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The Seventh Amendment Right to Jury Trial in Civil Penalties Actions: A Post-*Tull* Examination of the Insider Trading Sanctions Act of 1984

NAME: ERICA CLEMENTS**SUMMARY:**

... Insider trading, however, is one such "hot" topic. ... The right to jury trial alters the balance in civil insider trading prosecutions because the jury speaks with a different voice than does the court. ... Although labeled the Insider Trading Sanctions Act, the title may be something of a misnomer because it extends liability not only to traditional corporate insiders, but to anyone who trades on material nonpublic information. ... Furthermore, Congress extended the definition of insider trading in the legislative history — while expressly denying that it was defining the term — by emphasizing that it expected the SEC to pursue violations by "outsiders," such as underwriters, investment analysts, lawyers, accountants, financial printers, government officials, and others who, by virtue of access to nonpublic information, become "constructive insiders." ... This misappropriation theory has now become the SEC's primary vehicle for reaching nontraditional insider trading cases. ... Under the *Dirks* theory, a necessary precondition for insider trading liability is the breach of a fiduciary duty by a corporate insider. ... If SEC Chairman David Ruder is correct — that insider trading is a prevalent and pervasive practice that most Americans see as innocuous — the extension of the right to jury trial to insider trading cases may have a significant effect. ...

TEXT:

[*361] I. INTRODUCTION

Rarely does an esoteric legal issue evolve into a topic of heated public debate. Insider trading, however, is one such "hot" topic. Innumerable law journals, newspapers, and magazines have devoted countless pages to the subject. n1 Prosecution of those who illegally trade securities on the basis of "inside" information is now the number one priority n2 of the Securities and Exchange Commission [*362] (SEC), the federal agency that regulates the securities markets. n3

The current regime of insider trading enforcement, however, is profoundly troubling in many respects. For example, not only does the offense lack statutory definition, n4 but the term "insider trading" is misleading. n5 Traditional corporate insiders are not the only people who face insider trading liability. The SEC and the courts have extended liability to include almost anyone who trades on any material nonpublic information. n6 This extended liability is especially [*363] troubling because the trading public does not appear to find such conduct intuitively offensive. n7 Indeed, there is a general consensus that insider trading activity is widespread and pervasive in this country and, therefore, may be acceptable to community norms. n8 In addition, many observers believe that insider trading regulation is based on false assumptions regarding market function, composition, and the historical causes of the Great Depression. n9 A systematic lack of empirical data to support the regulatory structure, and the failure of the SEC, Congress, and the courts to perform systematic cost/benefit analyses, exacerbate these problems. n10

Despite these serious conceptual problems, the SEC and the courts severely sanction offenders. n11 Thus, the scales of justice are [*364] unfairly weighted against the accused. n12 The decision of the Supreme Court of the United States in *United States v. Tull*, n13 however, may alter the balance. In *Tull*, the Supreme Court extended the seventh amendment right to jury trial to actions involving statutory civil penalties. n14 Although *Tull* involved only the Clean Water Act,

n15 the Supreme Court's language suggests that all actions involving statutory civil penalties must be tried to a jury on demand. n16 Because nearly all civil enforcement actions that prosecute insider trading seek civil penalties under the Insider Trading Sanctions Act of 1984 (ITSA), the Supreme Court's decision in *Tull*, as applied to insider trading cases, may help to restore fairness to the judicial process and extend the social dialogue on the policy of securities regulation. n17

The right to jury trial alters the balance in civil insider trading prosecutions because the jury speaks with a different voice than does the court. n18 This voice becomes audible only when one recognizes [*365] that the jury decides the law, as well as the facts of the case. n19 The jury is free, in a sense, to make law because it has the power to interpret and apply the law in light of the factors present in the particular case. n20 Thus, when the jury applies abstract rules of law to the facts before it, a jury may disregard the letter of the law in order to mitigate its harshness, thereby giving legal rules often-needed flexibility. The jury's voice is significant because neither a court, a lawyer, nor a legislator can engage in the dialogue or discourse of adjudication without responding to the pointed and potent arguments that the jury's decision projects. n21 Only when it understands that the jury's dialogue is central to the question of adjudication can society begin to construct a regulatory vision that is no longer myopic. n22 Thus, society must [*366] incorporate the community's voice into the analytic framework of securities regulation. n23

This Comment examines the effects of the *Tull* decision in four sections. Section II discusses the Court's opinion in *Tull* and assesses some shortcomings in the Court's internal logic. Section III examines the current regime of civil enforcement of insider trading prohibitions under ITSA. n24 Section IV then discusses the increasing divergence between enunciated justifications for securities regulation and the perceived [*367] reality of the marketplace, a divergence that is causing increasing cognitive dissonance. In light of empirical studies on jury behavior, Section V speculates on the jury's effect on social policy regarding insider trading. This Comment concludes that by including the jury in the judicial process of insider trading litigation, the discourse has been altered in positive ways, whether a particular case is tried or settled n25 and whether the jury uses more or less stringent standards to assess liability. The possibility of a jury trial adds an important dimension to the legal discourse n26 and, hence, to social policy, n27 thus implementing the separation of powers doctrine by significantly enhancing the role of community in judicial decisionmaking. n28

II. AN ANALYSIS OF *UNITED STATES V. TULL*

A. *The Procedural Background*

In *United States v. Tull*, n29 the government brought a civil penalties [*368] action against a real estate developer accused of violating the Clean Water Act n30 by filling in wetlands property. n31 The developer did not deny having filled in the properties but contested their categorization as wetlands. n32 The government sought both equitable and monetary relief, and asked the judge to impose the maximum civil penalty, over \$22 million. n33 Despite the government's admission that there existed triable issues of fact regarding the composition and nature of the filings, the district court denied the developer's demand for a jury trial and, after a trial to the court and a finding of liability, fined the developer \$325,000. n34 The United States Court of Appeals for the Fourth Circuit affirmed and expressly held that the right to jury trial did not extend to civil penalties actions in which the statute is silent regarding this right. n35 The Supreme Court, however, reversed and held that the seventh amendment's guarantee of a jury trial applies to civil actions that seek to collect a civil penalty. n36 The Court reached this conclusion based on an historical analysis of the jurisdictional prerogatives of the courts of law and equity. n37

[*369] B. *The Supreme Court's Historical Analysis*

The seventh amendment to the Constitution of the United States requires that "[i]n suits at common law, where the value in controversy shall exceed twenty dollars, the right to trial by jury shall be preserved." n38 It, therefore, protects the right to jury trial only in actions "at law," and not those in equity. n39 Moreover, because the seventh amendment uses the word "preserved," the Supreme Court, in *Tull*, unanimously based its decision on the traditional historical analysis of the kinds of suits that could properly be brought in 18th-century English law courts. n40

[*370] In order to determine whether the seventh amendment's right to jury trial applied to the Clean Water Act, the Supreme Court, in *Tull*, applied a two-pronged test: First, it examined the nature of the action, and second, it examined the nature of the remedy. n41 In applying this two-pronged test, however, the Court specified that the search must be for "a single historical analogue," with reference to 18th-century English practice. n42 Thus, the Court required both the action and the remedy to be defined in light of 18th-century practice: the action, to determine where jurisdiction might have been found, and the remedy, to determine whether it is more "legal or equitable in nature." n43

