly available, of information that is hidden or unapparent to one of the trading parties, and of information held by one party but otherwise not publicly available. Whereas the defense of insider trading is usually the product of economic analysis, the condemnation of insider trading is typically the result of ethical examination. Equality arguments incorporate one's duty "to serve [others] and to place their interests, if not above [one's] own, then at least on the same level."⁸⁸ Levmore's approach is to apply the golden rule to the circumstances of insider trading, suggesting that since none of us would wish to be denied equal access to information, the practice is fundamentally unfair.⁸⁹ Werhane gives justification for the proposition that "no one should profit from exploitation of important information not available to the public."⁹⁰ Moore's ethical analysis results in the eventual rejection of insider trading, not because of the unfairness or harm that results, but rather because it "undermines the fiduciary relationship that lies at the heart of American business."⁹¹

Utilitarian "harm" analysis is the only category of ostensibly ethical application in which the soundness of regulating insider trading is seriously questioned. Critics have argued that no economic harm is visited upon any relevant player,⁹² or, alternatively, that the real problem is capitalism's employment of the dynamics of a casino,⁹³ resulting in abuses that are really consistent with and encouraged by the overall system. While these kinds of models may appear to be an aberration of the observation that ethical models consistently support regulation, the models are in fact primarily economic in their approach. Like Posner, the authors applying solely economic utility tests argue that these criteria them-

resentation can be inferred from silent trading when a duty to disclose exists.

⁸⁸ See Lawson, *supra* note 86, at 743.

⁸⁹ See Saul Levmore, *Securities and Secrets: Insider Trading and the Law of Contracts*, 68 VA. L. REV. 117, 122-23 (1982).

⁹⁰ See Hogue Werhane, *supra* note 81, at 841 (quoting George F. Will, *Keep Your Eye on Giuliani*, NEWSWEEK, Mar. 2, 1987, at 84).

⁹¹ Jennifer Moore, *What Is Really Unethical About Insider Trading?*, 9 J. BUS. ETHICS 171 (1990).

⁹² William J. Carney, *Signalling and Causation in Insider Trading*, 36 CATH. U. L. REV. 863, 863 (1987) (observing that "little harm can be demonstrated to particular investors, to markets generally, to issuers, or to bidders").

⁹³ Roman Tomasic & Brendan Pentony, *Insider Trading and Business Ethics*, 13 LEG. STUD. F. 151 (1989).

selves comprise a moral system, equivalent to Posner's concept of "social wealth." While these discussions all present themselves as ethical in nature, they do not resort to consideration of non-financial utility and are therefore categorized as essentially economic within this discussion.

IV. PROPERTY PARADIGMS AND CONTRACT PARADIGMS

Insider trading is the subject of regulatory initiative because abuse of information is considered potentially damaging in capital markets.⁹⁴ Transactions in securities can occur under varying levels of information availability and parity; regulation is considered when practices result in information asymmetry or disparity. When the judicial or academic level of analysis is either property-oriented or contractual and economic, the conclusion generally restricts or disfavors regulation. On the other hand, when the level of analysis is contractual and ethical, the findings generally defend broad and expansive regulation.

While both property and contract models examine insider trading in terms of "abuse of information," property models focus on the information as it is owned and potentially stolen. Under the gravamen of misappropriation, property analysis yields recommendation of restricted regulation.⁹⁵ Economic contract models view the abuse of information in terms of its potential to increase transaction costs or diminish efficiency, resulting in mandates for zero regulation.⁹⁶ Ethical contract models look for the violation of a tacit presumption of fairness through the occurrence of fraud or a

⁹⁴ The fear that information will be manipulated or exploited in pernicious ways is implicit not only in the existing proscription of insider trading, but also in disclosure requirements such as § 16(b) of the 1934 Act, which implicitly creates an irrebuttable presumption of abuse when insiders realize short-swing profits. See *supra* note 2. Section 16(b) reflects what some scholars believe to be regulatory excess in the artificial government constraint of naturally dynamic information markets. See, e.g., Marleen A. O'Connor, *Toward a More Efficient Deterrence of Insider Trading: The Repeal of Section 16(b)*, 58 *FORDHAM L. REV.* 309, 313 (1989) (arguing that § 16(b) fails to serve a useful purpose in deterring insider trading).

