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MISSING THE ROLE OF PROPERTY IN THE REGULATION OF INSIDER TRADING

Kevin R. Douglas[+]

Most scholars have missed the role of property in the U.S. regulation of insider trading. Decades of scholarship have grappled with whether future iterations of the regulation would be improved by treating insider trading as a property issue.[1]

[+] Assistant Professor at Michigan State University College of Law. I am grateful for helpful comments from and conversations with many scholars, including: John P. Anderson, Stephen M. Bainbridge, Mitchell F. Crusto, Loletta Darden, Mihailis E. Diamantis, Jonathan Glater, Joan MacLeod Heminway, Jeremy Kidd, and Jonathan R. Macey. I also benefited from feedback received during presentations at the Tenth Annual John Mercer Langston Writing Workshop, the 2019 Junior Faculty Forum at the University of Richmond, the New Scholars Workshop at the Southeastern Association of Law Schools (SEALS) 2019 Annual Conference, and several of Antonin Scalia Law School's Levy Workshops.

1. Jonathan R. Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9, 11 (1984) (encouraging a "new understanding of the fact that privileged corporate information is a valuable asset in the nature of a property interest"); Donna M. Nagy, *Reframing the Misappropriation Theory of Insider Trading Liability: A Post-O'Hagan Suggestion*, 59 OHIO ST. L.J. 1223, 1267 (1998) (noting that many legal scholars reject a property-

Some scholarship relies on economic analysis aimed at determining which allocation of rights in information will generate the greatest efficiency or liquidity in U.S. securities markets. Other scholarship attempts to reconcile the perceived incoherence or vagueness in the law using doctrinal analysis. However, almost everyone seems to miss the fact that under the classical theory officials have consistently predicated legal liability, in part, on the violation of the property rights of the information owner and have explicitly recognized the issuing corporation as the owner of the information.

In 1961, in the first administrative case imposing liability for insider trading, the U.S. Securities and Exchange Commission (SEC) explained that the defendants were penalized for two reasons. First,

> the existence of a relationship giving access, directly or indirectly, *to information intended to be available only for a corporate purpose and not for the personal benefit of anyone*, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.[2]

By predicating liability in part on the violation of the issuing company's exclusive use rights in inside information, the SEC identified a property principle as an animating feature of the doctrine. The U.S. Supreme Court adopted the SEC's two-part justification almost verbatim when it published its first insider trading decision in 1980.[3] Moreover, despite eliminating the

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rights rationale because "the goal of protecting property rights in secret information lies outside the zones of interest of the federal securities laws"); Stephen M. Bainbridge, *Insider Trading Under the Restatement of the Law Governing Lawyers*, 19 IOWA J. CORP. L. 1, 40 (1993) (assessing whether transaction attorneys should be allocated a property right in deal information, and concluding that prohibiting such an allocation would protect "the client's incentive to develop valuable information and…save the parties from engaging in costly and unnecessary negotiations"); Sung Hui Kim, *Insider Trading as Private Corruption*, 61 UCLA L. REV. 928, 977 (2014) (describing a property rationale as "a compelling normative approach to insider trading, but it lacks sufficient descriptive power"); Richard W. Jennings, *Insider Trading and the Stock Market*, 55 CAL. L. REV. 1229, 1234 (1967) (book review) (arguing that the prohibition is justified as a means of protecting the property rights of shareholders, who he describes as the ultimate owners of the information); Alan Strudler & Eric W. Orts, *Moral Principle in the Law of Insider Trading*, 78 TEX. L. REV. 375, 436 (1999) (using a property rationale to describe insider trading as a species of "wrongful conversion," and therefore supporting the prohibition on insider trading and rejecting the notion that shareholders' are able to consent to the use of inside information in securities trading); Frank H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 SUP. CT. REV. 309, 314, 317–18, 321 (1981) (advocating the treatment of insider trading as a species of the law regulating business information and warns against allowing the doctrine to be pigeonholed as securities law); *see generally* Gary Lawson, *The Ethics of Insider Trading*, 11 HARV. J.L. & PUB. POL'Y 727 (1988) (using a framework based on Aristotle's moral theory and John Locke's property theory to evaluate the practice of insider trading).

2. *In re* Cady, Roberts & Co., 40 S.E.C. 907, 912 (Nov. 9, 1961) (emphasis added).

3. Chiarella v. United States, 445 U.S. 222, 227 (1980) (stating that an insider's duty to disclose or abstain from trading "arose from (i) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) *the unfairness of*

"exclusive use" language, the Court continued to refer to the defendant's unauthorized use of confidential business information when it last explained why liability is imposed in classical theory cases.[4] The Court has previously stated that confidential business information "has long been recognized as property."[5]

As a consequence of missing the role of property in insider trading law, issues related to the legitimacy of the doctrine have been overlooked. Many scholars have noted the ways in which insider trading doctrine departs from the expected features of a property regime.[6] Several have noted that the inability of information owners to license inside information for trading in securities markets is a dramatic departure from the common elements of a property regime.[7] Others have raised concerns that imposing controlling person liability on information owners looks a lot like blaming the victim of theft for his own victimization.[8] Yet little has been said about how departures from property principles might undermine the authority of officials to impose liability for insider trading.[9] If the violation of property rights is used as a justification to impose liability for insider trading, then it would be reasonable to expect common and long-standing property principles to at least partially control the scope and limits of the law.

Scholars and lawmakers should be deeply concerned about the legitimacy issues raised by the departures from property principles in the law.[10] When a law restricts the exercise of specific rights while being described as protecting

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allowing a corporate insider to take advantage of that information by trading without disclosure.") (emphasis added).

4. United States v. O'Hagan, 521 U.S. 642, 651–52 (1997). Although the Court in *O'Hagan* does not explicitly identify the violation of rights of exclusive use and benefit, it did continue to describe the classical theory as in part premised on the insider's use of information. *Id.*

5. Carpenter v. United States, 484 U.S. 19, 25–26 (1987) (citations omitted).

6. Stephen M. Bainbridge, *Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud*, 52 S.M.U. L. REV. 1589, 1591 (1999) (arguing that "the SEC's regulatory jurisdiction over insider trading meant that the problem was treated as a species of securities fraud rather than one of property rights"); Roberta S. Karmel, *The Relationship Between Mandatory Disclosure and Prohibitions Against Insider Trading: Why A Property Rights Theory of Inside Information is Untenable*, 59 BROOK. L. REV. 149, 173 (1993) (arguing that the property and other private law limitations on the prohibition articulated by the Supreme Court in *Chiarella* and *Dirks* were "simply inadequate to cover the fact patterns of cases in which some have been enjoined by the SEC or have even gone to prison"); *see* Nagy, *supra* note 1, at 1321; *see also* Kim, *supra* note 1, at 975–77.

7. *See* Kim, *supra* note 1, at 955; *see also* Bainbridge, *supra* note 1, at 36–37.

8. *See* JOHN P. ANDERSON, INSIDER TRADING: LAW, ETHICS, AND REFORM 108–112 (2018); *see also* JONATHAN R. MACEY, INSIDER TRADING: ECONOMICS, POLITICS, AND POLICY 65–66 (1991) (concluding that "it is generally the employer who is harmed by the insider trading").

9. *But see*, Richard A. Epstein, *Returning to Common-Law Principles of Insider Trading after United States v. Newman*, 125 YALE L.J. 1482, 1512–1515 (2016) (questioning the legitimacy of Regulation FD and other gap fillers).

10. LON L. FULLER, THE MORALITY OF LAW 63–79 (1969); Raff Donelson, *Legal Inconsistencies*, 55 TULSA L. REV (2019).

the same rights, it makes judges and enforcement officials look incompetent at best. Worse, it suggests that some officials are hiding their true motives. Questions about the authority of insider trading law are more than abstract problems. Targets of the prohibition face decades in prison and the confiscation of millions of dollars. The longest criminal sentence imposed under the prohibition, eleven years, was given to Raj Rajaratnam in 2011.[11] Rajaratnam was also fined ten million dollars.[12] If his conviction was for violating a prohibition that premises liability on infringing on some party's property rights in information, then it would make sense that he would have had the opportunity to raise a defense based on receiving the consent or ratification of the information owners.[13] Without those options, insider trading decisions look more like the employment of vice laws or inalienability rules than the application of property doctrine.[14]

Anyone concerned with the overarching public policy objective of fostering the rule of law should want the principles used to justify liability to help define the limits of the authority to impose liability. Unless other valid and coherent principles of insider trading can explain the departures from property doctrine, courts, and enforcement officials should reconsider imposing liability for the practice. If valid and competing principles do exist in the doctrine, then they should be clarified.

With these concerns in mind, Part I describes the relevant elements of the federal insider trading regime. The analysis includes a discussion of the difference between the classical theory and the misappropriation theory of insider trading liability, as well as the requirements of tipper and tippee liability. Part II demonstrates that when described as a means of remedying fraud, the prohibition of insider trading has always relied in part on the violation of some party's property rights in order to impose liability. In its first fraud-based insider trading case, the SEC laid out a legal test that premises liability in part on the fact that a trader makes use of "information intended to be available only for a corporate purpose and not for the personal benefit of anyone."[15] The U.S. Supreme Court later adopted this legal test in *Chiarella*.[16] This property-based justification only became more prominent over time, with the introduction of the

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11. United States v. Rajaratnam, No. S-2:09 Cr. 01184, 2011 WL 6259591, at *2 (S.D.N.Y. Oct. 20, 2011).

12. *Id.*

13. *See* RESTATEMENT (SECOND) TORTS §§ 892–892D, 896–900 (AM. LAW. INST. 1977) (Division 12 of the Restatement categorizes consent and discharge as two of several defenses applicable to all tort claims).

14. *See* PATRICK DEVLIN, THE ENFORCEMENT OF MORALS 3 (1965) (discussing and ultimately rejecting the proposition that unless we want to equate 'religious sin' and 'crime,' then "there must remain a realm of private morality and immorality which is, in brief and crude terms, not the law's business."); Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1092–1093 (1972).

15. Calabresi & Melamed, *supra* note 14, at 912.

16. Chiarella v. United States, 445 U.S. 222, 241–42 (1980).

misappropriation theory of liability. Part III explores the scholarship that has either advocated for or opposed a greater reliance on property principles in future iterations of the U.S. regulation of insider trading. The analysis will show that many accept an unnecessarily strong distinction between property doctrine and other doctrinal areas in American law.

Part IV provides an overview of the implications of property principles consistently animating insider trading law. First, this Section will provide a detailed discussion of the issues raised by the failure to adhere to the long-standing elements of a property regime, focusing on the constitutional and statutory interpretation problems that emerge as a result. Second, the clear reliance on property doctrine and the failure to adhere to property principles suggests potential explanations for the incoherence in insider trading doctrine described by many scholars and enforcement officials.[17] If the other principles animating insider trading doctrine are not compatible with property principles, the tensions between these principles may be the cause of the ambiguity in the law. Third, the existence of property principles in the law provides a clear path forward for legal reform. Either lawmakers or courts can bring the doctrine into greater harmony with long-standing property principles, or they can clearly identify and prioritize the competing principles in the doctrine.

The discussion of the implications of the property principles animating the doctrine in Part IV will hopefully act as a starting point for future scholarship and policy analyses.