Applying this two-pronged test, the Court found that the civil penalties action was "clearly analogous to the 18th-century action in debt," which had traditionally required a jury trial. n44 The government had argued that an equitable action to abate a public nuisance, which traditionally did not require a jury trial, was the closer analogue to an action for civil penalties under the Clean Water Act. n45 The Court disagreed, however, and held that even if this were so, [*371] characterizing the relief was the more important inquiry. n46

In characterizing the relief of civil penalties as one at law, the Court determined that civil penalties "could only be enforced in courts of law" because they were punitive rather than compensatory in nature, and therefore, they were not issued by the courts at equity. n47 Thus, the Court concluded that civil penalties under the Clean Water Act were legal rather than equitable because they sought more than a mere restoration of the status quo. n48 The Court summarily disposed of the government's argument that courts in equity were traditionally able to assess monetary awards if they were "incidental to or intertwined with injunctive relief." n49 Instead, the Court concluded that even if "a court in equity [was permitted to] award monetary restitution as an adjunct to injunctive relief, it [was] not [permitted to] enforce civil penalties." n50 Therefore, if the government wants to keep a jury out of the deliberations, it is free to bring a separate equitable suit for injunction. n51 On the other hand, if, as in *Tull*, the government seeks both legal and equitable relief in the same suit, all the issues common to both claims must be tried to a jury. n52

[*372] C. *The Separation of Action and Remedy*

Although the Court focused on the type of remedy that the government requested in determining that a civil penalties action is triable to a jury, it is ironic that the Court did not extend this right to the remedy phase of the trial. n53 In civil jury practice, the court traditionally assigns both the liability and the damage determinations to the jury. n54 The majority, instead, concluded that because civil penalties are "highly discretionary calculations that take into account multiple factors," and because they are "the kind of calculations traditionally performed by judges," the jury should not make that determination. n55 Moreover, the majority concluded that "a determination of a civil penalty is not an essential function of a jury trial," and that it is not one of those "incidents which are regarded as fundamental, as inherent in and of the essence of the system of trial by jury." n56 Thus, the Court's holding is more analogous to criminal practice, in which the jury determines guilt and the judge determines the sentence. n57 The Court justified its departure from traditional civil practice by arguing that Congress "may fix the civil penalties [itself, or it] may delegate that determination to trial judges." n58 The Court determined that Congress had delegated the authority to fix civil penalties to the trial judges in the Clean Water Act. n59 Although the language of the Clean Water Act is silent on the jury trial issue, the Act's legislative history infers that judges are authorized to make the penalty calculations. n60

Although he concurred that a jury trial should be afforded in [*373] civil penalties actions, Justice Scalia dissented from the majority's withdrawal of the amount determination from the jury, calling this a total departure from existing precedent. n61 Justice Scalia remarked that if criminal trials were to be the model, a criminal standard of proof — guilt beyond a reasonable doubt — should be applied by the jury. n62

Removing the remedy determination from the jury because it is not a "fundamental element of a jury trial," n63 without defining either what the fundamental elements of a jury trial are, or what the "substance of a common-law right to a trial by jury" n64 consists, is troubling. The Court thereby removed an important area of jury discretion without engaging in the reasoned analysis necessary to clarify the law. n65

D. *The Effects of Tull*

Although *Tull* originally attracted little attention outside of environmental circles, it has become a landmark decision with extraordinary ramifications. A narrow reading of *Tull* holds that the right to jury trial only applies to civil penalties actions under the Clean Water Act. *Tull*'s broad language and constitutional basis, however, suggest that other statutory civil penalties actions must also be tried to a jury n66 because they, like the civil penalties obtainable under the Clean [*374] Water Act, are analogous to the actions in debt that were within the jurisdiction of the 18th-century courts of law. n67

When the statutory remedy of civil penalties seeks to do more than restore the status quo — such as when a statute seeks to punish the offender, rather than merely enjoin him or force him to disgorge his profits — civil penalties are properly considered legal in nature and bring the remedy within the ambit of the seventh amendment right to jury trial. n68 The Supreme Court in *Tull*, therefore, legitimized the increased use of the jury as an institution. In a strange twist on this theme, however, the Supreme Court limited the scope of the jury's function because the Court refused to permit it to calculate the appropriate amount of the penalty.

The Supreme Court's decision in *Tull* has profoundly affected the jurisprudence of several areas of the law. Statutory civil penalties actions encompass some of the most volatile and controversial legal areas. n69 Twenty-seven federal departments and agencies enforce approximately 348 statutes involving civil penalties, penalties that are ultimately collected through a civil action in a federal district court. n70 Although previously it was uncertain whether statutory civil penalties actions could be tried to a jury, the Supreme Court's holding in *Tull* makes it abundantly clear that such actions must be tried to a jury if demand is made, at least for the liability determination. By extension, this should be true not only for actions brought under the Clean Water Act, but for any actions brought by the government that seek civil penalties. n71

[*375] III. THE INSIDER TRADING SANCTIONS ACT OF 1984

A. *Statutory Provisions*

The Insider Trading Sanctions Act of 1984 (ITSA) is prominent among statutes authorizing the government to seek civil penalties. n72 ITSA resulted from the SEC's lobbying of Congress in 1982 for increased enforcement powers n73 and was enacted to curb perceived securities abuses by anyone "purchas[ing] or sell[ing] a security while in possession of material nonpublic information." n74 Although labeled the Insider Trading Sanctions Act, the title may be something of a misnomer because it extends liability not only to traditional corporate insiders, but to anyone who trades on material nonpublic information. n75 The statute authorizes the imposition of a "civil penalty . . . [in an amount that] shall not exceed three times the profit gained or loss avoided" by the trading activity. n76 The statute further provides for increased criminal fines. n77

ITSA, however, is silent on the right to jury trial. n78 Congress [*376] instead addressed the issue in the legislative history, where it stated that the right to jury trial under ITSA "should remain solely a question of constitutional law." n79 Although Congress expressed no view on the proper resolution of the right to jury trial concerning liability determinations under ITSA, it explicitly refused to extend the right to jury trial to the penalty determination phase of civil enforcement actions. n80 Thus, the subsequent Supreme Court decision in *Tull*, extending the seventh amendment right to jury trial to the liability phase but not the penalty phase of government civil penalties actions, is directly consistent with both ITSA and its legislative history.