⁹⁵ What I am labelling "restricted regulation" represents the current trend in insider trading cases. The misappropriation theory falls between zero regulation and significant regulation by prohibiting trades on inside information only when that information has been stolen or misappropriated from a person or entity toward whom a fiduciary duty is owed. See, e.g., *Chiarella v. United States*, 445 U.S. 222, 230 (1980) (limiting liability under rule 10b-5 to circumstances of breach of fiduciary duty).

⁹⁶ The now classic statements of Henry Manne are the most salient example of economic models that tend toward zero regulation recommendations. See *Manne, supra* note 6.

systemic and enforced institutional inequality, often rendering a prescription of total regulation.⁹⁷

A. *Property Paradigms*

Property approaches to insider trading begin with the idea that there can be ownership rights in information.⁹⁸ Since information is often property, the unauthorized utilization of proprietary information is a form of theft or misappropriation. If a trader of securities uses the information of another to his or her own advantage, and the trader owes the property owner a fiduciary duty, the use is viewed as fraudulent and therefore in violation of rule 10b-5.

The property paradigm as embodied in the misappropriation theory is steeped in an economic rather than an ethical metaphor, and is therefore restrictive in its application. Because the gravamen is the unauthorized use of property, the focus is highly transactional rather than macroeconomic, considering exclusively the microeconomic effect of a trade on the buyer's and seller's net wealth.⁹⁹ The doctrine that results from the property paradigm ignores issues of generic fairness and equality in the market for all players as they are affected by all other buying and selling behavior, exonerating trades that are made on nonpublic information provided that information has not been improperly acquired.¹⁰⁰

⁹⁷ See Salbu, *supra* note 58. Ethical contract models are being compared here to economic contract models. The former tend to be deontological, focusing on the fairness and equality of the transactions themselves rather than the ultimate consequences and utilities. More teleological models, such as those which assess degrees of ultimate harm caused by insider trading, are more economic in nature in their consistency with Posner's conception of aggregate economic utility as a moral measure.

⁹⁸ For a discussion of the nature of information as an asset, see Robert J. Haft, *The Effect of Insider Trading Rules on the Internal Efficiency of the Large Corporation*, 80 MICH. L. REV. 1051 (1982); Richard J. Morgan, *Insider Trading and the Infringement of Property Rights*, 48 OHIO ST. L.J. 79 (1987); Kenneth E. Scott, *Insider Trading: Rule 10b-5, Disclosure and Corporate Privacy*, 9 J. LEGAL STUD. 801 (1980).

⁹⁹ The dominance of transactional economics in supporting the misappropriation theory as policy is evident in the nature of analysis that restricts regulatory reach. Typically, recommendations to curb the application of rule 10b-5 are a detailed assessment of the net economic gains and losses realized by those in privity of contract related to the trade at issue. This kind of transactional economic analysis more often supports recommendations of zero regulation, so that the greater the reliance on microeconomic theory to the exclusion of non-economic ethical models, the more severe the recommendations are likely to be in favor of deregulation. See, e.g., David D. Haddock & Jonathan R. Macey, *Regulation on Demand: A Private Interest Model, with an Application to Insider Trading Regulation*, 30 J.L. & ECON. 311 (1987).

¹⁰⁰ See *United States v. Carpenter*, 791 F.2d 1024 (2d Cir. 1986), *aff'd in part*, 484 U.S. 19 (1987). In *Carpenter*, R. Foster Winans and his tippees at Kidder Peabody traded on

A growing movement in favor of shareholder-authorized insider trading¹⁰¹ reflects the current entrenchment of the misappropriation theory as it has been derived from a property-oriented conception of the problem. Implicit in recommendations that shareholders be allowed to authorize managerial insider trading, as emolument or in order to benefit the corporation,¹⁰² is the assumption that the only grounds for objection are those of shareholders claiming that their property has been misappropriated. Economic and ethical market integrity, in terms of investor confidence and systemic fairness, are not considerations when the level of analysis has been determined in advance to concern specific individual property rights. The nexus between the property paradigm and the movement favoring shareholder authorization is consistent with the theory that property analysis leads to policy recommendations favoring restricted regulation.