I. THE REGULATION OF INSIDER TRADING

The first thing to note about the federal prohibition against insider trading is that the name of the prohibition is misleading. Federal law prohibits much more than trading by insiders. The anti-fraud provisions of the Securities Act of 1933 and the Exchange Act of 1934 are both used to penalize employees, independent contractors, and other agents of the company whose shares are being traded (insiders), as well as the agents or fiduciaries of a source of information unrelated to the company whose shares are being traded (outsiders). In addition, Section 16(b) of the Exchange Act, which prohibits short-swing profits, penalizes not only directors and officers (insiders), but also principal stockholders (outsiders), without any proof that the stockholder's ownership position led to access to inside information.[18] The second thing to note is that

17. *See* Kim, *supra* note 1, at 949 ("To counter serious doctrinal instability and to answer persistent normative skepticism, we need a better theory of insider trading law."); ANDERSON, *supra* note 8, at 3 (Describing the "American insider trading enforcement regime [as] broken," Anderson argues that the uncertainty in the law "directly impacts shareholder value and leaves market players at the mercy of prosecutorial caprice."); *see also* Nagy, *supra* note 1; Strudler & Orts, *supra* note 1; Macey, *supra* note 1; *see also* Preet Bharara & Robert J. Jackson Jr., *Insider Trading Laws Haven't Kept Up With the Crooks*, N.Y. TIMES (Oct. 9, 2018), https://www.nytimes.com/2018/10/09/opinion/sec-insider-trading-united-states.html.

18. 15 U.S.C. § 78p (2012).

the prohibition of insider trading is justified and expressed through several statutory provisions and SEC rules.

A. Short-Swing Profits: Section 16(b) of the Exchange Act

The provision that looks most like an explicit attempt by Congress to regulate insider trading is Section 16(b) of the Exchange Act.[19] This provision aims to prevent "the unfair use of information which may have been obtained" by a company's directors, officers and principal stockholders[20] by prohibiting short-swing profits.[21] Section 16(b) defines "short-swing profits" as any profits generated by the purchase and sale or by the sale then purchase of securities, if those corresponding trades happened in the span of less than six months.[22] Section 16(b) allows a civil action to be brought for the disgorgement of any short-swing profits earned by a company's directors, officers, or principal stockholders.[23] The only parties recognized as having standing in a Section 16(b) civil action are the company that issued the traded shares or the shareholders of that company.[24] Whether or not the party bringing the suit is the company itself or one of the shareholders, the disgorged profits are given to the company. However, Section 16(b) does not authorize the SEC to bring enforcement actions under the provision.[25]

B. Fraud: Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5

When scholars discuss the prohibition of insider trading, they are most often discussing an application of the anti-fraud provisions of U.S. federal securities law.[26] io are the broad anti-fraud provisions generally used to support imposing legal liability for insider trading. Section 17(a) of the Securities Act makes it:

> unlawful for any person in the offer or sale of any securities…(1) to employ any device, scheme, or artifice to defraud, or (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact…or (3) to engage in any

19. Richard J. Morgan, *Insider Trading and the Infringement of Property Rights*, 48 OHIO ST. L.J. 79, 82 (1987) (describing Section 16(b) as "Congress' specific response to the problem of insider trading"); *see also* ANDERSON, *supra* note 8, at 27 (describing Section 16(b) as "the only provision of the Exchange Act that explicitly addresses insider trading").

20. A principal stockholder is defined in Section 16(a) of the Exchange Act as "the beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security) which is registered pursuant to section 12." *Id.*

21. *Id.*

22. *Id.*

23. *Id.*

24. *Id.*

25. STEPHEN M. BAINBRIDGE, INSIDER TRADING LAW AND POLICY 226 (2014).

26. *Id*. at 1–2.

> transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.[27]

SEC Rule 10b-5 makes it:

> unlawful for any person…(a) [t]o employ any device, scheme, or artifice to defraud, (b) [t]o make any untrue statement of a material fact or to omit to state a material fact…or (c) [t]o 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.[28]

Rule 10b-5 was authorized under Section 10(b) of the Exchange Act and was modeled on Section 17(a) of the Securities Act.[29] The important difference between the two provisions is that the language of Section 17(a) of the Securities Act limits liability to the context of an offer or sale and limits the harm recognized to those involving "a fraud or deceit *upon the purchaser*."[30] Rule 10b-5 covers fraud aimed at inducing either purchases or sales, and the rule contains no language limiting liability to those who deceive or defraud a buyer or seller.[31] The broader application of Rule 10b-5 likely explains why it dominates civil and criminal actions aimed at penalizing insider trading.[32] However, it is important to remember that the prohibition also relies on Securities Act 17(a). In addition to the SEC citing Section 17(a) of the Securities Act in *Cady, Roberts*,[33] the first modern insider trading case, the SEC also relied on the provision in *Dirks v. S.E.C.* in 1983.[34] Because neither Section 17(a) of the Securities Act, nor Rule 10b-5, explicitly prohibit insider trading, two theories have developed to justify the prohibition: the classical theory and the misappropriation theory. In addition, courts have developed a doctrine to find liability for tippers and tippees of material nonpublic information.

The Supreme Court gave the classical theory its final form in the case of *United States v. O'Hagan.*[35] The Court in *O'Hagan* describes the classical theory as follows:

> Under the "traditional" or "classical theory" of insider trading liability, [Section] 10(b) and Rule 10b-5 are violated when a corporate insider trades in the securities of his corporation on the basis of material, nonpublic information. Trading on such information qualifies as a "deceptive device" under [Section] 10(b)…because "a relationship of

27. 15 U.S.C. § 77q (2012).

28. 17 C.F.R. § 240.10b-5 (2018).

29. 15 U.S.C. § 78j (2012).

30. 15 U.S.C. § 77q (2012) (emphasis added).

31. 17 C.F.R. § 240.10b-5 (2018).

32. Donna M. Nagy, *Insider Trading and the Gradual Demise of Fiduciary Principles*, 94 IOWA L. REV. 1315, 1376–77 (2009).

33. *In re* Cady, Roberts & Co., 40 S.E.C. 907, 908 (Nov. 9, 1961).

34. Dirks v. S.E.C., 463 U.S. 646 (1983).

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

> trust and confidence [exists] between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation." That relationship, we recognized, "gives rise to a duty to disclose [or to abstain from trading] because of the 'necessity of preventing a corporate insider from…taking unfair advantage of…uninformed…stockholders.'" The classical theory applies not only to officers, directors, and other permanent insiders of a corporation, but also to attorneys, accountants, consultants, and others who temporarily become fiduciaries of a corporation.[36]

The Supreme Court first considered the misappropriation theory in *Chiarella*,[37] and gave the theory its stamp of approval in *O'Hagan*.[38] The Court in *O'Hagan* begins by explaining that the language of Section 10(b) of the Exchange Act does not limit liability to those who engage in the "deception of a purchaser or seller," but also reaches any deceptive device used "in connection with the purchase or sale of any security."[39] The Court then explains the misappropriation theory as follows:

> The "misappropriation theory" holds that a person commits fraud "in connection with" a securities transaction, and thereby violates [Section] 10(b) and Rule 10b-5, when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information….Under this theory, a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information. In lieu of premising liability on a fiduciary relationship between company insider and purchaser or seller of the company's stock, the misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information.[40]

Note that under both the classical theory and the misappropriation theory, disclosure is a defense against liability.[41]

Finally, the tipper and tippee doctrines that have developed as courts have applied Section 17(a) of the Securities Act, Section (10)(b) of the Exchange Act, and Rule 10b-5 to insider trading creates liability for those individuals not obviously covered by the classical or misappropriation theories.[42] When a fiduciary covered under the classical or misappropriation theory (a tipper)

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36. *Id.* at 651–52 (internal citations omitted).
37. Chiarella v. United States, 445 U.S. 222, 237 n.21 (1980).
38. *O'Hagan*, 521 U.S. at 650.
39. *Id.* at 651 (internal quotations omitted).
40. *Id.* at 652.
41. *Id*. at 651–52, 655.
42. *Id*. at 697–98.

discloses information to someone not covered under either theory (a tippee), liability will be imposed on the tipper and tippee, if the disclosure constitutes a breach of duty. In *Dirks v. S.E.C.*, the U.S. Supreme Court stated that to determine if there has been a breach of duty "requires courts to focus on objective criteria, i.e., whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings."[43] In addition to those circumstances in which the tipper receives an explicit pecuniary gain, the Court declared that "elements of [a breach of] fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend."[44]

C. Tender Offers and Nonpublic Information: Section 14(e) of the Exchange Act and Rule 14e-3

Section 14(e) of the Exchange Act was added as a result of Congress passing the Williams Act, which was aimed at regulating tender offers for publicly traded securities.[45] Section 14(e) authorizes the SEC to create "rules and regulations [that] define [which] acts and practices [are] fraudulent, deceptive, or manipulative."[46] As a result, the SEC created Rule 14e-3, which defines anyone other than the offeror trading on nonpublic information about an impending tender offer as a "fraudulent, deceptive or manipulative act or practice within the meaning of section 14(e)."[47] Rule 14e-3 also makes it unlawful for tender offerors to "communicate material, nonpublic information relating to a tender offer to any other person under circumstances in which it is reasonably foreseeable that such communication is likely to result in" trading on nonpublic information about an impending tender offer.[48]

D. Remedies for Private Plaintiffs: Section 20A of the Exchange Act

In 1988, Congress enacted Section 20A of the Exchange Act[49] in response to a circuit split over the question of whether a private plaintiff could recover when another person violates the prohibition on insider trading.[50] Because the federal

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43. Dirks v. S.E.C., 463 U.S. 646, 663 (1983).

44. *Id.* at 664.

45. Jonathan G. Katz, *SEC Interpretation: Commission Guidance on Mini-Tender Offers and Limited Partnership Tender Offers*, U.S. SECURITIES AND EXCHANGE COMMISSION (Jul. 31, 2000), https://www.sec.gov/rules/interp/34-43069.htm.

46. 15 U.S.C. § 78n (2012).

47. 17 C.F.R. § 240.14e-3 (2018).

48. *Id*.

49. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100–704, 102 Stat 4677.

50. LARRY D. SODERQUIST & THERESA A. GABALDON, SECURITIES REGULATION 549–50 (Robert C. Clark et al. eds., 9th ed. 2018) ("Legislative history cited with approval the [Shapiro] opinion discussed in *Fridrich*.") (internal citations omitted).

prohibition is most often justified under the anti-fraud provisions of securities regulations, many courts held plaintiffs responsible for proving all of the elements of fraud recognized in Rule 10b-5 civil actions before a plaintiff could recover.[51] These elements include reliance, which courts describe as providing "the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury."[52] Some courts, as in the case of *Fridrich v. Bradford*,[53] determined that in the context of trading over an impersonal exchange, it was almost impossible to prove that the act of one party trading with material nonpublic information could have been relied upon by a second party who had no interaction with the first.