1. STATUTORY PENALTIES

ITSA permits the SEC or the court to set the amount of the penalty in "light of the facts and circumstances," as long as the amount does not exceed triple the profits made or losses avoided by the illegal trading. n81 The penalty is payable to the United States Treasury. n82 ITSA [*377] provides no guidelines for determining the amount of any fines n83 that the SEC may seek or the court may impose, nor does it limit other remedies that may be sought. n84 Indeed, one person's payment of these fines does not preclude similar or additional payment from any other person involved in the illegal trading. n85

The SEC has sought civil penalties in nearly all insider trading cases, n86 including the cases it has settled. n87 Before the passage of [*378] ITSA, the inside trader could be penalized — other than by injunction or disgorgement of profits — only after a criminal conviction in a trial attended by the constitutional protections afforded in all criminal trials. n88 Under ITSA, however, penalties may be exacted following civil enforcement proceedings that lack these constitutional safeguards. n89

[*379] ITSA's impact extends far beyond the stated penalties. The mere commencement of an informal investigation by the SEC may be sufficient to cause extreme hardship to the subject of such an investigation. n90 The investigative process can irreparably damage the employment relationships and the business goodwill of those investigated because of the attendant publicity that results when the SEC files a complaint or administrative order. n91 This publicity n92 may also trigger private suits that could result in potentially draconian damage awards. n93 Moreover, findings of fact from enforcement proceedings, but not from consent decrees, n94 operate as collateral estoppel in subsequent litigation. n95 Thus, these factors give the SEC an enormous advantage in any settlement negotiations. n96

Furthermore, insider trading violations are often investigated without procedural safeguards. n97 The SEC's extremely broad investigative [*380] powers may promote speed and efficiency in the investigative process, but they may also result in substantial unfairness to the subject of an investigation. n98 The targets of SEC investigations often are not given sufficient warning to afford them the opportunity to prepare a proper defense. n99 Many SEC practices are unwritten and, thus, are "not . . . readily accessible to those witnesses and their counsel who must appear before

the SEC in investigations." n100 Moreover, the few written rules that do exist are inadequate to assure due process, let alone fundamental fairness. n101 For example, even in formal investigations, n102 the SEC is not required to provide transcripts of testimony that assure an adequate record for subsequent review. n103 All of these factors give the SEC a substantial advantage in settlement negotiations and have the potential to make the application of insider trading legislation substantially unfair to those caught in the net of SEC enforcement proceedings.

[*381] 2. STATUTORY LIABILITY

ITSA applies to "any person [who] purchas[es] or sell[s] a security while in possession of material nonpublic information." n104 Thus, ITSA may impose sanctions for any violation of the antifraud provisions of the Securities Exchange Act of 1934 (1934 Act) that involves trading. n105 This prohibition against possession and use of material nonpublic information includes options and other derivative instruments, n106 as well as any securities traded "on or through the facilities of a national securities exchange or from or through a broker or dealer," n107 unless the securities were part of a public offering. n108 Furthermore, any person "aiding and abetting the violation" is similarly liable. n109 ITSA, however, precludes liability "solely because that person aided and abetted a transaction . . . in a manner other than by communicating material nonpublic information." n110 This provision protects brokers or dealers acting without knowledge that they are trading on the basis of material nonpublic information. Finally, the statute limits the liability of employers so that "[n]o person shall be liable . . . solely by reason of employing another person who is liable." n111

Congress, however, explicitly declined to address the substantive elements of an insider trading violation. n112 Rather, Congress decided to rely on "the evolving case law under section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5," n113 implying an endorsement of the judicial interpretation of these securities fraud regulations. n114 The securities fraud regulations that involve insider trading include [*382] Sections 10(b) n115 and 14(e) n116 of the 1934 Act, and Rules 10b-5 n117 and 14e-3 n118 promulgated thereunder. n119 A violation of any of these Sections, therefore, is subject to sanctions under ITSA. n120

a. Liability Under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 Promulgated Thereunder

Although the SEC and the courts have used both Section 10(b) and Rule 10b-5 extensively for the prosecution of insider trading, neither provision directly addresses insider trading. n121 Until 1961, only three cases imposed a duty by corporate insiders either to disclose material nonpublic information or to abstain from trading. n122 That [*383] year, in the seminal case of *In re Cady Roberts & Co.*, n123 the SEC concluded that corporate insiders have a duty either to disclose material nonpublic information or to abstain from trading. n124 *Cady Roberts & Co.* involved an administrative disciplinary proceeding concerning a stockbroker who traded on tipped information for his customers' accounts. n125 A director of the Curtiss-Wright Corporation, who was employed as a stockbroker at Cady Roberts & Co., disclosed nonpublic information concerning the reduction of Curtiss-Wright's dividend to another stockbroker at the same brokerage house. n126 The SEC concluded that corporate insiders have a duty either to disclose material nonpublic information or to abstain from trading. n127 The Commission based its conclusion that a duty existed on two elements: the special relationship that provides access to corporate information, and the inherent unfairness of an insider taking advantage of information that is unavailable to other traders. n128 This second element appears to envision a parity of access to information standard for trading.

In *SEC v. Texas Gulf Sulphur Co.*, n129 the judiciary contributed to the development of the SEC's abstain or disclose rule. In *Texas Gulf Sulphur Co.*, the United States Court of Appeals for the Second Circuit suggested, in dicta, that the duty either to disclose material non-public information or to abstain from trading applies to anyone in possession of material nonpublic information, regardless of the existence of a special relationship that provides access to the information. n130 This broad standard of liability remained in effect until 1980, when the Supreme Court narrowed the applicability of the duty either to disclose material nonpublic information or to abstain from trading in *Chiarella v. United States*. n131

The Supreme Court first issued an opinion on the issue of insider trading in *Chiarella*. n132 In *Chiarella*, the United States brought criminal [*384] charges against the employee of a financial printer. n133 The employee guessed the identities of target companies from takeover documents that the acquiring companies delivered to the printer and then traded on that information before the corporations publicly announced their takeover bids. n134 *Chiarella*, the employee, was convicted of securities law violations, n135 based on the theory that anyone — even those not possessing a special relationship — either must disclose material nonpublic information or abstain from trading. n136 The United States Court of Appeals for the Second Circuit affirmed *Chiarella*'s conviction n137 and concluded that there was both a violation of the duty to disclose or abstain and a misappropriation of information that belonged to his employer. n138

The Second Circuit reasoned that Chiarella breached a duty owed to the acquiring corporations not to disclose when he traded on the information he had obtained through his employment by the financial printer. n139 The Second Circuit's theory of misappropriation, therefore, would hold someone liable for fraud if that person converted confidential corporate information for personal gain. n140

[*385] The Supreme Court reversed Chiarella's conviction and held that a specific fiduciary relationship must exist before trading on material nonpublic information can become a violation of Rule 10b-5. n141 Because no such fiduciary relationship existed between Chiarella and the people who sold securities to him, the Court held that he had not committed securities fraud. n142 The Court explicitly rejected the notion of a general duty either to disclose material nonpublic information or to abstain from trading. n143

The Court declined to address the misappropriation theory because it had not been submitted to the jury. n144 In his dissenting opinion, n145 however, Chief Justice Burger endorsed the misappropriation theory because he felt that permitting Chiarella to profit on information belonging to his employer's clients gave Chiarella an unfair advantage that he had not earned. n146 Consequently, Chief Justice Burger felt that Chiarella should have been penalized because his conduct "serve[d] no useful function except his own enrichment at the expense of others." n147 Justices Brennan and Stevens agreed with this position in their concurring opinions n148 and would have extended insider trading liability to people who trade in violation of a duty owed to someone other than purchasers or sellers of securities — generally, a duty owed either to employers or to clients of the employers. n149