B. Contract Paradigms Under Economic Analysis

Economists and philosophers attempting to understand transactions¹⁰³ and rational bargaining¹⁰⁴ have been led irresistibly to

information acquired from Winans's "Heard on the Street" columns in *The Wall Street Journal* prior to the publication of these columns. *Id.* at 1026-27. The Second Circuit decision applied the misappropriation theory broadly to find the requisite fraud in Winans's use of his employer's column, despite the fact that *The Wall Street Journal* was neither a buyer nor a seller of the relevant securities. *Id.* at 1027-34. The majority of the Supreme Court in *Carpenter* supported the lower court's finding of mail fraud, but reached a 4:4 impasse on the issue of misappropriation. *Carpenter*, 484 U.S. at 24.

The *Carpenter* decision can be viewed as a missed opportunity for the Court to expand the misappropriation theory, to which it had previously alluded in *Chiarella v. United States*, 445 U.S. 222 (1980). *Chiarella*, the defendant, worked for a printer who did jobs concerning tender offers. *Id.* at 224. When *Chiarella* traded on information he discovered from the documents he handled on the job, he was prosecuted for insider trading. *Id.* He was acquitted on the ground that he owed no fiduciary duty to the corporations whose securities he traded. *Id.* at 237. The concurring and dissenting opinions suggested that application of the misappropriation theory would have sustained *Chiarella's* conviction. *Id.* at 239 (Brennan, J., concurring), 240-45 (Burger, C.J., dissenting). The result to date is that the relatively rigorous limitations and restrictions applied to rule 10b-5 by *Chiarella* remain intact.

¹⁰¹ See Bill Shaw, *Shareholder Authorized Insider Trading: A Legal and Moral Analysis*, 9 J. Bus. Ethics 913 (1990).

¹⁰² See Helen A. Garten, *Insider Trading in the Corporate Interest*, 1987 Wis. L. Rev. 573 (discussing arguments suggesting that insider trading can in fact benefit relevant corporation).

¹⁰³ See *supra* notes 64-72 and accompanying text (discussing transaction cost theory under generic economic paradigm).

¹⁰⁴ See DAVID P. GAUTHIER, *MORAL DEALING: CONTRACT, ETHICS, AND REASON* 187-206 (1990).

the examination of contract dynamics and contract law. The "economic approach" to contract analysis tends to incorporate three assumptions or some corollaries thereof.

1. The Lockean Assumption that Property Distribution Ought To Represent the Commingling of Labor with the Property *Res*¹⁰⁵

Transactional analysis evaluates a contractual relationship in terms of the effective and efficient allocation of rights between two parties, such that legitimate interests in property are preserved as well as conserved from waste. The prescribed mitigation of contract maintenance costs is in the service of both net social wealth and valid, legally enforceable ownership rights. Like the neoclassical economic paradigm from which they are derived, economic contract models rank freedom over equality,¹⁰⁶ at least as the latter is broadly defined by critical theorists.¹⁰⁷ The bias of the models therefore discourages regulation (i) in general, because of its tendency to add increments of transaction cost to the contracting process system-wide, and (ii) in particular, when the regulatory scheme limits the free, unfettered activity of individual labor in its transformation to property interests.

¹⁰⁵ John Locke's theory of acquisition states that rights are developed in an unowned thing by mixing one's labor with it. Locke was particularly concerned with the relationship of individual property rights and the potentially usurping power of the government. The analogy between pre-Revolutionary property confiscation and the potential regulatory usurpation of insider trading profits is implicit in the arguments of economists and philosophers whose reasoning is based on Lockean assumptions. See John Locke, *An Essay Concerning the True Original, Extent and End of Civil Government*, in *SOCIAL CONTRACT: LOCKE, HUME, ROUSSEAU* 3-143 (E. Baker ed., 1960) (general discussion of Locke's principles).