Although in line with the reasoning in pre-SEC state court decisions,[54] the court in *Fridrich* explicitly rejected the reasoning of the court in *Shapiro v. Merrill Lynch*,[55] which determined that "the Supreme Court eliminated proof of reliance as a prerequisite to recovery in a 10b-5 case involving nondisclosure."[56] In response to this circuit split, Congress added Section 20A to the Exchange Act, which—instead of proof of reliance—requires proof that a plaintiff traded contemporaneously with and in opposition to a party engaged in insider trading.[57] A defendant's liability to all potential plaintiffs is limited to the gross profit realized or loss avoided by the violator.[58] In addition, a defendant's potential liability to private plaintiffs is reduced by any amount already disgorged by the SEC or the Department of Justice in a government enforcement action.[59] However, Section 20A of the Exchange Act does not prohibit or restrict insider trading; it only creates standing for private parties who trade contemporaneously with someone who trades in violation of some other provision barring insider trading to recover from the violator.[60]

Now, compare Section 20A of the Exchange Act to Section 16(b) of the Exchange Act. Section 16(b) of the Exchange Act only gives the issuer or current shareholders standing to sue for a violation of the provision, and only allows the issuer to recover the profits disgorged from officers, directors, or principal stockholders.[61] Section 20A of the Exchange Act is indifferent to a plaintiff's position as shareholder or non-shareholder both before and after the

51. Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341–42 (2005).
52. Basic Inc. v. Levinson, 485 U.S. 224, 243 (1988).
53. Fridrich v. Bradford, 542 F.2d 307, 318–19 (6th Cir. 1976).
54. Goodwin v. Agassiz, 186 N.E. 659, 661 (1933).
55. Shapiro v. Merrill Lynch, Pierce, Fenner & Smith Inc., 353 F. Supp. 264 (S.D.N.Y. 1972), aff'd, 495 F.2d 228 (2d Cir. 1974).
56. *Id.* at 275 (citing Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972)).
57. 15 U.S.C. § 78t-1 (2012).
58. *Id.*
59. *Id.*
60. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100–704, § 5, 102 Stat. 4677, 4680–81 (1988).
61. 15 U.S.C § 78p (2012).

prohibited transaction.[62] The salient factor is whether the plaintiff traded contemporaneously with the defendant.[63] Further, it is unlikely (though not impossible) that an issuer will become a plaintiff in a Section 20A action, since issuers seldom have less material nonpublic information when trading with insiders.[64] As a result, the parties with standing to sue and recover damages under the only clear restriction on insider trading created by Congress, Section 16(b), are completely different than the parties able to sue and recover damages under Section 20A.

II. THE ROLE OF PROPERTY IN THE REGULATION

What is the role of property in the prohibition of insider trading? In short, the SEC and federal courts rely on property to justify imposing liability for insider trading. As this Section will demonstrate, the SEC and federal courts (1) cite statutes aimed at the protection of property rights and (2) identify the violation of some party's property rights in inside information when imposing liability for insider trading. The most explicit reliance on property principles can be seen in the application of the anti-fraud provisions of the Securities Act and the Exchange Act to prohibit insider trading. Section 17(a)(2) of the Securities Act makes it unlawful to use material misrepresentations "to obtain money or property…in the offer or sale of any securities,"[65] and Exchange Act Rule 10b-5 is modeled on Section 17(a) of the Securities Act. In applying these provisions under the misappropriation theory, several courts explicitly call the information in question the property of the source of the information. In applying these provisions under the classical theory, the SEC in *Cady, Roberts* and several courts in other cases claim that the information obtained by insiders was information only intended for the benefit of the company. This invocation of the exclusive use principle explicitly identifies the violation of the security issuer's property rights in confidential business information as a premise for insider trading liability.

A more implicit reliance on property principles can be found in the effects of eliminating the need for enforcement officials or civil plaintiffs to prove reliance or intentional inducement in order to make defendants face liability. Because the doctrine eliminates the need to show an interference with a plaintiff's liberty interest to impose liability, federal U.S. insider trading doctrine may place greater reliance on the violation of some party's property rights when compared to common law fraudulent misrepresentation and fraudulent nondisclosure doctrines.

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62. § 5, 102 Stat. at 4680–81.

63. *Id.*

64. *Id.* As an exception to this expectation, consider that some of the defendants in *Texas Gulf Sulfur* were officers who accepted stock options from the issuer without first disclosing the ore find in Canada. *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 856–57 (2d Cir. 1968).

65. 15 U.S.C. § 77q (2012).

A. Reliance on Property-Based Statutes and Rules

When enforcement officials and federal courts cite the anti-fraud provisions of the Securities Act and the Exchange Act as giving them the authority to prohibit insider trading, they are explicitly invoking the property-protecting functions written into those provisions. Although Section 17(a) of the Securities Act was enacted in May 1933[66] and Rule 10b-5 was adopted in December 1948,[67] the first enforcement action applying these provisions to insider trading, *In re Cady, Roberts & Co.*,[68] did not occur until 1961. As outlined in Section I.A. above, Section 17(a)(2) of the Securities Act makes it unlawful to use material misrepresentations "to obtain money or property" in the offer or sale of any securities. Subsection (a)(2) is one of three subsections of Section 17(a) of the Securities Act. In *Cady, Roberts* the SEC claimed that the three main subdivisions of Section 17(a) are "mutually supporting rather than mutually exclusive. Thus, a breach of duty of disclosure may be viewed as a device or scheme, an implied misrepresentation, and an act or practice, violative of all three subdivisions."[69] To draw this conclusion, the SEC followed the lead of the Delaware district court in *Speed v. Transamerica Corp.*, which made the same claim about the interrelated nature of all three subsections of Exchange Act Rule 10b-5.[70]

Recall that Rule 10b-5 was modeled on Section 17(a) of the Securities Act. Although Rule 10b-5 does not contain the term "property," it is reasonable to conclude that the concept is captured by the language restricting the application of the rule to "the purchase or sale of any *security*," because securities are a species of property.[71] Similar reasoning provides additional support for the conclusion that liability under Section 17(a) of the Securities Act is limited to cases that involve the violation of some party's property rights, because that provision is limited to cases involving the "offer or sale of any securities."[72] This explicit property language in the anti-fraud provisions of U.S. securities

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66. 15 U.S.C. § 77q (2012).

67. Rules and Regulations under Securities Exchange Act of 1934, 13 Fed. Reg. 8177, 8183 (Dec. 22, 1948).

68. *In re* Cady, Roberts & Co., 40 S.E.C. 907, 907 (Nov. 9, 1961).

69. *Id.* at 913.

70. Speed v. Transamerica Corp., 99 F. Supp. 808, 829 (D. Del. 1951).

71. Rules and Regulations under Securities Exchange Act of 1934, 13 Fed. Reg. at 8183. The Deleware Code explicity states, "[t]he shares of stock in every corporation shall be deemed personal property." Del. Code Ann. tit. 8, § 159 (West 2019). After describing an equity investor's share interests in a corporation as distinct from the property legally owned by the corporation itself in every jurisdiction, Allen et al. describe each share as an investor's "personal legal property." ALLEN, ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 99, (3rd ed. 2009).

72. 15 U.S.C. § 77q. (2012).

law is in harmony with the view of scholars who describe property as defining "the entitlements people…can sue in tort in order to protect."[73]

The next two subsections of this Article demonstrate how the case law based on Section 17(a) and Rule 10b-5 continue to identify the violation of property rights as a partial justification of legal liability.

B. Reliance on Property in Insider Trading Case Law

The misappropriation theory of liability comes later in the history of insider trading jurisprudence. However, it is useful to consider misappropriation cases first because they explicitly cite *the violation of some party's property rights in breach of a fiduciary duty* as the justification for legal liability. The Court in *O'Hagan* explains that liability will be imposed under the misappropriation theory when "a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information."[74] The Court elaborates that a "company's confidential information qualifies as property to which the company has a right of exclusive use; the undisclosed misappropriation of such information constitutes fraud akin to embezzlement."[75]

It is noteworthy that the Court views insider trading under the misappropriation theory as analogous to embezzlement and not conversion. A person can commit conversion against a stranger. However, the Court reminds readers that embezzlement entails "the fraudulent appropriation to one's own use of the money or goods entrusted to one's care by another."[76] Referencing embezzlement and not conversion reminds us that even under the misappropriation theory of liability concerns about the violation of property rights are inextricably tied to concerns about fiduciary obligations.

The explicit role of property under the misappropriation theory of liability is widely acknowledged by scholars.[77] Less discussed is the connection that courts make between property rights and fiduciary obligations in these cases. However, recognizing that connection in misappropriation theory cases makes it easier to recognize the reliance on property to justify the classical theory of liability.[78] After rejecting the equal access rational, the Court in *Chiarella* explained that nondisclosure prior to securities trading is fraudulent only when an insider trades in violation of "a fiduciary or other similar relation of trust and

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73. THOMAS W. MERRILL & HENRY E. SMITH, THE OXFORD INTRODUCTIONS TO U.S. LAW: PROPERTY 1 (2010).

74. United States v. O'Hagan, 521 U.S. 642, 652 (1997).

75. *Id.* at 643.

76. *Id.* at 654 (quoting Carpenter v. United States, 484 U.S. 19, 27 (1987)).

77. *See* Nagy, *supra* note 1, at 1265–66.

78. This is true despite the language quoted above coming from the portion of the *Carpenter* opinion grappling with the application of the mail and wire fraud statutes, instead of those sections dealing with the application of securities laws.

confidence."[79] This declaration has led many scholars to conclude that the classical theory of liability is either solely or fundamentally justified by a breach of the fiduciary duty of loyalty. However, the next few paragraphs show how concerns about a breach of the duty of loyalty in classical theory cases is always linked to concerns about property rights.

The breach of fiduciary duty used to justify liability in classical theory cases is derivative of some party's property rights in confidential business information. Beginning with the SEC's administrative release on *Cady, Roberts*, a long line of classical theory cases describe the nonpublic information involved as only available for the use of the issuing company. In explaining the principles that allow the prohibition of insider trading to extend beyond classical insiders, the SEC states that the obligation rests in part on "*the existence of a relationship giving access . . . to information intended to be available only for a corporate purpose and not for the personal benefit of anyone*."[80] Several federal courts have repeated this test for liability, which identifies (1) making personal use of (2) information received through certain kinds of relationships (3) when that information was solely available for the benefit of the corporate entity. This test was repeated by the Second Circuit Court of Appeals in *Texas Gulf Sulfurs*[81] and by the Supreme Court in *Chiarella*.[82]

Describing inside information as "available only for a corporate purpose and not for the personal benefit of anyone" is similar to the language used by the Court in *Carpenter* when it describes business information as "a species of property to which the corporation has the exclusive right and benefit."[83] The statement also resembles Merrill and Smith's description of ownership as identifying when someone "has the right to exclude others' use of the thing and . . . has the right to use the thing."[84] These similarities support the conclusion that the SEC and federal courts recognize that liability for insider trading under the classical theory is predicated in part on the violation of the issuing company's property rights.

The Supreme Court's most recent statement of classical theory liability does not explicitly mention a violation of exclusive use rights.[85] This makes the role

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79. Chiarella v. United States, 445 U.S. 222, 228 (1980) ("[O]ne who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so. And the duty to disclose arises when one party has information 'that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.'" (quoting RESTATEMENT (SECOND) OF TORTS § 551(2)(a) (1976))).

80. *In re* Cady, Roberts & Co., 40 S.E.C. 907, 912 (Nov. 8, 1961) (emphasis added).

81. S.E.C. v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968).

82. *Chiarella*, 445 U.S. at 227 (internal citations omitted) ("The Commission emphasized that the duty arose from (i) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure.").

83. Carpenter v. United States, 484 U.S. 19, 26 (1987).

84. *See* MERRILL & SMITH, *supra* note 76, at 4–5.

85. United States v. O'Hagan, 521 U.S. 642, 643 (1997).

of property less obvious, but no less relevant. In *O'Hagan*, the Court explains that liability is imposed under the classical theory "when a corporate insider trades in his corporation's securities on the basis of material, confidential information he has obtained by reason of his position."[86] Consider that the Supreme Court has stated that confidential business information "has long been recognized as property." This supports viewing the most recent statement of classical theory liability as imposing liability when an insider (1) makes personal use of (2) information meant for the sole benefit of the corporate entity (3) if the information is received through certain kinds of relationships.