Although the majority declined to address the misappropriation theory, the favorable concurring opinions of Justices Stevens n150 and Brennan n151 and the dissenting opinion of Justice Burger n152 apparently [*386] encouraged the Second Circuit subsequently to adopt the misappropriation theory in *United States v. Newman*. n153 In *Newman*, two investment bank employees tipped confidential information regarding pending mergers and acquisitions to Newman, a securities trader. n154 Newman traded on this information before it was made public and, in addition, passed the information to two foreigners who also traded on it. n155 Following an SEC enforcement proceeding, the Department of Justice brought criminal charges against Newman and the two investment bankers. n156 The Second Circuit found that because the investment bankers breached their fiduciary duties to their employers by misappropriating information and tipping Newman, Newman's conduct was a criminal violation of Rule 10b-5. n157 The Second Circuit found it irrelevant that the defendants had not purchased securities from the investment banking firms or their corporate clients. n158 Rather, it was sufficient that the investment banking firms' reputations were at stake, and that the defendants' conduct inflated the prices of the target companies' shares. n159

Under the same set of facts in a private civil action, however, the Second Circuit did not find Newman liable for securities violations. n160 In *Moss v. Morgan Stanley, Inc.*, n161 the plaintiff sold stock in one of the target companies on the same day that Newman purchased the stock. n162 The trial court dismissed the case, and the Second Circuit affirmed. n163 The Second Circuit held that Newman, a registered broker/dealer, owed no duty either to abstain from trading or to disclose the material nonpublic information to the general public. n164 The Second Circuit also held that because none of the defendants — the same defendants that were found guilty of securities fraud in *Newman* — had a relationship with the plaintiff, who was merely a target company shareholder, the investment bankers' breach of duty to their employers was not sufficient to provide civil liability. n165 Thus, it [*387] appears that under the same facts, liability under the misappropriation theory depends upon whether the case is a civil or a criminal action. n166

In *Dirks v. SEC*, n167 the Supreme Court reaffirmed and reinforced the *Chiarella* limitations on liability. n168 In *Dirks*, a former director of an insurance company informed Dirks, an investment analyst, that the company fraudulently had overstated its assets on financial reports. n169 Dirks investigated the situation and attempted to interest the *Wall Street Journal* in publishing an expose of the fraud, but was not immediately successful. n170 Dirks also informed clients and investors of his findings, n171 many of whom sold their holdings based on that information. n172

The SEC brought enforcement proceedings against Dirks and found that he had violated Rule 10b-5, as well as other provisions of the securities laws, but penalized him only with a censure. n173 Dirks appealed, and the United States Court of Appeals for the District of Columbia affirmed the censure. n174 The Supreme Court reversed n175 and held that because Dirks had no relationship with the insurance company, he could not have breached a fiduciary duty. n176 The Court explicitly rejected the parity of access to information standard for liability and reaffirmed its position in *Chiarella* that the duty either to disclose material nonpublic information or to abstain from trading does not arise from the mere possession of material nonpublic information, but from the use of that information to violate a fiduciary duty. n177 Furthermore, the Court held that for a tippee to be found to have violated Rule 10b-5, the *tipper* must breach a fiduciary

duty. n178 Thus, the tippee's duty — in this case, Dirk's duty either to disclose material nonpublic information or to abstain from trading — depends on whether the tipper — in this case, the former corporate directors — breached a fiduciary duty by revealing the information. n179 Because [*388] the tipper — the former director of the insurance company — did not use the information for personal benefit, he breached no fiduciary duty. n180

In the most recent Supreme Court case to address the issue of insider trading, *United States v. Carpenter*, n181 R. Foster Winans, a reporter for the *Wall Street Journal*, disclosed the contents and timing of his upcoming articles to two stockbroker friends. n182 All three traded on this information before the articles were published. n183 Following an SEC investigation, in which Winans voluntarily confessed to the scheme, n184 the Department of Justice brought criminal charges against all three traders. n185 All three were convicted of mail and wire fraud, securities fraud, and conspiracy. n186 On appeal, the Second Circuit reversed the conspiracy conviction but upheld the conviction on the other counts. n187 Applying the misappropriation theory, the Second Circuit held that Winans was prohibited from using information that belonged to his employer for personal gain. n188 The court held that the defendants' conduct violated the securities laws because, even though none of the defendants had a relationship with any of the corporate subjects of the articles, the only breach was to the *Wall Street Journal* and the only harm that the *Journal* suffered was to its reputation. n189

The Supreme Court affirmed the defendants' convictions on both the mail and wire fraud counts n190 but split evenly over the 10b-5 violations. n191 The [*389] Court did not issue a written opinion on the securities law issues. n192 Thus, it is uncertain what, if any, precedent the case will establish. n193 Because the Supreme Court's split has the effect of affirming the misappropriation theory under which Winans was found guilty of securities fraud violations, the misappropriation theory appears to be a viable theory of liability. n194

In sum, the judicial construction of Rule 10b-5 has embraced several theories. Originally, the gravamen of the violation concerned a failure to fulfill a duty either to abstain from trading or to disclose confidential information. n195 The definition of this duty and to whom it is owed, however, has been the subject of much judicial debate. The *Cady Roberts* theory of fiduciary duty n196 flowered into the broad possession theory of *Texas Gulf Sulphur*. n197 The Supreme Court, however, rejected the broad possession theory in *Chiarella*. n198 Nonetheless, the Second Circuit's decision in *Newman* n199 undermined the *Chiarella* limitation by its application of the misappropriation theory. Moreover, the Supreme Court's decision in *Dirks* n200 established an affirmative duty to speak for traditional corporate insiders and extended that duty to include people who work for the corporation within the purview of insiders. n201 Therefore, in a total silence case such as *Dirks*, a person may be liable for trading on the basis of material nonpublic information, even though there is no duty either to disclose the information or to abstain from trading. n202 *Dirks* renewed [*390] and reinforced the rejection of the *Texas Gulf Sulfur* broad possession theory but left questions unanswered regarding the misappropriation theory. n203 Furthermore, the Supreme Court may have undermined its own stance of limited liability in *Carpenter*. n204 Therefore, the evolving case law that Congress expected to develop the definition of insider trading is lacking in clear guidelines.

b. Liability Under Section 14(e) of the Securities Exchange Act of 1934 and Rule 14e-3 Promulgated Thereunder

Section 14(e) of the 1934 Act, and Rule 14e-3 thereunder, extend liability for antifraud violations to trading in connection with tender offers. n205 Rule 14e-3 contains a broad prohibition against tipping, proscribing all communication of information relating to a tender offer if it is reasonably foreseeable that the communication will result in prohibited trading. n206 The SEC issued Rule 14e-3 shortly after the Supreme Court's decision in *Chiarella*, perhaps as an attempt to restore SEC enforcement powers that had been curbed by the [*391] *Chiarella* decision. n207 There is, in practice, little distinction in the applications of Section 14(e) and Rule 10b-5. n208 Both provisions are so intertwined that decisions involving both provisions are often unclear as to which provision is dispositive. n209

B. Legislative History: Conceptual Problems

ITSA's conceptual utilization of the antifraud provisions of the 1934 Act is not unproblematic. To begin with, Section 10(b) is directed at fraud, not unfair trading, and is limited by its terms to manipulative or deceptive devices. n210 This requires an element of deception, misrepresentation, or nondisclosure. n211 Thus, motivation is the controlling factor for Section 10(b) liability. The controlling factor in assessing ITSA liability, on the other hand, is "possession of material nonpublic information" on which the accused has traded. n212 Therefore, possession and use, rather than motivation, are the controlling factors under ITSA.