¹⁰⁶ The definitive neoclassical treatment extolling the preeminent virtues of freedom comes from Milton Friedman. Since freedom and equality cannot be optimized simultaneously (again, assuming the relatively broad definition of equality employed by critical theory), the elevated status of the former must be to some extent at the expense of the latter. For a succinct statement of Friedman's economic philosophy, see MILTON FRIEDMAN, *CAPITALISM AND FREEDOM* (1971).

¹⁰⁷ The conservative conception of equality tends to be labelled "equal opportunity": the critical response is that conservative efforts at creating comparable starting points are deficient in their failure to account for historically accrued differences that continue prospectively to effect disparity in opportunity despite seemingly blind or neutral standards. See KELMAN, *supra* note 32, at 114-50 (critical discussion of ostensibly social component of law and economics).

2. The Assumption that Rational and Voluntary Choice Should Determine the Distribution of Social Goods, and that Rational Actors Would Choose Disparate Distribution Proportionate to Natural Talent and Accrued Social Endowment, as well as Effort

David Gauthier rejects Rawls's contention¹⁰⁸ that justice demands the equal distribution of social primary goods.¹⁰⁹ Gauthier attacks Rawls's purportedly rational contractual foundation¹¹⁰ by questioning the validity of employing a veil of ignorance. Reckoning from the original position warps the perspectives of the contracting parties. A legitimate, rational contractual arrangement for the distribution of social goods cannot result from artificially imposed fictional constraints.¹¹¹

The economist's acceptance of inequality as the inevitable, rational contractual choice is implicit in the defense of insider trading. Scholars praise the expedient market dispersement of information that occurs when insiders are allowed to trade before public announcement can be made, arguing that markets gain in efficiency as soon as rational trading occurs, regardless of whether the basis for the trading decision consists of public or private information.¹¹² Ethical arguments of fairness and equality of opportunity

¹⁰⁸ Rawls's "general conception" states, "All social primary goods—liberty and opportunity, income and wealth, and the bases of self-respect—are to be distributed equally unless an unequal distribution of any or all of these goods is to the advantage of the least favored." JOHN RAWLS, *A THEORY OF JUSTICE* 303 (1971).

¹⁰⁹ See GAUTHIER, *supra* note 104, at 154.

¹¹⁰ *Id.* at 150-70.

¹¹¹ Gauthier states that

a principle establishing the terms of association must be rational, not only prospectively but also retrospectively. By this I mean, not that the choice made in ignorance be the choice one would make, if one could, when one is aware of the actual circumstances governing the outcome, but that awareness of the outcome should not lead one to judge the original choice irrational, when one in imagination reimposes the constraints under which it was made. The choice must be rationally acceptable, in this sense, to each representative person after the veil of ignorance is lifted.

Id. at 156.

¹¹² See Carlton & Fischel, *supra* note 6. While most economic analysis favors some degree of deregulation, there are exceptions. See, e.g., Michael J. Fishman & Kathleen Hagerty, *Insider Trading and the Efficiency of Stock Prices* (1989) (Northwestern University, Department of Finance mimeograph) (suggesting that insider trading may discourage generation of information by stock analysts); see also Frank H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 11 SUP. CT. REV. 309 (1981) (contending that potential gains from insider trading may cause strategic withholding of information, resulting in reduced market efficiency).

are quickly subordinated to theorized economic gains in the effectiveness of the market's valuation mechanism. The ultimate message is clear: any individual advantage held during contracting is supported by rational actors who approve of systemic inequalities when they enhance market efficiency. If there is a moral framework that supports this ultimately economic model, it appears to be a sanitized hybrid of Social Darwinism.¹¹³

3. The Assumption that Economic Metaphors of Utility Can Be Shifted from the Individual to the Social Level of Abstraction, Resulting in a Concomitant Shift from Economics to Ethics