Further obscuring the reliance on a violation of the issuer's property rights in information, the Court in *O'Hagan* does not describe the insider's duty to disclose as arising out of a relationship between the insider and the company. Instead, the Court states that the duty arises out of "a relationship of trust and confidence between the corporation's shareholders and the insider."[87] However, as explained in Section II.C. below, it makes sense to view any fiduciary obligations that insiders owe to shareholders as arising out of shareholders' equitable title to the information in which the issuer holds legal title.[88]

C. Reliance on Property in Other Misrepresentation or Nondisclosure Cases

The role of property in common law fraudulent misrepresentation and fraudulent nondisclosure cases provides an interesting point of comparison. In many ways, both the statutes relied on for authority and the case law explaining the prerequisites of liability for insider trading place a greater emphasis on property rights than the common law doctrines of misrepresentation and nondisclosure resulting in pecuniary loss. According to the *Restatement (Second) of Torts*, in addition to remedying the interference with a person's rights to "money or property,"[89] common law misrepresentation and nondisclosure doctrines seem equally if not more focused on addressing an interference with the liberty interests of the defrauded party. The concern for liberty interests is shown by the fact that several of the elements in the legal tests for liability under these doctrines are related to the defendant inducing the plaintiff to take or avoid some action. Of the five elements required for fraudulent misrepresentation described in the *Restatement*, three relate to the actions or inactions of the plaintiff. Expectation of inducing conduct,[90] justifiable reliance,[91] and causation[92] each limit the defendant's liability to harm caused by the plaintiff's actions or inactions that were the result of or intended

86. *Id.*
87. *Id.*
88. *See infra* notes 130–32 and accompanying text.
89. *See* Shapiro v. Merrill Lynch, Pierce, Fenner & Smith Inc., 353 F. Supp. 264 (S.D.N.Y. 1972), aff'd, 495 F.2d 228 (2d Cir. 1974).
90. RESTATEMENT (SECOND) OF TORTS § 531 (AM. LAW. INST. 1977).
91. *Id.* § 537.
92. *Id.* § 546 cmt. a.

from the defendant's misrepresentation. Showing a similar concern for liberty interests, liability for nondisclosure is imposed under common law when a person fails to disclose facts he knows "may justifiably *induce the other to act or refrain from acting* in a business transaction."[93]

Private actions brought under Rule 10b-5 follow the pattern of common law misrepresentation and nondisclosure cases by requiring proof that the defendant interfered with a plaintiff's liberty interests.[94] Outside of insider trading, plaintiffs bringing a Rule 10b-5 claim most either prove reliance or a breach of a duty to disclose in order to establish "the necessary nexus between the plaintiffs' injury and the defendant's wrongful conduct."[95]

Property only comes into play under the damages[96] element of common law fraudulent misrepresentation, and the role is limited compared to the anti-fraud provisions of federal securities law. The *Restatement* describes damages as generally measured based on (a) the difference in market value of (1) the object received from the tortfeasor and (2) the consideration paid for the object, plus (b) any other financial loss suffered because of relying on the misrepresentation.[97] We can assume that plaintiffs in these cases had property rights in the consideration that they used in the transaction and some expectation of the *usefulness* of the objects that they acquired in exchange for their consideration. We can also think of the liberty interests identified in these doctrines as liberty related to controlling the use and disposal of one's property.

In addition to relying on a violation of a defrauded party's property rights in the transaction consideration, nondisclosure cases sometimes impose liability based on a violation of the defrauded person's equitable ownership rights in property to which the defendant held legal title before the transaction.[98] Under common law, nondisclosure is viewed as analogous to an affirmative misrepresentation only in exceptional cases, including when the nondisclosing party has information that "the other is entitled to know because of a fiduciary or other similar relation of trust and confidence between them."[99] An example of such a case is the failure of a trustee to disclose all material information before transacting with a trust beneficiary in trust assets. Many cite the trust beneficiary's equitable title to trust assets as a justification for the fiduciary's

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93. *Id.* § 551 (emphasis added).

94. Basic Inc. v. Levinson, 485 U.S. 224, 243 (1988).

95. RESTATEMENT (SECOND) OF TORTS § 551.

96. *Id.* § 549 cmt. 1.

97. *Id.* § 549.

98. RESTATEMENT (SECOND) OF TRUSTS §170 (AM. LAW. INST. 1959) ("The trustee in dealing with the beneficiary on the trustee's own account is under a duty to the beneficiary to deal fairly with him and to communicate to him all material facts in connection with the transaction which the trustee knows or should know."); *see also id.* § 2 ("A trust, as the term is used in [this] Restatement…is a fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it.").

99. RESTATEMENT (SECOND) OF TORTS § 551 (AM. LAW. INST. 1977).

duty to disclose all material information related to a conflicted transaction.[100] Because some treatises describe these disclosure obligations as required to ensure a "fair" transaction, it suggests that some legal doctrines rely on property or consent-based notions of fairness.[101]

It is worth noting that the damages element in common law fraudulent misrepresentation and fraudulent nondisclosure doctrines does not exclusively rely on the violation of property rights. In addition, losses related to rights arising out of contractual agreements are also recoverable under these doctrines. Plaintiffs defrauded in a business transaction are "also entitled to recover additional damages sufficient to give him the benefit of his contract with the maker, if these damages are proved with reasonable certainty."[102] Separately, in addition to liability resulting from a breach of fiduciary duty, one can face liability for nondisclosure under common law in exceptional cases that involve no violation of equitable ownership rights. For example, one can face liability for nondisclosure if there are "matters known to him that he knows to be necessary to prevent his partial or ambiguous statement of the facts from being misleading," or he "subsequently [acquires] information that he knows will make untrue or misleading a previous representation that when made was true or believed to be [true]."[103]

Therefore, few elements under common law fraudulent misrepresentation or fraudulent nondisclosure rely on the violation of some party's property rights to justify imposing liability, and these elements do not rely exclusively on the violation of property rights.

By comparison, because Section 20A of the Exchange Act effectively eliminates the need to prove an interference with a party's liberty interests, insider trading cases brought by civilians implicitly place a greater emphasis on the violation of some party's property rights to justify imposing liability. Most agree that liability under the misappropriation theory is premised on the defendant violating the property rights of the source of the information.[104] In addition, the statement of what justifies imposing legal liability under the classical theory of insider trading describes liability as premised on the violation of the issuer's property rights in information.[105] The element of the test for

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100. RESTATEMENT (SECOND) OF TRUSTS § 170 (AM. LAW. INST. 1959); *see also* MERRILL & SMITH, *supra* note 76, at 153–157.

101. RESTATEMENT (SECOND) OF TRUSTS § 170 (AM. LAW. INST. 1959) ("The trustee in dealing with the beneficiary on the trustee's own account is under a duty to the beneficiary to deal fairly with him and to communicate to him all material facts in connection with the transaction which the trustee knows or should know."); *see also id.* § 216 ("The consent of the beneficiary does not preclude him from holding the trustee liable for a breach of trust, if…the beneficiary, when he gave his consent, did not know of his rights and of the material facts which the trustee knew or should have known and which the trustee did not reasonably believe that the beneficiary knew.").

102. RESTATEMENT (SECOND) OF TORTS § 549 (AM. LAW. INST. 1977).

103. *Id.* § 551.

104. Bainbridge, *supra* note 6, at 1606.

105. *See supra* Section II.C.

insider trading liability that is based on a violation of the issuer's property rights in information is in addition to and separate from any property interests that parties trading without inside information have in their transaction consideration. This aspect of the prohibition is analogous to common law trust cases in which defendants face liability for a breach of a fiduciary duty to disclose.[106] But the analogy ends there in insider trading cases.

Cases brought under the classical and misappropriation theories of insider trading seem to disregard the information owner's liberty interests. Because it is not the source of the information who trades with the defendant in a misappropriation case, the deception in question does not induce any action or inaction on the part of the legal *and* equitable owner of the information. Moreover, defendants in misappropriation theory cases can avoid insider trading liability for using the source's information without consent. In explaining that deception is an essential element of the misappropriation theory, the Court in *O'Hagan* reiterated that "[t]o satisfy the common law rule that a trustee may not use the property that [has] been entrusted [to] him, there would have to be consent. To satisfy the requirement of the Securities Act that there be no deception, there would only have to be disclosure."[107] In addition, consider that issuers in classical theory cases are subject to the same obligation to disclose material nonpublic information or abstain from trading under Rule 10b-5.[108] If issuers are not permitted to trade on the information themselves, we cannot expect them to be able to lawfully consent to their employees or other agents trading on the information. Both classical and misappropriation theory cases minimize the role of consent. Therefore, both theories places less reliance on the interference with a liberty interest than common law fraud or other Rule 10b-5 cases.

The elimination of the need to prove a violation of some party's liberty interests to impose liability for insider trading suggests an increased reliance on the violation of property rights to justify these doctrines.[109]

D. Summary

The foregoing discussion demonstrates that misappropriation theory cases are not the only cases in which liability for insider trading is premised on the violation of some party's property rights. The duty to disclose or abstain from

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106. It is unclear whether enforcement officials or federal courts are relying on a violation of the issuer's legal title or a transacting shareholder's equitable title to the information in order to impose liability.

107. United States v. O'Hagan, 521 U.S. 642, 654 (1997) (internal citations omitted).

108. *See* McCormick v. Fund Am. Companies, Inc., 26 F.3d 869, 876 (9th Cir. 1994) (internal citations omitted) ("Numerous authorities have held or otherwise stated that the corporate issuer in possession of material nonpublic information, must, like other insiders in the same situation, disclose that information to its shareholders or refrain from trading with them.").

109. Alternatively, the reduced reliance on the violation of liberty interests may be the result of an increased reliance on some new animating principle in the doctrine.

trading in classical theory cases is derivative of the legal or equitable ownership rights that stock issuers and their shareholders have in confidential business information. Beginning with the SEC in *Cady, Roberts* and continuing with the Supreme Court in *Chiarella* (and beyond), an insider making personal use of information intended for the sole benefit of the company is the breach of fiduciary duty that justifies liability in classical theory cases. The connection between the fiduciary duties in classical theory cases and property rights becomes more obvious when we recognize that the violation of property rights in misappropriation theory cases is always tied to breaches of duty arising out of fiduciary or similar relationships of trust and confidence.

In addition, the SEC and federal courts rely on Section 17(a) of the Securities Act and Rule 10b-5, which aim to protect investors' property rights in their securities, money, and other transaction consideration. Finally, unlike other fraudulent deception cases, insider trading doctrine almost eliminates the need to prove an interference with the plaintiff's liberty interests. As a result, the prohibition may place a greater reliance on the violation of some party's property rights to justify imposing liability.

Of course, the preceding analysis does not support the conclusion that U.S. insider trading doctrine can be fully explained by a property rationale. However, the evidence does support accepting the conclusion that property principles always play a role in the regulation of insider trading. With the continuous and undeniable reliance on property principles to justify liability under both the classical and misappropriation theories of insider trading, one should ask why so many scholars have missed the fact that the SEC and courts rely on property, in part, to justify the prohibition under the classical theory. The next Section explores one explanation: many scholars treat property principles as either unimportant or nonexistent in an area of law that clearly embodies some other doctrine.

III. MISSING THE ROLE OF PROPERTY IN THE REGULATION

Many legal scholars view insider trading law as either devoid of or only occasionally motivated by property principles.[110] Some have described this area of law as a form of federal securities fraud doctrine, or common law fraud and fiduciary duties doctrine—not property doctrine.[111] For these scholars, the

110. *See, e.g.*, Bainbridge, *supra* note 6, at 1591; Easterbrook, *supra* note 1, at 314; Karmel, *supra* note 6, at 168.