In addition, the traditional understanding of fraud requires two parties, one of whom reaps a pecuniary benefit through

deceit at the expense of the other. n213 In the context of the impersonal marketplace, unless there is a preexisting special relationship between the trading parties, it is difficult to fit insider trading within the rubric of fraud. The inside trader is not benefitting at the expense of those who sell or buy on the market; presumably, they would have bought or sold anyway. n214 The "victims" of insider trading have no right to the information traded upon; thus, insider trading may well be a victimless crime. n215 The duty either to abstain from trading or to disclose the material nonpublic information traded upon is a duty that seeks to [*392] equalize bargaining positions, rather than insure against losses. n216 When an insider abstains from trading on the basis of nonpublic information, any loss suffered by public investors is a normal business risk of the investment. n217 It would be difficult — if not impossible — to demonstrate the degree to which insider trading, as opposed to other factors, affects the market. n218

Congress announced that it enacted ITSA in order to curb "trading in the securities markets . . . of 'material' information (generally, information that would be important to an investor in making a decision to buy or sell a security) that is not available to the general public." n219 The stated purpose of the legislation was to proscribe trading that undermined "the public's expectations of honest and fair securities markets where all participants play by the same rules." n220 The Supreme Court, however, has stated explicitly that "not every instance of financial unfairness constitutes fraudulent activity under Section 10(b)." n221 ITSA's legislative history, nonetheless, boldly proclaims that it intends to curb the "abuse of informational advantages that other investors cannot hope to overcome through their own efforts." n222 ITSA, therefore, appears to apply the parity of access to information standard that was rejected by the Supreme Court in *Dirks*. n223 These statements also indicate that Congress contemplated a much broader theory of liability than applied by the Supreme Court in *Chiarella*, in which the Court limited liability to persons who have a fiduciary relationship to the shareholders. n224

The House Report made no mention of *Chiarella* and only discussed *Dirks* in order to limit the case to its "unique facts." n225 Rather, Congress relied on *Cady Roberts* and *Texas Gulf Sulphur* for the proposition that "trading by corporate officials and employees on [*393] information gained in their employment violates fiduciary duties and violates the federal securities laws." n226 In doing so, Congress circumvented the Supreme Court's express ruling in *Chiarella* that the fiduciary duty must extend to the shareholders of the corporation whose securities were traded. n227

Furthermore, Congress extended the definition of insider trading in the legislative history — while expressly denying that it was defining the term — by emphasizing that it expected the SEC to pursue violations by "outsiders," such as underwriters, investment analysts, lawyers, accountants, financial printers, government officials, and others who, by virtue of access to nonpublic information, become "constructive insiders." n228 Congress stated that "for the purposes of the antifraud provisions, it does not matter whether the information about a corporation or its securities originates from inside or outside the corporation." n229 Congress also explicitly endorsed the misappropriation theory in the House Report, stating that because conversion of information is punished in other areas of the law, an equally rigorous code of conduct should be enforced under the securities laws. n230

Congress further expanded liability under ITSA by failing to define the ill that ITSA was promulgated to remedy. n231 Congress explicitly declined to define insider trading in ITSA, due, at least in part, to a fear that "the adoption of a statutory definition could reduce flexibility." n232 To support its assertion that a statutory definition was not necessary because "the law with respect to insider trading [was] sufficiently well-developed at [the] time to provide adequate guidance," Congress endorsed only three lower court cases: *Texas Gulf Sulphur*; n233 *SEC v. Lund*, n234 and *United States v. Newman*. n235 Congress also cited Rule 14e-3 n236 in support of this proposition. n237

[*394] As discussed previously, n238 *Texas Gulf Sulphur* and *Newman* utilize broad theories of insider trading liability. In *Texas Gulf Sulphur*, the Second Circuit asserted the parity of access to information standard, concluding that liability for trading on nonpublic information was proper, even without a fiduciary relationship. n239 In *Newman*, the Second Circuit's theory of liability was that converting confidential information for personal gain is a fraud on the source of the confidential information. n240 This misappropriation theory has now become the SEC's primary vehicle for reaching nontraditional insider trading cases. n241

Moreover, Congress, by citing *Lund* in the House Report, further extended liability for insider trading to include the mere implication of a confidential relationship. n242 In *Lund*, the president of a venture capital firm called Lund, his long-term friend and business associate, to see if Lund's company would be interested in investing in a corporate joint venture. n243 Although Lund's company declined the opportunity, Lund personally bought securities based on this nonpublic information. n244 The district court recognized that Horowitz, the venture capital firm president, did not breach a fiduciary duty to his company or its shareholders by divulging the information to Lund because Horowitz

had a legitimate business reason for discussing the joint venture plans with Lund. n245 The district court also found that, absent a breach of fiduciary duty by Horowitz, Lund could not be liable under Section 10(b) as a tippee. n246 The district court, instead, assessed liability against Lund for insider trading based on a theory of temporary insider trading status derived from the friendly relationship between the two men. n247 This relationship, the district court held, gave Lund temporary insider status and created an implication of confidentiality. n248

Liability for insider trading based on the mere implication of confidentiality derived from a personal friendship is a much different standard of liability than the one announced by the Supreme Court in *Dirks*, in which the Court required the existence of a fiduciary relationship, [*395] with a legitimate expectation of confidentiality, for liability to attach. n249 Under the *Dirks* theory, a necessary precondition for insider trading liability is the breach of a fiduciary duty by a corporate insider. n250 In *Lund*, however, Horowitz breached no duty. Rather, the district court found Lund to be a "temporary insider" by virtue of his friendship with Horowitz. n251

Thus, although explicitly declining to provide a statutory definition of the offense, ITSA, in fact, has significantly altered the definition of insider trading. n252 This expanded concept of liability results in a definition of insider trading that now encompasses a very broad range of activity on the part of a wide variety of stock exchange players. n253 The legislative history of ITSA supports a view that the personal use of any material nonpublic informational advantage is [*396] actionable. n254 Moreover, "under both rules 10b-5 and 14e-3, a person may commit a violation without appreciating the illegality of his actions." n255 This burgeoning liability, with no clear notice of what conduct may be criminal, creates restrictive impediments to lawful business activity, business uncertainty, and a lack of liquidity, due to a fear of being inadvertently trapped in an insider trading violation. n256 Consequently, a clear definition of insider trading is essential. n257