Gauthier states, "What the good is to an individual, the just is to society."¹¹⁴ Applying the presumption that an ethical system can be captured completely in the utility maximization model discussed earlier, economic analysts claim to provide morality through efficiency.¹¹⁵ The syllogism from which the economic-moral equation is derived can be stated as follows: Utilities measure degree of individual good; efficiency maximizes the sum of individual goods, therefore the most efficient system, by optimizing aggregate good, is the most ethically sound under a legitimate utilitarian approach. If the syllogism is accepted into the model for evaluating insider trading laws, normative questions regarding the boundaries of fraud and contract doctrine can be answered simply by assuming that rational actors would choose that system which provides the greatest good for the greatest number by minimizing transaction costs.¹¹⁶ Henry Manne's classic statement of the case against regu-

¹¹³ The tenets of Social Darwinism seem to be implicit in the economic analysis of contract, although they are not identified as such given the current disrepute of Social Darwinist theory. Darwin himself discussed "natural selection as affecting civilized nations." CHARLES DARWIN, *THE DESCENT OF MAN* (1871). Social Darwinism has been defined as "that enterprise or ideology, founded in the nineteenth century, which holds social evolution to depend upon the operation of the law of natural selection of favourable heritable variations." R.J. Halliday, *Social Darwinism: A Definition*, 1971 *VICTORIAN STUD.* 389, 404. Like economic contract analysis, Social Darwinism suggests that unequal distribution of goods, even when based on advantages of inheritance or hereditary talent, both reflects and contributes to the future aggregate social wealth.

¹¹⁴ See GAUTHIER, *supra* note 104, at 171.

¹¹⁵ See *supra* notes 57-78 and accompanying text.

¹¹⁶ A law and economics approach to Rawls's veil of ignorance might lead to the following reasoning: I don't know who I'll be and what advantages I will have once the veil is lifted. Given that the random answer to this question could ultimately fall anywhere on the spectrum, I can maximize the expected value of my return by approving of an economic contract system that minimizes transaction costs, thereby maximizing the total pool of

lating insider trading follows precisely this kind of logic. Manne contends that insider trading yields benefits such as the expedient movement of information through the market as well as improved managerial performance.¹¹⁷ He claims as well that the perceived costs of insider trading are largely illusory, so that allowing the practice to occur unfettered by regulation maximizes social utility and is therefore both the economically and the ethically sound choice.¹¹⁸ This kind of reasoning can be made to fit the common law of contract and fraud through an implication of social knowledge and acceptance of practices that reduce transaction costs of contracting. Under this model, an omission to disclose material, nonpublic information is not a misrepresentation because rational consensus approves of the practice, understanding its value in the economy and legitimizing its status within the boundaries of acceptable and expected behavior. From this perspective, existing regulations prohibiting insider trading should be abolished in the spirit of the rationally and economically efficient reconstruction of the common law.

C. *Contract Paradigms Under Ethical Analysis*

Not all contract paradigms are steeped in the theory of neo-classical economics and transaction cost analysis. Ethical contract paradigms differ from their economic analogues in (a) their receptiveness to other-than-utilitarian conceptions of morality, and (b) their view that a consensual model of shared values can rationally include choices other than net efficiency ends as derived by transaction cost analysis either because (i) moral systems should not be consequentialist, or (ii) moral systems that can validly be consequentialist would not necessarily extol the virtues of efficiency over those of equality and fairness.

Ethical contract models do not reject utilitarian or economics-influenced approaches to moral decision-making. Instead, they rec-

wealth. This speculation of rational behavior diverges from Rawls's more egalitarian assumptions of rationality in its assumptions regarding (a) the degree to which the decision maker is risk-averse, and (b) the degree to which the decision maker calculates the welfare of others in choosing a system. While neoclassical economic theory typically responds to criticism of its most basic assumptions by claiming that utilities must be measured broadly to represent all units of satisfaction, including charitable instincts, the models that result are criticized by others for their lack of compassion and their failure to incorporate non-quantifiable objectives.

¹¹⁷ See Manne, *supra* note 6.

¹¹⁸ *Id.*

ognize the diversity of ethical frameworks that have developed and the conflict that occurs when multiple communities apply them.¹¹⁹ The social contract governing transactions in securities is identified by rigorous examination of prevailing norms. For example, there may be wide social consensus that rules which maximize aggregate wealth are most desirable. If this is found to be the case, then the approach recommended by the economic analysis of contract would coincidentally be supported by the ethical contract analysts as well. But whereas the prevailing economic view recognizes efficiency as the only ultimate moral choice,¹²⁰ those who evaluate the social contract ethically seek an actual democratic accounting of the true nature of the extant contract.