111. *See* Bainbridge, *supra* note 6, at 1591 ("The insider trading prohibition ought to be viewed as a means of protecting property rights in information, rather than as a means of preventing securities fraud….Unfortunately, the SEC's regulatory jurisdiction over insider trading meant that the problem was treated as a species of securities fraud rather than one of property rights."); *see also* Easterbrook, *supra* note 1, at 314 ("Whenever the question of property rights in information arises, the legislature or the court must confront the tensions between principles that encourage the creation of new information and those that allow the existing stock of information to be well used. If the Court puts information cases in securities law or evidence law pigeonholes, it may overlook

driving force behind federal securities regulation is the mandatory disclosure requirements aimed at investor protection, which they describe as being at odds with protecting property rights in information.[112] Many only view the misappropriation theory of liability as justified by the goal of protecting property rights and treat the classical theory of liability as devoid of property justifications.[113]

The debate among securities regulation scholars over whether property principles best explain the current insider trading regime is analogous to a debate that intellectual property scholars are having about trade secret law.[114] Many of these scholars seem to take an underinclusive approach to identifying distinct doctrinal principles in one area of law. Its seems as if many securities regulation scholars are looking for the one legal doctrine that explains all insider trading cases.[115] Yet there are bodies of law containing property principles while simultaneously containing tort[116] or contract[117] principles. It is therefore possible for federal securities regulations to simultaneously contain multiple doctrines. This Section highlights a few examples of the underinclusive approach to identifying property principles in insider trading scholarship. It then identifies examples of property doctrine operating concurrently with other legal doctrines.

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the need to consider the way in which the incentive to produce information and the demands of current use conflict."); *see also* Karmel, *supra* note 6, at 168 (Karmel, a former Securities and Exchange Commissioner, described the "view that inside information is a property right that insiders should be permitted to exploit [as] morally obnoxious and legally unsound.").

112. Bainbridge, *supra* note 6, at 1608 ("The basic function of a securities fraud regime is to ensure timely disclosure of accurate information to investors."); *see also id.* at 1649 ("If we want to protect investors from informational disadvantages that cannot be overcome by research or skill…[then] the equal access test is far better suited to doing so than the *Chiarella/Dirks* [property rights] framework."); *see* Karmel, *supra* note 6, at 168–173 (Karmel concluded that the property and other private law rationales for the insider trading prohibition were "simply inadequate to cover the fact patterns of cases in which some have been enjoined by the SEC or have even gone to prison." She argued that a better doctrinal fit would come from an increased understanding of the prohibition as protecting investors by supplementing the "mandatory continuous disclosure system" in U.S. securities law).

113. *See* Kim, *supra* note 1, at 947, 974–986.

114. Robert G. Bone, *A New Look at Trade Secret Law: Doctrine in Search of Justification*, 86 CALIF. L. REV. 241, 244 (1998). ("The relational focus of trade secret's liability rules aligns trade secret law more closely with the law of contract than with the law of property."); Mark A. Lemley, *The Surprising Virtues of Treating Trade Secrets as IP Rights*, 61 STAN. L. REV. 311, 313 (2008) (Arguing "that trade secrets can be justified as a form, not of traditional property, but of intellectual property (IP)."); Eric R. Claeys, *Private Law Theory and Corrective Justice in Trade Secrecy*, 4 J. TORT L. [ii], 63 (2011) (Arguing "that the proprietary account of trade secrecy explains the most features of trade secrecy.").

115. *See* United States v. O'Hagan, 521 U.S. 642 (1997).

116. See Bainbridge, *supra* note 1, at 22. Consider that trespass and conversion are viewed as both tort and property doctrine.

117. *Id.* at 36. Consider that lease and license frameworks are viewed as embodying both property and contract principles.

A. Property Or . . .

One of the first articles to address the property implications of the prohibition on insider trading was a response to Henry Manne's seminal *Insider Trading and the Stock Market*.[118] Manne opposed the prohibition on insider trading on economic grounds. In a review of Manne's book, Richard W. Jennings argued that the prohibition was justified as a means of protecting the property rights of shareholders, who he described as the ultimate owners of the information.[119] Manne countered that Jennings' argument was a red herring and rejected the concept of "property" as useful for resolving any policy dispute.[120] Manne declared that "the concept of property is no more nor less than the rights and obligations recognized by law," and that the real issue is determining how the law should develop based on objective methods of analysis.[121]

Scholars using economic analysis eventually combined Manne's call for objective analysis with a focus on property doctrine. In the early 1980s, scholars such as Frank Easterbrook and Jonathan Macey began to explore whether a property-based approach to the regulation of insider trading (as opposed to, respectively, securities fraud and fairness approaches) would increase or decrease efficiency in securities markets.[122] In 1981, Easterbrook claimed that the Supreme Court was treating insider trading cases as securities cases, thereby putting "them in pigeonholes having little to do with information."[123] By contrast, Easterbrook assumed that in information cases "the central question was whether the principal had a property interest sufficient to require the agent neither to use nor to disclose without the principal's consent."[124] In 1984, Macey attempted to encourage what he described as the U.S. Supreme Court's "new understanding of the fact that privileged corporate information is a valuable asset in the nature of a property interest."[125] Macey described this as a new understanding because he considered the pre-*Chiarella* interpretation of Rule 10b-5 as intended to maximize fairness among trading parties and as (at best) indifferent to the protection of property or contract rights.[126]

Many of the scholars who followed Macey and Easterbrook continued to draw sharp distinctions viewing insider trading as a form of property doctrine and some other doctrine. For example, in 1987 Richard J. Morgan offered what he described as "a proposed property rights approach to the analysis of insider trading restrictions," which he argued would resolve many of the analytical

118. HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET (1966).

119. *See* Jennings, *supra* note 1, at 1234.

120. Henry G. Manne, *Insider Trading and the Law Professors*, 23 VAND. L. REV. 547, 550 (1970).

121. *Id.* at 550.

122. *See* Easterbrook, *supra* note 1; Macey, *supra* note 1.

123. *See* Easterbrook, *supra* note 1, at 312.

124. *See id*.

125. *See* Macey, *supra* note 1, at 11.

126. MACEY, *supra* note 8, at 50–58; *see also* Macey, *supra* note 1, at 10–11.

problems inherent in the doctrine at that time.[127] Morgan concluded that the Supreme Court's focus on "common law fraud [and] fiduciary duties…contributed to the continuing uncertainty concerning the justification and the application of the insider trading rules."[128] Later, Roberta S. Karmel, a former commissioner of the SEC, described the "view that inside information is a property right that insiders should be permitted to exploit [as] morally obnoxious and legally unsound."[129] Karmel concluded that, as a doctrinal matter, property and other private law limitations on the prohibition articulated by the Supreme Court were "simply inadequate to cover the fact patterns of cases in which some have been enjoined by the SEC or have even gone to prison."[130] She argued that a better doctrinal fit would come from an increased understanding of the prohibition as protecting investors by supplementing the "mandatory continuous disclosure system" in U.S. securities law.[131]

Karmel's conclusion that a property rationale does a poor job of explaining past decisions has been echoed in recent scholarship. In *Insider Trading as Private Corruption*, Sung Hui Kim concludes that although a property rationale may offer a "compelling normative approach to insider trading, [the rationale] lacks sufficient descriptive power."[132] She argues that current insider trading doctrine is missing two central features of American property doctrine—exclusion and alienability. As a result, she concludes that a property rationale not only does a poor job of describing past cases, but also has almost no "chance at real-world relevance for judges and regulators grappling with hard cases."[133]

The prior scholarship grappling with the role of property in insider trading cases seems to take for granted that the current law is devoid of property principles in some important way. It then proceeds to argue about how or why lawmakers, regulators, and courts should or should not regulate insider trading using property principles in the future. An example of this implicit assumption is Stephen M. Bainbridge's article *Insider Trader Regulation: The Path Dependent Choice between Property Rights and Securities Fraud*.[134] In that article, Bainbridge states that:

> The insider trading prohibition ought to be viewed as a means of protecting property rights in information, rather than as a means of preventing securities fraud. Viewed from that perspective, the pre-*O'Hagan* misappropriation theory correctly imposed liability on those who converted information that belonged to another for their own personal profit. Unfortunately, the SEC's regulatory jurisdiction over

127. Morgan, *supra* note 14, at 81.
128. *Id.* at 90.
129. *See* Karmel, *supra* note 6, at 168.
130. *Id.* at 173.
131. *Id.* at 169.
132. *See* Kim, *supra* note 1, at 977.
133. *Id.* at 986.
134. *See* Bainbridge, *supra* note 6, at 1589.

> insider trading meant that the problem was treated as a species of securities fraud rather than one of property rights. [A] property rights-based understanding of the prohibition…would premise liability on theft, not deception. Because the text of Section 10(b), or Rule 10b-5, clearly addresses deceit, not conversion of intellectual property, the strict textualist approach to statutory interpretation mandated by *Central Bank* proscribes such an understanding.[135]

According to Bainbridge, treating insider trading as a species of securities fraud means that disclosure is the primary tool used to protect investors—not the recognition and protection of property rights.[136] He goes so far as to describe the protection of investors as being at odds with the protection of property rights.[137] His view of a necessary split between securities fraud and property protection is similar to the separation perceived by Morgan, Karmel, Easterbrook and Macey. Morgan offered his property proposal as a cure to a perceived overreliance on common law fraud and fiduciary duty concepts. Karmel treats a property approach as necessarily in conflict with a regime committed to using disclosure requirements in order to protect investors. Easterbrook wanted to use a property rationale as an alternative to a securities fraud rationale and, like Macey, argued that the "fairness arguments get us nowhere."[138]

What makes these perceived dichotomies strange is that securities fraud doctrines are always property doctrines. As explained in Part II.C. above, fiduciary duties of disclosure are generally aimed at the protection of a beneficiary's property interests. This fact makes sense considering that many fiduciary relationships cannot be created without the existence of property being held in trust.[139] In addition, there are many areas in American law in which fairness is defined as the protection of property or other private rights. Moreover, many tort and criminal doctrines, such as trespass and conversion, are specifically *property* tort and *property* crime doctrines. These *property-and* doctrines can be understood in contrast to doctrines based exclusively on liberty interests, such as battery or false imprisonment. Property-and doctrines can also be understood by differentiating them from exclusively public law doctrines, such as those prohibiting the capture of endangered species.

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135. *Id.* at 1591, 1618.

136. *Id.* at 1608 ("The basic function of a securities fraud regime is to ensure timely disclosure of accurate information to investors.").

137. *See id.* at 1606 ("There is a growing consensus that the federal insider trading prohibition is more easily justified as a means of protecting property rights in information than as a way of protecting investors."); *see also id.* at 1649 ("If we want to protect investors from informational disadvantages that cannot be overcome by research or skill…[then] the equal access test is far better suited to doing so than the *Chiarella/Dirks* [property rights] framework.").

138. *See* Easterbrook, *supra* note 1, at 330; *see also* Macey, *supra* note 1, at 10 (Concluding that the fairness "justifications were vague and ill formed and did not provide a coherent basis for imposing legal sanctions.").

139. RESTATEMENT (SECOND) OF TRUSTS § 66 (AM. LAW INST. 1959).

B. Property And . . .

As explained in Part II.D, liability for common law fraudulent misrepresentation or fraudulent nondisclosure almost always requires the interference with both a plaintiff's liberty and property interests for liability to be imposed.[140] The duty to disclose or abstain from trading in insider trading cases is analogous to the fiduciary duty of a trustee to disclose all material information to a trust beneficiary before transacting in trust assets for the benefit of the trustee.[141] The law recognizes this duty as arising from the trust beneficiary's equitable title to trust assets being superior to the trustee's legal title to trust assets.[142]

In the context of publicly traded companies, it is not unreasonable to view the issuer as analogous to a trustee, the shareholder as analogous to a trust beneficiary, and insiders as analogous to agents of the trustee. Under this framework, insiders might acquire the issuer's duty of disclosure to shareholders because they have agreed to manage corporate assets for the benefit of the corporation, and the corporation has a duty to generate profits for the sole benefit of shareholders as a whole. Therefore, the disclose or abstain rule has the potential to operate as a form of protection of each shareholder's equitable title in the value of inside information, which would eliminate any conflict between disclosure rules and rules that protect property rights in information.