This broad expansion of liability results in a vision of widespread, nearly universal, conduct that is becoming uncontrollable. n258 If SEC Chairman David Ruder is correct — that insider trading is a prevalent and pervasive practice that most Americans see as innocuous n259 — the [*397] extension of the right to jury trial n260 to insider trading cases may have a significant effect. n261 The legal mechanisms of argument and cross-examination may promote a clarification of the intellectual issues involved in securities regulation by way of a repeated consideration of multiple viewpoints. n262

IV. COGNITIVE DISSONANCE: PROBLEMS IN INSIDER TRADING REGULATION

Cognitive dissonance is the human phenomenon of psychological stress that occurs whenever theory and observed reality become irreconcilable. n263 The amount of cognitive dissonance a person or group experiences after making a decision is directly proportional to the observed results that are perceived inconsistent with the basis for making that decision. n264 The greater the conflict a group experiences before making a particular decision, the greater the subsequent dissonance is likely to be, and the greater the tendency to justify the decision by increasing the perceived attractiveness of the chosen alternative and decreasing the perceived merits of the rejected alternative. n265 The regulation of insider trading is a paradigm of this behavior [*398] pattern. The SEC's preoccupation with insider trading strikes an increasingly dissonant note as the distance between regulation theory and the reality of the marketplace grows increasingly irreconcilable. n266 Although the SEC readily admits — as it must in the face of overwhelming evidence — that insider trading is a prevalent practice that pervades all levels of society, n267 it declares that its enforcement efforts are a success. n268 Congress assumed that increased penalties would deter insider trading. n269 As the current SEC Chairman readily admits, however, insider trading is not only widespread, it is unstoppable. n270 Furthermore, there are significant questions as to whether it makes economic sense to stop the practice, even if it were possible to do so. n271

Since the 1930's, the American system of securities regulation has been based on a set of assumptions, assumptions that recent advances in information technology have rendered invalid. n272 The advent of the computer age makes the instantaneous reflection of information in stock prices a reality. n273 Modern technology alters the market structure and makes the market more efficient by minimizing [*399] transaction costs and facilitating the flow of information. n274 Efficient markets permit the individual investor to forego independent research regarding risks and returns of particular securities because the price approximates the public consensus of the security's value. n275 Modern technology also offers investors access to the instantaneous collection and dissemination of investment information in other ways, such as on-line market data. n276 This improved access to information makes the opportunity to identify undervalued stock — to the extent such opportunity exists at all — a minimal one. n277 Thus, it is no longer valid to assume that public access to information in the form of official disclosure is necessary to make the markets fair and assure investor confidence. n278 The theory that market fairness requires equal access to information — a parity of information standard enunciated

by Congress in ITSA's legislative history n279 — ignores the modern fact that there is near instantaneous assimilation of all information in the price of securities. n280 With the advent of modern technology, insider trading impacts the market significantly faster than any form of official public disclosure. n281 Because a security's price reflects the consensus of investor evaluations of all available information almost instantaneously, [*400] market price is, in itself, a fair indication of a stock's fair value. n282 Other safeguards, therefore, are unnecessary and may impede the efficiency of the market.

Congress attributed the growth of the insider trading problem to market developments, such as the increased trade in stock options and "the explosion in the size and volume of tender offers." n283 In fact, the explicit rationale that Congress gave for the legislation was that "abuse of informational advantages that other investors cannot hope to overcome through their own efforts is unfair and inconsistent with the investing public's legitimate expectation of honest and fair securities markets where all participants play by the same rules." n284 When describing the effects of insider trading on the market, however, Congress did not refer to the investing public's losses. Rather, the House Report cited the losses of market makers and specialists. n285

A. *The Economic Validity of the Insider Trading Sanctions Act of 1984*

In neither the 1934 Act nor ITSA is the economic theory of efficient markets utilized either in conception or in application. n286 The [*401] efficient market hypothesis assumes that stock prices reflect all available relevant information and leave no opportunity to make economic profits. n287 This theory implies that an investment strategy that attempts to outguess the market must be suspect. Moreover, the efficient market hypothesis posits that price captures information about, and predicts the future payout of, a security. n288 Despite transaction costs and unequal access to, or differing assessments of, information, prevailing prices fully reflect all available information. n289 This is not to say, however, that there will not be occasional windfalls or losses. Rather, the efficient market model incorporates the idea of luck. n290

Finally, the efficient market hypothesis suggests that regulating insider trading may be a theoretical misconception. Insider trading, far from being a detriment to the functioning of securities markets, may provide a valuable benefit by moving market prices in the proper direction. n291 To the extent that the market undervalues securities, it is [*402] because there is relevant information that is unknown to the marketplace. n292

Under the current regulations, corporations routinely are permitted to withhold information from the market, as long as withholding this information does not render any of the information that the corporation does release misleading, and as long as corporate insiders do not trade on this information. n293 Thus, the market — if these regulations are obeyed — does not receive all of the information necessary to operate efficiently. n294 To the extent that this withheld information is leaked to the market in the form of insider trading, the market price is pushed in the proper direction. n295 If the insider trading prohibitions were actually successful — which by all accounts they are not n296 — the market would be deprived of this important equalizing force. n297 In other words, "the partial information that it receives from the market activity of the insiders [is] activity that at least moves the market in the direction that it will take when full disclosure is made. n298

[*403] B. *Changes in the Market Structure*

Not only have these economic theories clarified the way markets function, there also have been major and unanticipated changes in the market environment since the enactment of the 1934 Act. In the 1930's, private investors effected most transactions; today, however, most investors are institutional. n299 Presently, only 10% of the New York Stock Exchange volume is based on individual investor transactions. n300 Institutions, on the other hand, account for over 50%, and brokerage firms account for 30%. n301 Although some commentators bemoan this fact and ascribe it to the public's perception that the market is rigged, n302 it is unlikely that individuals will regain their former prominence in the market. Simply stated, institutional investors are likely to continue to predominate n303 because they currently are more efficient than individuals. n304 Thus, it may be erroneous to base an entire regulatory scheme on a structural foundation that is only questionably valid. If the individual investor is no longer the predominant force in the market, maintaining his confidence in market fairness may no longer be a priority. n305 Moreover, even if investor confidence were a major concern, burgeoning insider trading activity does not seem to have affected investor confidence. n306 Rather, investors continue to participate in the securities market despite the well-publicized prevalence of insider trading. n307

If insider trading is not an evil from which public investors need protection, then heavy regulation in this area creates considerable cognitive dissonance. n308 Congress' explanation that legislation should [*404] be enacted to protect "market makers and specialists" was that those actors are "necessary to the liquidity of the market." n309 No further

explanation or justification was offered. In fact, there is evidence that insider trading regulation does not, and is not intended to, protect public investors; rather, the evidence shows that insider trading regulation benefits a specific interest group — the market professionals. n310 These are competing and contradictory messages that create an increasing cognitive dissonance both within the SEC and the society that tries to implement these rules.