Stated differently, economists deduce the nature of the social contract by the application of logic to the assumptions that support neoclassical theory. Ethicists, using evidence supplied by organizational theory, are cynical of the economic deductive method because the conclusions are only as valid as the assumptions, which are viewed as highly suspect.¹²¹ Rejecting the notions that maximization of social wealth is the only rational moral imperative, and that the extant social contract can only embrace this limited goal, ethicists reopen the search for potential contractual content. They suggest social norms under which fairness and equality of opportunity may be elevated beyond the endless accumulation of greater wealth, however gained and however distributed.¹²²

¹¹⁹ See Thomas W. Dunfee, *Business Ethics and Extant Social Contracts*, 10 J. Bus. ETHICS 23, 25 (1991). Dunfee uses insider trading as an example to explicate his social contract model. He states that "in evaluating certain forms of insider trading, inconsistent answers may be given by utilitarians, Kantians and contractarians." *Id.* Given the conflict that arises when these differing models are applied, a consensual ethics can be derived by finding and understanding the extant social contracts and resolving conflicts through the use of priority rules.

¹²⁰ According to the received economic model, (a) decision makers are rational, and (b) the rational normative goal is to optimize total wealth, thereby maximizing net utility or good, therefore (c) the social contract regarding insider trading approves that degree of regulation which is most economically efficient and which produces the greatest total wealth.

¹²¹ The rational actor model of decision-making has been assaulted by the Carnegie school of organizational theorists, who have argued convincingly that while humans are intendedly rational, this effort is bounded by the limitations of cognition, time, and available information. See RICHARD M. CYERT & JAMES G. MARCH, *A BEHAVIORAL THEORY OF THE FIRM* (1963); JAMES G. MARCH & HERBERT H. SIMON, *ORGANIZATIONS* (1958).

¹²² The ethical approach to contract can be put into economic terms. The ethicist would argue that the marginal utility of material goods declines as wealth increases, and that the utility of a fair and equal system is typically undervalued by economists. Utilitarian analysis is not, therefore, fatally doomed to be financially driven in the direction of neoclassical economic values. Rather, utilitarianism is an ethical model of substantial legitimacy from which

Recommendation of significant regulation¹²³ usually results from the application of an ethical contract model to the question of insider trading. According to Levmore, “[t]he regulation of insider trading . . . has had strong support among those who look to non-economic values to determine the proper role of government and the ideal content of laws in our society, but it has had much weaker support among observers who identify with the law-and-economics movement.”¹²⁴ In a 1982 speech, Boris Longstreth, then Commissioner of the Securities and Exchange Commission, stated: “The prohibition against insider trading rests principally on the notion of fairness—both specifically in the operation of the marketplace and generally as an ethical concept.”¹²⁵ Likewise, the most expansive judicial decisions in the history of interpreting rule 10b-5 have been grounded in ethical contract reasoning, even in their application to market dynamics.¹²⁶ The resilience of ethical arguments in the face of significant assault from the law-and-economics camp is in part a function of economic critique. Ethicists trained in economics and the application of utilitarian normative philosophy have questioned the economic arguments favoring deregulation.¹²⁷

inaccurate results are derived when costs and benefits are calculated according to the bias of the theorist rather than according to true social utility preference function.

¹²³ “Significant regulation” refers to the blanket prohibition of insider trading, regardless of the source of information. The movement to regulate insider trading significantly includes a recommendation to nullify the misappropriation theory and to render illegal all trading that occurs on information that is not available to the public. *See supra* note 58.

¹²⁴ Saul Levmore, *In Defense of the Regulation of Insider Trading*, 11 HARV. J.L. & PUB. POL’Y 101, 101 (1988).

¹²⁵ Boris Longstreth, *SEC Battle Against Insider Trading Is Worth the Effort*, LEGAL TIMES OF WASH., May 10, 1982, at 16, col 3. Fairness considered “generally as an ethical concept” implies its widespread acceptance in the framework of the American social contract.