Finally, defining fairness as the protection of some party's property rights is a common aspect of American law, especially in the area of trade secrets.[143] As a form of unfair competition, the *Restatements* identify the "appropriation of intangible trade values including trade secrets."[144] In applying Texas' trade secret law, the Fifth Circuit Court of Appeals described the principle in the following manner:

> That the cost of devising the secret and the value the secret provides are criteria in the legal formulation of a trade secret shows the equitable underpinnings of this area of the law. It seems only fair that one should be able to keep and enjoy the fruits of his labor. If a businessman has worked hard, has used his imagination, and has taken bold steps to gain an advantage over his competitors, he should be able to profit from his efforts. Because a commercial advantage can vanish once the competition learns of it, the law should protect the businessman's efforts to keep his achievements secret. As is discussed

140. *See infra* Section II.D.

141. *See* Oliver v. Oliver, 45 S.E. 232, 233–34 (Ga. 1903) (describing a director as "a quasi trustee as to the shareholder's interest in the shares").

142. RESTATEMENT (SECOND) OF TRUSTS §§ 2, 74, and 170 (AM. LAW INST. 1959).

143. While some scholars dispute whether the area of trade secrets is properly conceived of as property, tort, or some other doctrine, other scholars view this distinction as false. Further, as discussed, *infra* in Section II.B., the U.S. Supreme Court emphatically endorsed the recognition of confidential business information as a form of property in *Carpenter v. United States.*

144. RESTATEMENT (THIRD) OF UNFAIR COMPETITION, § 1 (AM. LAW INST. 1995).

> below, this is an area of law in which simple fairness still plays a large role.[145]

Despite the fact that liability for insider trading is premised on the misuse of confidential business information, it has gone almost unacknowledged that the conception of fairness used to impose liability in insider trading cases is almost completely at odds with the conception of fairness used in trade secret cases.[146] The version of fairness embodied in trade secret and other unfair competition doctrines can be thought of as the "sweat equity" or the "property-based" conception of fairness (property-based fairness).[147]

The foregoing analysis does not support the claim that U.S. insider trading doctrine *is* a property doctrine, or that a property rationale is sufficient for explaining past cases or deciding future cases. However, the analysis does support the conclusion that it would be a mistake to treat certain non-property doctrines as completely unrelated to property doctrine. Although the U.S. insider trading regime does not strictly or consistently rely on common law fraudulent misrepresentation, fraudulent nondisclosure, or trust principles when imposing liability, the fact that these doctrines can and often do rely on property principles demonstrates that treating fraud, fiduciary duty, fairness, or disclosure doctrines as mutually exclusive from property doctrine is a mistake.

Of course, simply knowing that property principles have consistently animated insider trading law is not that useful. Therefore, the next Section explores a few of the implications of this fact.

IV. IMPLICATIONS FOR FUTURE ANALYSIS OF THE REGULATION

Using the defendant's violation of some party's property rights in information as a justification to impose legal liability has implications for the appropriate scope and limits of insider trading doctrine. To the extent that the protection of property rights cannot explain the scope of the law, then either something has gone wrong or there are other valid principles animating this area of law. If something has gone wrong, then some or all of the current insider trading regime may be illegitimate. If other valid principles are animating this area of law, then what are they? Both alternatives have implications for insider trading reform. This Section explores these issues.

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145. Metallurgical Indus. v. Fourtek, Inc., 790 F.2d 1195, 1201 (5th Cir. 1986).

146. *See* Albert D. Spalding, *Insider Tradings: Is there a Better Way? A proposed "Trade Secrets" Approach*, 11 MIDWEST L. REV. 140 (1993).

147. *See Sweat Equity*, DICTIONARY OF FINANCE AND INVESTMENT TERMS (BARRON'S BUSINESS GUIDES) (9th ed. 2014) (Equity created in a property by the hard work of the owner. For example, a small business may be built up more on the efforts of its founders than on the capital raised to finance it).

A. Illegitimacy and Insider Trading

If there are no other principles animating this area of law, then the failure of the current insider trading regime to adhere to property principles should raise concerns about legality. One question is whether the current regime meets the standards of the Administrative Procedure Act (APA). The APA requires courts to hold an agency action unlawful if it is found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[148] Further, although economic regulations generally receive deference when constitutional challenges are brought, that deference might be undermined if the justifications presented by enforcement officials appear to be pretextual.[149] The Supreme Court will not always revisit the reasonableness of enforcement actions and statutory interpretations once approved.[150] However, an exception may be warranted by the anomalous character of a regime that is justified by reference to statutes and rules aimed at the protection of property rights and that premises liability on the violation of property rights, while simultaneously restricting the exercise of those rights. Unless the APA creates a statute of limitations on reviewing agency actions, the disconnect between the current insider trading regime and property principles may warrant determining whether imposing liability for the practice fails to accord with the law.

If the ban on insider trading is motivated by a government policy objective that conflicts with the protection of property rights, then justifying liability based on the goal of protecting property rights becomes problematic. Recall that there are myriad ways in which the current enforcement of the law and related statutes undermine the protection of property and other private rights. Scholars like Nagy,[151] Karmel,[152] and Kim[153] have highlighted several departures from the expected elements of a property regime. These departures from the expected elements of a property regime may be the result of valid complementary principles animating the law.[154] However, they may also be the result of agency reasoning that was arbitrary, capricious, or an abuse of discretion. The disconnect is substantial enough to warrant an investigation.

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148. 5 U.S.C. § 706(2)(A) (2012).

149. Dep't of Commerce v. New York, 139 S.Ct. 2551, 2573–74 (2019) (The Supreme Court upheld the inclusion of a citizenship question in the 2020 census because the plaintiffs were able demonstrate "that the Government had submitted an incomplete administrative record and that the existing evidence supported a prima facie showing that the VRA rationale was pretextual.").

150. *See Stare Decisis*, BLACK'S LAW DICTIONARY (11th ed. 2019) (The doctrine of precedent, under which a court must follow earlier judicial decisions when the same points arise again in litigation).

151. Nagy, *supra* note 43, at 1336–64 (discussing how federal courts and enforcement officials have cast aside fiduciary principles, implying casting aside related property principles).

152. *See* Karmel, *supra* note 6, at 152.

153. *See* Kim, *supra* note 1, at 979–86 (highlighting the absences of alienability in insider trading doctrine).

154. *See supra* Section III.B.

An alternative concern is that lawmakers and courts have unintentionally constructed a convoluted and unworkable regime in the area of insider trading. John P. Anderson has argued that the current doctrine is vague, irrational, and incoherent to the point of being unjust.[155] If he is correct, then the current regime might fail the constitutional test by lacking a rational basis or for being too vague. These concerns may seem irrelevant since laws that restrict property rights (e.g., zoning laws) have been accepted by courts as plausibly aimed at serving some property protecting functions.[156] Further, laws are only infrequently deemed void for vagueness and that doctrine is generally only applied to statues, not judge-made law.[157] However, because the Supreme Court has shown decreasing levels of deference to flexible interpretations of the law over the last several decades, there may be enough of a shift in approach in the near future to undercut the continued viability of the insider trading regime.

The first constitutional concern is related to two statutory changes that Congress made in the 1980s. With Section 20A of the Exchange Act, Congress authorized standing to bring private suits for those who trade contemporaneously and in the opposite direction of defendants in insider trading cases.[158] Congress also amended Section 20A of the Exchange Act to increase the controlling person liability faced by the employers of defendants in insider trading cases.[159] Because of the amendments to Section 20(a), issuers in classical theory cases and sources of information in misappropriation cases face liability for three times the profits generated or losses avoided by the defendants in these cases.[160] If a constitutional challenge is brought, courts may conclude that both provisions fail to meet the flexible limits of the rational basis test.

Section 20A of the Exchange Act is constitutionally suspect because it gives standing to someone other than the information owner to bring a private suit for violating a prohibition that is premised on the violation of the owner's property rights in information. If there are no other principles animating this area of law, then allowing those who trade contemporaneously to have standing to sue is bizarre. In misappropriation theory cases the source of the information is both the legal and equitable owner of the information. Therefore, it makes no sense for a violation of the source's property rights in information to authorize an unrelated third party to sue the defendants in these cases. In classical theory

155. ANDERSON, *supra* note 8, at 5.

156. Vill. of Euclid, Ohio v. Ambler Realty Co., 272 U.S. 365, 388 (1926) ("There is no serious difference of opinion in respect of the validity of laws and regulations fixing the height of buildings within reasonable limits, the character of materials and methods of construction, and the adjoining area which must be left open, in order to minimize the danger of fire or collapse, the evils of overcrowding and the like, and excluding from residential sections offensive trades, industries and structures likely to create nuisances.").

157. *See* Ryan McCarl, *Incoherent and Indefensible: An Interdisciplinary Critque of the Supreme Court's "Void -For-Vagueness" Doctrine*, 42 HASTINGS CONST. L.Q. 73, 91 (2014).

158. 15 U.S.C. § 78t-1(a) (2012).

159. 15 U.S.C. § 78u-1(a)(3) (2012).

160. 15 U.S.C. § 78u-1(a)(2) (2012).

cases, parties with and without any ownership interest in the information have standing to sue. Section 20A of the Exchange Act gives standing to counterparties who were shareholders before the prohibited trades, which implies that standing is justified by the shareholders' equitable title to inside information. However, Section 20A also gives standing to counterparties who were not shareholders before the transaction. This standing framework is a continuation of SEC and court decisions that recognized non-shareholders as being injured by insiders who sell their shares without first disclosing material nonpublic information.[161] This framework, however, conflicts with a regime premised on the violation of some party's property rights in information.

Scholars such as Macey and Anderson have argued that using Section 20(a) to impose controlling person liability on the information owners in insider trading cases is irrational.[162] The case law is replete with references to information in classical theory cases being "available only for a corporate purpose."[163] In addition, recall that the Court in *O'Hagan* argued that insider trading in misappropriation theory cases is akin to the defendant embezzling the property of the source of the information.[164] Yet Congress has authorized the corporate issuer in classical theory cases and the source of the information in misappropriation theory cases to face legal penalties if it can be shown that they did not take sufficient steps to prevent the violation of their property rights. The same violation of property rights cited to justify imposing liability for insider trading on the agents of the information owners. If insider trading is analogous to embezzlement, then the use of Section 20(a) in these cases is analogous to punishing the victims of embezzlement for being robbed by their agents.

It is difficult to imagine a rational basis for punishing the victims in cases of theft or fraud. It may be tempting to explain this approach by claiming that by failing to prevent insider trading, the owners of the information are vicariously liable for the third-party harm caused by their agents' illegal trading. However, recall the problems with Section 20A of the Exchange Act noted in this Section and the issues raised in the circuit split that inspired Section 20A of the Exchange Act.[165] If insiders are unable to influence the counter parties to their transactions to participate, then insider trading does not embodying the reliance and causation elements required to prove fraudulent nondisclosure in other cases.[166] Therefore, it seems mistaken to view insider trading resulting in the infringement of the property or liberty interests of any market participant other than the information owners—who now face legal penalties under Section 20A of the Exchange Act if they do not do enough to prevent their agents from stealing their information.