C. *The regulation Theory and the Reality of the Marketplace*

Neither of the two current models of regulatory action theory accounts for insider trading regulation. According to the public choice model, n311 regulatory actions should divert wealth from relatively diffuse groups to strong interest groups. n312 If Congress, however, drew the lines correctly between public investors and insiders — corporate officers, directors, other key employees, and large stockholders — then the SEC is diverting wealth from a group with cohesion, the insiders, to a diffuse group, the public investors. Thus, the regulations do not appear to fit within this model. n313

The public interest model of regulation theory, on the other hand, relies on efficiency theory and explains that market regulation is motivated by a search for greater efficiency in the economy. n314 Thus, insider trading regulation, under this theory, is explained as a way of increasing economic efficiency and is justified by gains that exceed the costs of regulation. Because there is strong evidence that insider trading regulation is economically inefficient — evidence that indicates that shareholders would actually benefit if insiders were permitted to trade on the basis of information not yet reflected in the securities' price n315 — this model is also inadequate to describe the intense political [*405] demand for increased penalties reflected in ITSA.

The problem can be resolved and understood by redrawing the lines in the public choice model. n316 Congress drew the line between public investors and insiders. If the line is redrawn between insiders and market professionals, each interest group will have incentives to compete for favor with the SEC, and each will be more cohesive than the investing public. The market professionals, however, are more cohesive than insiders, and have more of an incentive to seek prohibitions on uses of inside information. n317 Although market professionals are a more cohesive group, however, they systematically lose "to those with better information who include insiders trading on inside information and arbitrageurs trading on the basis of tips." n318 Thus, abolishing the right of insiders to trade on inside information removes a competitor for market profits and, at the same time, leaves intact the market professionals' informational advantage — based on superior research skills — over the general public. n319

Furthermore, this modified public choice theory demonstrates that the regulatory agency, the SEC, has a strong incentive to barrage the most disfavored of the three groups involved, the public, n320 with misinformation in order to prevent it from discovering where its true [*406] interests lie. n321 An example of this propaganda is the assertion that [*407] insider trading threatens the fairness and integrity of capital markets. n322 Fair play, although never expressly defined, appears to encompass a standard of equal access to market trading information. n323 This policy of misinformation reduces opposition to agency action, increases support from the favored group, the market professionals, and results in an overall increase in agency support. n324

Along these redrawn lines, the market professionals have an increased incentive to support SEC enforcement efforts because their support enhances the public perception of industry honesty, which, in [*408] turn, may increase client use of their services. n325 This theory also explains the exchanges' willingness to provide the SEC with computerized information regarding trading patterns consistent with insider trading activity. n326

Congress primarily assumed in promulgating ITSA that curbing insider trading would randomly redistribute market profits among all market participants. n327 This is not true, however, because the market professionals possess a significant informational advantage over the investing public. Thus, the group that benefits from insider trading regulation is the market professionals and not, as Congress and the SEC asserted, the investing public. n328 This dissonance between the SEC's regulatory stance and the social reality of pervasive practices and efficient markets suggests that this is an area that needs the particularized situation-specific discourse of the community — the prime function of the jury.

V. RESTORING FAIRNESS: A DIFFERENT VOICE

Although there is no guarantee that the jury will alter the social discourse on insider trading regulations either in tone or direction, the jury system provides an important bulwark against unwise legislation and restores community values to the inherently arbitrary process of decisionmaking. n329 When the legislature enacts laws that appear senseless and unfair to the community, the jury serves its most necessary function — ensuring that community values are implemented in the legal process. Because of this critical function, the jury is a necessary and important part of the American system of

checks and balances. n330 This protective function of the jury originally motivated the [*409] inclusion of the seventh amendment in the Constitution n331 and has sparked heated debate ever since. n332

Because trial to a jury is fundamentally different from trial to the court, jury trials have the potential to significantly alter the legal discourse. Jury law differs from judge-made law in precisely those areas in which the jury's sense of justice leads it to consider policies that differ from official legal policies. n333 The jury adds a dimension to the legal process by interjecting discretion, equity, and flexibility. n334 This essential jury trait makes it an enduring feature of the American legal landscape. n335

When law and common sense conflict, as they arguably do in the insider trading arena, the institution of the jury may alter the terms of the legal dialogue. n336 In at least some of these cases, the jury will [*410] decide differently than the judge. n337 The research of Professors Kalven and Zeisel, that found that there was an overall disagreement rate between judges and juries for both criminal and civil trials of approximately twenty percent, supports this assumption. n338

One might expect that in a random sampling of cases, disagreements between the judge and the jury randomly would favor the defense and the prosecution, regardless of the law at issue. Jury sentiment, however, is not random. Rather, there is a distinct pattern to these disagreements. n339 Specific prosecution and defense equities motivate juries. n340 The question is whether the jury's inclusion in the decision of insider trading liability will make a difference in the application of the law, and if so, whether that difference will be toward greater or lesser leniency.

A. *The Jury Makes Law*

Juries supposedly determine the facts, not the law. n341 Nonetheless, because ordinarily the jury brings in a general verdict, with no requirement to state the basis of its beliefs on the questions of fact, the jury actually determines the legal rights and obligations of the parties. n342 The Kalven/Zeisel study substantiates this hypothesis by finding [*411] that 50% of the disagreements between the judge and the jury were based on differing sentiments about the law to be applied. n343

The study showed that the overall imbalance in favor of the defendant differed in civil and criminal trials. n344 In criminal trials, the study showed that the jury was harsher toward the defendant than was the judge in only 3% of the cases, and more lenient — biased toward the defendant — in 19% of the cases. n345 In the civil cases, the bulk of which were products liability cases, the judge/jury disagreement produced a net jury imbalance of 12% in favor of the plaintiff, while the net judge imbalance was 10% in favor of the plaintiff. n346 In criminal fraud cases, however, the judge and the jury agreed only 69% of the time, n347 as opposed to the 80% agreement rate for criminal and civil trials, and the jury was 25% more lenient than the judge in these criminal fraud cases. n348

Thus, there appears to be a significant difference between a judge's and a jury's concept of what constitutes liability for fraud. n349 Because the prosecution of insider trading cases is accomplished under the rubric of fraud, however inappropriate that may be, n350 those cases offer a better analogy for purposes of assessing jury reaction than do general civil liability cases. Therefore, one might expect a jury trying an insider trading action to be more lenient than the court.

One of the foremost reasons for disagreement between the judge and the jury is that the jury generally demands a higher degree and [*412] quantity of evidence to meet the burden of proof than does the judge. n351 Although the Kalven/Zeisel study focused on the reasonable doubt standard, rather than the preponderance of the evidence standard, the underlying premise for the basis of the disagreement is the same in both cases: "[T]he jury, as an expression of the community's conscience, interprets this norm more generously and more intensely than does the judge." n352 Although civil liability for insider trading actions brought under Section 10(b) of the 1934 Act must satisfy only a preponderance of the evidence standard, n353 a jury may require a higher evidentiary standard. This is especially true for ITSA because the statute provides no definition of culpable conduct, such conduct is pervasive in society, and insider trading apparently does not outrage community mores. n354

If the judge and the jury disagreement rates, as Kalven and Zeisel hypothesize, are the result of the non-rule orientation of the jury and its willingness to look beyond the formalities of the law into the intricacies of the particular case, n355 then the crucial determinant in deciding whether to request a jury trial in a securities fraud action — indeed, whether to settle it by means of a consent decree n356 — will be whether the case is persuasive to the jury's situation-sense. n357 The parties' sense of whether the jury understands and condemns the defendant's actions informs this determination.