¹²⁶ *Texas Gulf Sulphur*, 401 F.2d at 847-48. Judge Waterman’s decision states, in part, the following:

Rule 10b-5 was promulgated pursuant to the grant of authority given the SEC by Congress in Section 10(b) of the Securities Exchange Act of 1934. By that Act Congress proposed to prevent inequitable and unfair practices and to insure fairness in securities transactions generally, whether conducted face-to-face, over the counter, or on exchanges

. . . .
The core of Rule 10b-5 is the implementation of the Congressional purpose that all investors should have equal access to the rewards of participation in securities transactions. It was the intent of Congress that all members of the investing public should be subject to identical market risks

Id. at 847-48, 851-52.

¹²⁷ Thus, I have contended that even from an economic standpoint, insider trading is harmful and inefficient in that it reduces confidence in markets, creates information asym-

More importantly, the entrenchment of the prohibition of insider trading in our regulatory system reflects a relative consensus regarding the social contract. Notions of fairness of opportunity pervade court decisions, scholarship, and journalism espousing significant regulation. Those who fall within this cluster contend that their recommendations of fairness and equality reflect widespread social consensus.

V. THE EFFECT OF PARADIGM SELECTION ON POLICY

The spectrum of policy choices for the regulation of insider trading ranges from zero to significant regulation. Scholarly and judicial opinions on the subject virtually always address the particular concerns that have been deemed relevant to insider trading.¹²⁸ While the manifest focus is on the special considerations of insider trading, the latent function of a position is often the promotion of the more generic paradigm orientations that have been discussed. An orientation toward positivist, economic-contract models favors the zero regulation position. Conversely, when post-realist, ethical-contract models are applied, conclusions tend to favor significant regulation. The use of a property paradigm rather than a contract paradigm will tend to moderate or temper the positivist/realist effects and the economic/ethical effects, yielding mid-range policy recommendations of restricted regulation.

The effects of the three paradigm selections on policy can be diagrammed as follows:

metry, and defrauds all market participants, including those not in immediate privity of contract. See *supra* notes 57-58. Likewise, Levmore has argued that allowing insider trading does not only permit the moral hazard of encouraging insiders to create bad news; it also results in economic dysfunction by reducing information "in an unregulated world where it can be withheld with impunity." See Levmore, *supra* note 124, at 108.

¹²⁸ As has been noted throughout, different commentators choose from among these salient concerns. It is rare to find one analysis that gives thorough consideration to ethical and economic issues of both contract and property law.

SIGNIFICANT REGULATION

H

RESTRICTED REGULATION

L

ZERO REGULATION

[-----]

Positivist
ParadigmsPost-
Realist
ParadigmsEconomic
Contract
ParadigmsProperty
ParadigmsEthical
Contract
Paradigms

The three paradigm choices are the components of a more generic philosophical orientation concerning the function of law.¹²⁹ Implicit in the zero-regulation paradigms is an orientation toward social control. Talcott Parsons's functional analysis of the law concentrates on the integrative effect of law in the maintenance of social order.¹³⁰ He emphasizes consistency and interpretive clarity as factors that relate to the law's potency in effecting social control. Legal positivist and economic-contract paradigms are internally consistent: they operate simultaneously and harmoniously under the metaphor of law as social control. The pure positivist's source of legal authority is command and sovereignty.¹³¹ The conservative interpretation of legal text is in the service of social control and

¹²⁹ Functionalism is a sociological school that attempts to explain institutions, structures and systems by the social ends or functions they serve. For a view of the development of sociological and anthropological functionalism, see BRONISLAW MALINOWSKI, *A SCIENTIFIC THEORY OF CULTURE* (1944); TALCOTT PARSONS, *THE STRUCTURE OF SOCIAL ACTION* (1937); MAX WEBER, *THE THEORY OF SOCIAL AND ECONOMIC ORGANIZATION* (A.M. Henderson & Talcott Parsons trans., 1947); A.R. Radcliffe-Brown, *On the Concept of Function in Social Science*, 37 AM. ANTHROPOLOGIST 394 (1935).