161. *See In re* Cady, Roberts & Co., 40 S.E.C. 907, 911–13 (Nov. 8, 1961).
162. *See supra* note 8 and accompanying text.
163. *See supra* Section II.B.
164. United States v. O'Hagan, 521 U.S. 642, 654 (1997).
165. *See supra* Section I.D.
166. *See supra* Section II.C.

A second question is whether the interpretations of the anti-fraud statues and rules used to prohibit insider trading can continue to be described as reasonable. This concern is related to the question of constitutionality but is more precisely a matter of statutory interpretation. In *Chiarella*, the Supreme Court argues that it is "not a novel twist of the law" that insiders in possession of material nonpublic information are required to disclose that information or abstain from trading.[167] In *O'Hagan*, the Court described the misappropriation theory of liability as punishing behavior that constitutes common law fraudulent deception "akin to embezzlement."[168] These determinations were made with Section 17(a) of the Securities Act and Rule 10b-5 in mind. Recall that Section 17(a) of the Securities Act and Exchange Act Rule 10b-5 are explicitly aimed at protecting the property and liberty interests of market participants. Section 17(a) of the Securities Act specifically outlaws the use of misrepresentations "to obtain money or property" of investors through "the offer or sale of any securities."[169] The question remains: how can courts continue to describe a regime that restricts so many incidents of ownership as plausibly aimed at preventing or remedying fraudulent deception or nondisclosure?

Holding property owners liable for using their own property or for allowing third parties to use their property is more analogous to an inalienability rule or a vice law than a property rule.[170] Insider trading doctrine both prohibits certain information owners from using their information for securities trading and bars these owners from licensing third parties to do the same. These restrictions contradict the common and long-standing expectation that property owners have a right to partially alienate their property for consideration.[171] Consider that the restrictions on the owners' use of their own inside information found in Rule 14e-3 was deemed acceptable by the Court in part because Congress authorized the SEC to define new behaviors as fraudulent in the context of regulating tender offers.[172] Rule 10b-5 and Section 17(a) do not make similar delegations of lawmaking authority, so it is problematic that a doctrine based on statutes aimed

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167. Chiarella v. United States, 445 U.S. 222, 227 (1980).

168. *O'Hagan*, 521 U.S. at 654.

169. 15 U.S.C. § 77q(a) (2012).

170. *See* Calabresi & Melamed, *supra* note 13, at 1111–12; ; *also see* Devlin, *supra* note 13, at 3.

171. *See* RESTATEMENT (FIRST) OF PROPERTY § 489 cmt. a (AM. LAW INST. 1944) ("Property interests are, in general, alienable. If a particular property interest is not alienable, this result must be due to some policy against the alienability of such an interest."); *see* Kim, *supra* note 1, at 979–986 (highlighting the absences of alienability in insider trading doctrine); *see* DEL. CODE ANN. Tit. 8, §122(4) (empowering corporations to "sell…or otherwise dispose of…all or any of its property and assets, or any interest therein."); *see* MODEL BUSINESS CORPORATION ACT § 3.02(e) (AM. BAR ASS'N 2016) (authorizing corporations to "to sell…and otherwise dispose of all or any part of its property").

172. *O'Hagan*, 521 U.S. at 667 (Section 14(e) prohibits "fraudulent…acts…in connection with any tender offer," and authorizes the SEC to "define, and prescribe means reasonably designed to prevent, such acts.").

at protecting property and other private rights would break from the common elements of property regimes in so many ways.[173]

However problematic the Courts interpretive decisions in *Chiarella* and *O'Hagan* may seem in hindsight, there are canons of statutory interpretation that would support maintaining the status quo. Many would argue that stare decisis warrants accepting these prior interpretations and deferring to Congress to make any changes that would contradict the expectations that have developed around these decisions. Consider, for example, the passage of the Insider Trading Sanctions Act of 1984 (ITSA) and the Insider Trading and Securities Fraud Enforcement Act of 1988 (ITSFEA). Some argue that the reenactment doctrine requires treating the passage of ITSA and ITSFEA as congressional authorization of the insider trading doctrine previously developed in the courts.[174]

There is good reason, however, to doubt that adhering to either stare decisis or the reenactment doctrine would weigh in favor of deference in the context of insider trading law. To the extent that both canons are aimed at fostering rule of law principles such as stability and notice, the popular view that insider trading doctrine is incoherent and confusing may make both canons of interpretation inapplicable to this area of law. For decades, scholars have lamented the incoherence of insider trading law.[175] Recall that Anderson has recently described the doctrine as vague and incoherent to the point of being unjust.[176] Even some prominent enforcement officials have recently described the law as so confusing that it leaves investors uncertain "about what sorts of information-sharing or other activities by investors would be considered insider trading."[177]

The popularity of describing insider trading law as unclear is surprising considering that the complaints come from scholars who disagree about whether insider trading should be prohibited[178] and from enforcement officials who are

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173. *See id.* at 672 (the Supreme Court decided to side step the task of resolving "whether the Commission's authority under [Section] 14(e) to "define…such acts and practices as are fraudulent" is broader than the Commission's fraud-defining authority under [Section] 10(b).").

174. *See* Bainbridge, *supra* note 6, at 1617 ("…the recent amendments arguably constitute an authoritative congressional endorsement of the insider trading prohibition. Under the so-called re-enactment doctrine, where Congress revises a statute without reversing prior on-point judicial holdings, that failure has been taken as evidence of congressional approval of those prior holdings.").

175. *See* Kim, *supra* note 1, at 949 ("To counter serious doctrinal instability and to answer persistent normative skepticism, we need a better theory of insider trading law."); *see* ANDERSON, *supra* note 8, at 3 (describing how the "American insider trading enforcement regime is broken," Anderson argues that the uncertainty in the law "directly impacts shareholder value and unjustly leaves market players at the mercy of prosecutorial caprice.").

176. ANDERSON, *supra* note 8, at 89.

177. Preet Bharara & Robert J. Jackson Jr., *Insider Trading Laws Haven't Kept Up With the Crooks*, N.Y. TIMES (Oct. 9, 2018), https://www.nytimes.com/2018/10/09/opinion/sec-insider-trading-united-states.html.

178. Anderson, who describes the doctrine as vague, incoherent, and unjust has argued that some forms of insider trading should be decriminalized. *See* ANDERSON, *supra* note 8, at 235, 243.

known for penalizing dozens of individuals and organizations under the current doctrine.[179] The consensus that the doctrine is incoherent undermines the conclusion that the law is stable enough for market participants to rely on past decisions to have notice of the law. It also warrants viewing Congress' decision not to define insider trading in either 1980s statute as more akin to a student turning in an incomplete assignment, than as an implied endorsement of the ambiguous status quo.

Whether the Supreme Court will decide to abandon the current interpretations of Rule 10b-5 or Section 17(a) of the Securities Act in the context of insider trading is impossible to tell. If the analysis in this Article is correct, however, and many have missed the property principles animating the doctrine, then the Court has at least one reason to reconsider its prior decisions.

B. Property And . . . Other Valid Principles

The alternative explanation for the failure of the current insider trading regime to adhere to property principles is that valid competing principles are also motivating the doctrine. Most legal regimes contain general rules and exceptions to those rules. Some exceptions are authorized by an overarching policy objective that also justifies the general rule. Consider the statute of frauds, which limits the availability of injunctive relief to those real property transactions that are reduced to writing.[180] The goal of reducing the incidents of fraudulent transfers by increasing the demands for a certain quality of evidence is clearly in harmony with the goal of protecting an owner's rights of exclusive use and disposal in a parcel of land. Other exceptions to general rules are authorized by a competing government interest that is given explicit priority in a specific context. For example, consider conservation laws that prohibit capturing or selling wild animals that are listed under the Endangered Species Act.[181] The

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On the other hand, Nagy supports the prohibition and has complained the current doctrine lack sufficient "coherence and legitimacy." *See* Nagy, *supra* note 43, at 1321.

179. Bharara has often been referred to as the "Sheriff of Wall Street," and Jackson is a sitting Securities Exchange Commissioner. *See* Andrew Ross Sorkin, *Preet Bharara: 'Sheriff of Wall Street' or Pragmatic Showman?*, N.Y. TIMES (March 13, 2017), https://www.nytimes.com/2017/03/13/business/dealbook/preet-bharara-us-attorney-wall-street.html; *see also* U.S SEC, BIOGRAPHY, COMMISSIONER ROBERT J. JACKSON JR. https://www.sec.gov/biography/commissioner-robert-j-jackson.

180. The purpose of the original statute was to prevent individuals from being held responsible for promises that were never made and were only evidenced by perjured testimonies. *See* Hugh Evander Willis, *The Statute of Frauds–A Legal Anachronism*, 3 IND. L.J. 427, 428n.5 (1928) (citing the preamble of the original statute as describing its purpose). For a reproduction of the original statute, see Crawford D. Hening, *The Original Drafts of the Statute of Frauds and Their Authors*, 61 U. PA. L. REV. 283, 285–287 (1913).

181. *See* 16 U.S.C. § 1538 (2012).

Act unambiguously prioritizes the conservation of specific species over the property principles of acquisition[182] and alienation.[183]

Insider trading doctrine may be best understood as prioritizing a competing government interest over a general rule aimed at protecting the property rights of information owners. The starting assumption in insider trading classical theory cases is that inside information is intended for the exclusive use and benefit of the issuer and its shareholders. Issuing companies are free to use their inside information to run their organizations.[184] For example, they can use the information about a planned decrease in their quarterly dividends to execute the dividend and put cash into the hands of their shareholders. They may also use the information related to undisclosed merger negotiations to conduct the diligence and planning necessary to complete the merger. Similarly, the tender offerors in misappropriation theory cases may use material nonpublic information about their planned acquisition to successfully take control of a target company.

Based on this starting assumption, some scholars have argued that the prohibition on insider trading can be thought of as a means of achieving the overarching objective of protecting the property rights of issuers and other sources of information.[185] Yet information owners in both classical and misappropriation theory cases face controlling person liability and treble damages under Section 20(a) of the Exchange Act if their agents engage in illegal trading—with or without the owner's consent.[186] Because controlling person liability under Section 20(a) of the Exchange Act increases the harm to the information owner's property interest, it would not be reasonable to view the prohibition as an exception aimed at fostering an underlying objective of the general rule. Moreover, viewing the prohibition as aimed at protecting the property interests of information owners seems absurd because information owners are barred by other rules from *consenting to* the use of the information in securities trading.

So what competing government interest(s) explains the departures from the common characteristics of a property regime found in insider trading doctrine? Fairness and investor confidence are two obvious candidates for the additional principles in insider trading law that compete with property doctrine. The first is not simply fairness, but specifically an equal-information conception of fairness (equal-information fairness). The two-pronged test explaining liability for insider trading found in *Cady, Roberts* and *Chiarella* contains a second justification for imposing liability, which may have been reaffirmed by the

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182. *See* Pierson v. Post, 3 Cai. R. 175 (N.Y. Sup. Ct. 1805).

183. *See* RESTATEMENT (FIRST) OF PROPERTY § 489 cmt. a (1944) ("Property interests are, in general, alienable.").

184. For the powers of corporations, *see* DEL. CODE. ANN. Tit. 8 § 122; MODEL BUSINESS CORPORATION ACT § 3.02(e) (AM. BAR ASS'N 2016).

185. *See* Bainbridge, *supra* note 1; Jennings, *supra* note 11; Strudler & Orts, *supra* note 11.

186. 15 U.S.C. § 78t-1 (2012).