¹³⁰ See Talcott Parsons, *The Law and Social Control*, in *LAW AND SOCIOLOGY* 56 (W.M. Evan ed., 1962). Parsons states,

[i]n the larger social perspective the primary function of a legal system is integrative. It serves to mitigate potential elements of conflict and to oil the machinery of social intercourse. It is, indeed, only by adherence to a system of rules that systems of social interaction can function without breaking down into overt or chronic covert conflict.

Id. at 58. In this vein, he contends that "[n]ormative consistency may be assumed to be one of the most important criteria of effectiveness of a system of law." *Id.*

¹³¹ See *supra* note 12.

stability. The economic-contract mode is compatible with non-critical, positivist, literal statutory interpretation. Its adherence to non-intervention and its rejection of activist interpretation place the economic-contract paradigm squarely in line with positivist jurisprudence. It is difficult to imagine the alignment of these ideologies resulting in any response to insider trading except zero regulation.

Inherent in the significant regulation position is a view that the function of law is to act as the agent of social change, an idea advanced by William Evan.¹³² The post-realist approach to insider trading is likewise receptive to non-conservative and activist interpretation of the law, intended to reveal the political power structures that exist beneath its surface. The tools of textual analysis that have been used to deconstruct legal doctrine have tended to be aligned with the position of equality rather than efficiency, viewing the latter as the expedient through which vested property interests have traditionally been protected.¹³³ Ethical contract models, which are receptive to non-efficiency objectives such as equality, support critical commentary by admitting the legitimacy of its goals. As the positivist position arose with and from classical concepts of contract and property, so post-realism aligns itself with the organic conception of rights, the open texture of which is likely to transcend the more traditional focus on individualism and efficiency.¹³⁴

In tandem, the ethical-contract and post-realist paradigms are filtered into a substantial regulation position on insider trading. Expansive statutory interpretation, combined with the legitimization of equality goals over efficiency goals, is likely to result in policy recommendations that optimize market fairness and parity of opportunity. Judicial and scholarly arguments favoring the broad

¹³² William M. Evan, *Law as an Instrument of Social Change*, in *APPLIED SOCIOLOGY: OPPORTUNITIES AND PROBLEMS* 285 (Alvin W. Gouldner & S.M. Miller eds., 1965). Evan suggests that the function of law goes beyond mere codification of customs and values, extending to the modification of behavior.

¹³³ Whereas the law and economics movement is basically neoclassical in its economic approach, both literary deconstruction and critical legal studies have been sympathetic to Marxist critique. Egalitarianism is a substantive characteristic that has become associated with critical movements. See, e.g., Roberto Mangabeira Unger, *The Critical Legal Studies Movement*, 96 *HARV. L. REV.* 563 (1983).

¹³⁴ See KELMAN, *supra* note 32, at 153. Kelman discusses the positivist and realist approaches to consequentialist and rights-oriented legal philosophies as they are reflected in Western legal institutions.

and inclusive regulation of insider trading are largely a reflection of these more basic paradigm predilections.

VI. CONCLUSION

Recommendations concerning the appropriate boundaries of regulation are grounded in detailed, highly focused analysis of the particular dynamics of insider trading. Applying the intended objective language traditionally valued by lawyers, judges, and law professors, commentators strive to convince us of the merits of their policy choices using the voice of dispassionate reason. Behind this image of disinterested and informed persuasion lie the assumptions and value systems of entrenched jurisprudence.

It can be assumed that the phenomenon occurs regularly in all areas of statutory and regulatory interpretation. This analysis has focused on the regulatory evolution concerning insider trading. Efforts to deregulate, or to minimize the impact of existing regulation, can be seen in larger context as the manifestation of legal positivist and economic-contract paradigms. At the opposite end of the spectrum, arguments supporting substantial regulation are derived from post-realist and ethical-contract paradigms. If we recognize that the real debate is fundamental and not specialized, we can refocus our evaluation and concentrate on the true points of contention. As recognition of the issues becomes clearer, their reconciliation will benefit from the illumination of basic philosophical differences.