Supreme Court in *O'Hagan*.[187] In *Chiarella*, the Court explained that the duty to disclose or abstain from trading on inside information arose from "(i) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) *the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure*."[188]

Recall that both common law fraudulent nondisclosure doctrine and trade secret doctrine seem to be animated by property-based fairness principles.[189] Property-based fairness generally requires the consent of the information owner for a conflicted transaction to be lawful. As a consequences, the disclosure requirements in fraudulent nondisclosure cases outside of insider trading facilitate achieving the kind of consent required to ensure that conflicted transactions do not result in a breach a fiduciary or similar duty of loyalty.[190]

By contrast, the classical and misappropriation theories of insider trading abandon consent and make simple disclosure a defense against liability. Viewing disclosure as sufficient for avoiding liability for insider trading, and not as a means of obtaining the right kind of consent, suggests that the doctrine is animated by something other than the protection of property rights. And focusing on the parties recognized as victims of insider trading may help us to identify the government interest that has been prioritized over the protection of the property rights of information owners.

In addition to identifying the information owners as victims, insider trading legislation and case law also recognizes the counterparties to the trade as the parties who have been injured by the prohibited trading. The view that an investor is injured if they trade with counterparties bearing less risk or counterparties holding more valuable information suggests that the doctrine is animated by an equal-information or economic equality principle.

The second candidate for an additional principle animating this area of law is the investor confidence or market integrity rationale offered by the Court in *O'Hagan*.[191] In *O'Hagan,* the Court states that imposing liability under the misappropriation theory is in line with the "animating purpose of the Exchange Act: to ensure honest securities markets and thereby promoting investor confidence."[192] The Court acknowledges that some information asymmetries are inevitable in securities markets. It then goes on to argue that investors are likely to avoid markets where some participants have misappropriation-derived

187. *See* Chiarella v. United States, 445 U.S. 222, 228, 230–31 (1980); United States v. O'Hagan, 521 U.S. 642, 651–52 (1997).

188. *Chiarella*, 445 U.S. at 227.

189. *See infra* Section III.B.

190. *See* RESTATEMENT (SECOND) OF TORTS § 551 (AM. LAW INST. 1976).

191. *O'Hagan*, 521 U.S. at 658.

192. *Id.* at 658.

information advantages, because those advantages stem "from contrivance, not luck; it is a disadvantage that cannot be overcome with research or skill."[193]

It is unclear how the average investor would determine which kind of information advantages (if any) are being used by his counterparties in the marketplace.[194] This epistemic challenge may explain how the pursuit of some version of investor confidence through the prohibition of *some* information asymmetries might cause departures from long-standing property principles. If investors would find it difficult to differentiate between counterparties with acceptable and unacceptable information advantages, then it may be equally difficult for courts and enforcement officials to do so. Therefore, to the extent that insider trading doctrine departs from the common elements of a property regime, the difficulty of precisely differentiating between acceptable and unacceptable information advantages may have caused the development of conflicts in the doctrine.

Of course, we do not have to choose only one of these two principles to explain the departures from a property regime in insider trading doctrine. Recall that the scholars who rejected the explanatory power of property principles in insider trading doctrine may have held unnecessarily narrow expectations by assuming that one rationale would explain the entirety of a doctrine without the existence of other animating principles.[195] If common law nondisclosure and trade secret doctrines can contain property principles and fairness principles, it may be possible for insider trading doctrine to contain equal-information principles and investor confidence principles, while simultaneously being motivated by property principles. The question becomes whether the many principles present in the doctrine can operate together harmoniously.

C. Opportunities for Legal Reform

A third implication of property principles animating insider trading doctrine is that the call for legal reform might be satisfied by bringing the doctrine into greater harmony with the expected features of a property regime.[196] Alternatively, reformers can *clearly* authorize a departure from the expectations of a property regime. Section IV.C. describes legal regimes in which general rules are qualified by either (1) exceptions that are in harmony with some

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193. *Id.* at 658–59.

194. Some scholars have argued that pervasive trading based on information asymmetries discourages liquidity providers from participating in securities markets, which makes investing less profitable for the average investor and makes raising capital more expensive for companies. *See* Kevin S. Haeberle & M. Todd Henderson, *Information-Dissemination Law: The Regulation of How Market-Moving Information Is Revealed*, 101 CORNELL L. REV. 1373 (2016).

195. *See supra* Section II.

196. Preet Bharara et al., *The Bharara Task Force on Insider Trading* 1 (Jan. 2020), https://static1.squarespace.com/static/5e1f2462d354fa5f5bac2699/t/5e2a1e9d12e0c33aefc41303/1579818654541/Report+of+the+Bharara+Task+Force+on+Insider+Trading.pdf.

overarching government interest or (2) exceptions that clearly prioritize a competing government interest. It is also possible, however, to have a legal regime in which the general rule is modified by *opaquely* prioritizing a competing government interest. This last possibility would likely lead to confusion on the part of enforcement officials, courts, and civilians; it may also explain the perceived incoherence of the current insider trading regime.

The equal-information or investor confidence goals discussed above may be the competing government interest(s) that are opaquely prioritized over a general rule aimed at protecting the property rights of information owners. A legal regime cannot protect property—or exclusive use—rights in information while simultaneously fostering equal access to or use of the same information. The tension between these two principles may explain why the current doctrine identifies disclosure by the fiduciary—not the consent of the beneficiary—as a defense against liability for insider trading. It may also explain why courts have held issuers in classical theory cases to the same duty to disclose material information or abstain from trading. Both departures would make sense in a regime animated by equal access principles, even if liability is often limited to those defendants who obtained the information through a fiduciary or similar relationship of trust and confidence. Moreover, the Supreme Court's explicit rejection of the equal access rationale in Chiarella would force anyone committed to information equality to use the opaque prioritization approach. The confidence of market participants is often fostered by the protection of property rights—including those rights used to facilitate trading based on information asymmetries. Still, the courts have concluded that fostering investor confidence requires prohibiting trading with some information asymmetries without clarifying the relationship between the kinds of information asymmetries prohibited and information owners' exclusive use rights.

Clarifying which, if any, government interests will be prioritized over the protection of property rights in the regulation of insider trading could solve the over-inclusiveness problems lurking in two prominent reform proposals. The current proposals for insider trading reform start with the assumption that the confusion in the law is rooted in the narrowness of what qualifies as a breach of the fiduciary duty of loyalty. Many have argued that the duty of loyalty concept is too narrow, because some defendants were able to avoid liability for trading with information obtained by hacking into a company's computers.[197] As a corrective, these proposals recommend statutes that premise liability on the "wrongful use" of information in securities trading.[198] Recognizing the risk of over-correction by replacing an under-inclusive concept with an over-inclusive concept, both major proposals define what might constitute "wrongful use." Unfortunately, neither proposed clarification will prevent the proposed regimes

197. Donna M. Nagy, *Beyond Dirks: Gratuitous Tipping and Insider Trading*, 42 IOWA J. CORP. L. 1, 51–52 (2016).

198. Insider Trading Proscriptions Act of 1987, S. 1380, 100th Cong. (1987).

from being problematically unambiguous without addressing the role of consent in the law.

"Consent" is the key issue if officials want to clarify which kind of informed trading will be deemed wrongful. In addition to the case law presenting conflicting justifications for insider trading liability, the statutes and rules regulating the practice express conflicting views of the rights and obligations of securities market participants. Insider trading cases are primarily brought under Section 10(b) of the Exchange Act, Rule 10b-5 and Section 17(a) of the Securities Act. Outside of insider trading cases, those provisions are applied using a framework that resembles the common law principles for fraudulent misrepresentation and fraudulent nondisclosure.[199] This means that outside of insider trading cases, when defendants face liability for fraudulent nondisclosure under Rule 10b-5 and 17(a) it is because by failing to make the appropriate disclosures they failed to obtain the right kind of consent.[200]

At least two Supreme Court decisions tried to revitalize the principle of consent in insider trading cases, but without using the word. In *Chiarella*, both the Court and the SEC acknowledged that a tender offeror could authorize friendly investors to purchase stock in a target company ahead of a public announcement of the offer without violating Rule 10b-5.[201] In Dirks, the majority warned against over-inclusive restrictions on trading with information advantages, because the approach would prevent issuers from engaging in selective disclosure of valuable information when doing so was beneficial to the company.[202] Nevertheless, the SEC adoption of Regulation FD[203] and Rule 14e-3[204] make it unlawful for information owners to consent to the use of their information for securities trading. These rules were described by the SEC as being aimed at closing loopholes in the regulation of insider trading.

Combined with the case law that penalizes issuers in classical theory cases for trading on their own information, the rejection of consent in Regulation FD and Rule 14e-3 make the current insider trading regime operate more like inalienability rules or vice laws, than like property rules. Combined with the case law and statutory provisions rooting the authority to impose liability for insider trading in the violation of some party's property rights in information, the inalienability features in insider trading doctrine make the regime unnecessarily confusing. Reformers can solve this problem by using consent to define the outer limits of their proposed wrongful use principle. If insider trading defendants can avoid liability by obtaining consent or ratification from the information owner, then market participants will know that property and related

199. *See supra* Section II.D.
200. *See supra* Section II.D.
201. Chiarella v. United States, 445 U.S. 222, 233 (1980).
202. Dirks v. S.E.C., 463 U.S. 646 (1983).
203. Selective Disclosure and Insider Trading, 17 C.F.R. § 243 (2000).
204. *Id.* § 240.14e-3.

principles are controlling the regime.[205] If neither consent nor ratification are defenses against insider trading liability, then market participants will know that some other government interest has been prioritized.

Solidifying the role of consent in the doctrine also be helpful in the event that the "wrongful use" proposals fail. Some want the regulation of insider trading to focus on fostering some form of "economic efficiency." Others want the regulation to focus on fostering "fairness." Like "wrongful," all terms expressing evaluations can be used to convey dramatically different ideas and therefore used to reach substantially different conclusions based on the term's underlying standard of evaluation. Would a fairness approach aim for economic equality or for an economy based on consent? Would an economic efficiency approach chose to use property rules or inalienability rules to protect entitlements to information?

Of course, the proposed reform assumes that law makers would want to make the insider trading regime less ambiguous.[206]

V. Conclusion

This Article has shown that the SEC and federal courts have always premised liability for insider trading on the violation of some party's property rights under the classical theory of liability. Most scholars recognize that the U.S. Supreme Court premises liability for insider trading on a breaches of fiduciary duty in classical theory cases. Unfortunately, many scholars draw unnecessarily strict distinctions between property doctrine and other doctrines—i.e., fraud, fiduciary duty, fairness, or disclosure doctrines. Because they are often searching for the one best rationale to explain insider trading doctrine, many have missed the fact that the fiduciary duty of loyalty at work in all insider trading cases involves the duty to use corporate assets—including confidential business information—for the sole benefit of the corporation and its shareholders. Therefore, liability in these cases is not premised on property principles or fairness principles or duty of loyalty principles. Liability in these cases is premised on *property and* other principles.

Recognizing the undeniable presence of property principles in insider trading doctrine is no reason to treat property as the best rationale for explaining past cases or as the best rationale for deciding tough cases in the future. Yet acknowledging property principles does raise doubts about whether officials are authorized to impose liability for insider trading. However, recognizing property principles also highlights possible solutions for the confusion in the doctrine that many scholars and enforcement officials lament. At a minimum,

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205. RESTATEMENT (SECOND) OF TORTS § 606 (1938); *see also* ERIC R. CLAEYS, ON THE "PROPERTY" AND THE "TORT" IN TRESPASS in PHILOSOPHICAL FOUNDATIONS OF THE LAW OF TORTS (John Oberdick ed. 2014).

206. *See* Jill E. Fisch, *Constructive Ambiguity and Judicial Development of Insider Trading*, 71 SMU L. REV 750 (2018).

reformers interested in eliminating unnecessary ambiguity must clarify the role of consent in their reform proposals.