[*413] B. *Jury Nullification: Extending the Social Dialogue*

When society tolerates the widespread violation of a rule, a jury's sense of equity is mobilized in sympathy for the defendant. n358 This results in "jury nullification" — the refusal by a jury to follow the strictures of the law. Jury nullification is frequent when a jury perceives legal distinctions to be artificial — creating a false boundary between permissible and violative conduct. n359 Jury nullification appears to be a contradiction in terms only because the jury is supposed to determine facts, not law. n360 When the jury actually determines both facts and law in the case before it, n361 however, jury nullification operates as the power of the community asserting itself for the purpose of promoting justice. n362

Jury response to gaming and gambling laws is a current example of jury nullification of laws forbidding conduct pervasive in the society. n363 In cases involving gambling and gaming, even where the evidence is ample to establish that a violation of the law has occurred, the jury will acquit the defendant because it "thinks the law is too severe." n364 It is important, however, not to carry the theme of jury nullification too far in the context of insider trading. Modern jury revolt is moderate; n365 there does not appear to be an issue that inflames jury sentiment against unwise legislation in the way that the prohibition or the colonial sedition laws did. n366 Rather, modern jury [*414] revolt is a moderate, discrete, and illuminating voice for a poorly defined and controversial area of the law.

Moreover, the jury operates as an important check, not only on the law itself, but on the uneven application of the law. For example, in the Kalven/Zeisel study, when the jury perceived that prosecution of gambling laws was arbitrary and political, it often acquitted offenders, even though the judge found that the evidence was ample to convict. n367 Because uneven prosecution of the insider trading laws is practically inescapable, if the SEC's perception of a widespread and pervasive practice is correct, the jury may well perceive such prosecution as arbitrary and political. The jury therefore may be more lenient under these circumstances than would the judge. n368

In addition to inequitable prosecution, the appropriateness of the punishment may be of special concern in insider trading cases. n369 In such cases, which often involve multiple parties, the jury may perceive any discrepancy in the treatment of the parties to be unfair. More lenient treatment of the dominant "partner in crime" particularly aggravates jury sensibilities because it adversely affects the jury's perception of evenhanded justice. n370 In the scandal involving Dennis Levine and Ivan Boesky, n371 for example, it rapidly became apparent [*415] that those who were most involved — those who made the most money from their trading activity and who, therefore, had the most to tell the SEC regarding their accomplices — received relatively light sentences compared to their less culpable cohorts. n372 These appear to be the type of cases referred to in the Kalven/Zeisel study as those in which the jury perceives "the differentiation in treatment, if any is warranted, [to be] moving in the wrong direction." n373 For example, in an instance of complex corporate fraud involving the president and the chief accountant of a corporation, Kalven and Zeisel reported that the judge's directed acquittal of the president precipitated the jury's acquittal of the accountant, based on the jury's unwillingness to convict the agent when the principal went free. n374

Logically, if disproportionate punishment stimulates jury leniency, then permitting the jury to determine the appropriate civil penalty will result in less disagreement between the judge and the jury. n375 Unfortunately, in *Tull*, the Supreme Court foreclosed that avenue in insider trading cases by separating the liability and penalty assessments between the jury and judge in civil penalties actions. n376 The jury will only be able to determine liability, and therefore, its discretion will be limited.

It is possible, however, that the jury may be ambivalent about the acceptability of insider trading, even if it perceives the practice as pervasive and its prosecution uneven and unwise. Although the analogy is inexact, this is certainly the case with drunken driving, which apparently elicits a complex response from the jury, depending on how many jurors are drinkers themselves and whether any harm [*416] other than property damage occurred. n377 Moreover, common knowledge of the penalty involved, and a consensus that the penalty is too severe, intensifies the complexity of the jury's reaction in drunken driving cases. n378 Likewise, in insider trading cases, the jury may view the penalty as overly severe, even if the jury does not condone the defendant's conduct. This perception of the penalty's severity may depend greatly on the financial ramifications to the individual defendant resulting from a finding of liability. In addition, the response of the jury may also depend on how many jurors have experience trading on the market, and whether they view insider trading as a victimless crime.

In addition to the effect it has on individual defendants, jury nullification is a frequent source of legislative change. n379 In the Kalven/Zeisel study, the authors noted that when the Indiana legislature observed the high rate of drunken driving acquittals in Indiana, it amended its law to make the penalty less severe. n380 A historical example of a legislative response to jury nullification derives from the refusal of English juries to convict for crimes that carried the death penalty

in the early Nineteenth Century. n381 Parliament subsequently abolished the death penalty for the large majority of crimes in England as a direct result of this kind of jury activism. n382

Even if the majority of insider trading enforcement actions are settled, n383 the possibility of jury nullification adds an important check on the unbridled power of a government agency that has increased significantly its enforcement activity in recent years. n384 This ability to check a government agency is even more important in the context of the SEC, an agency that purports to regulate the economic activity of the securities markets, but does not utilize empirical economic research in assessing the costs and benefits of its regulatory agenda and ignores current economic theory in its conceptual framework. n385 Despite the modern day politeness of the jury's war with the law, n386 [*417] the jury is a force to be reckoned with. n387 Neither the courts, the SEC, nor the legislature can afford to ignore the jury's voice.

VI. CONCLUSION

This Comment has attempted to show how several factors combine to make the current regime of insider trading regulation shortsighted and unwise. These factors include broad liability without guidelines that delineate the legality of specific conduct, broad liability for conduct that is pervasive in American society and is not intuitively immoral, regulation based on false assumptions about history and the marketplace, misconceptions about the economics of the market, and a lack of empirical support for the regulations.

The Supreme Court's decision in *United States v. Tull* will help to clarify this much-debated area of the law. Whether the Court intended that its decision have such far-reaching consequences is immaterial. The fact remains that the extension of the seventh amendment right to jury trial to civil penalties actions means that the community's voice will be added to the legal discourse regarding the implementation of such penalties.

By increasing the role of the community in the judicial process, the jury increases accountability not only of the judiciary, but of the legislature. Furthermore, by extending the dialogue on social policy to the courtroom, the jury positively alters the legal discourse, regardless of whether the particular case is tried or settled. This is an especially important function when the controlling legislation in the case before the jury is unclear in concept and extremely broad in application.

Because the Insider Trading Sanctions Act of 1984 permits the SEC to seek civil penalties in the district courts of the United States, enforcement actions that are not settled by means of a consent decree should be tried to a jury. This has important ramifications, both for the individual defendant and for the clarification of the legislation. It will extend the social dialogue on insider trading policy by necessitating a coherent explanation of its rationale, as applied in the individual case and for society as a whole.

Although extending the dialogue to the community may result in greater leniency toward defendants, there is no guarantee that this, in fact, will be the effect. Whether the effect of the jury's inclusion in the debate is toward greater or lesser leniency, however, or even whether [*418] jury nullification occurs at all, including the jury's voice in the social debate is a positive step.

FOOTNOTES:

n1. As Harvey L. Pitt, an eminent authority on securities law, writes, insider trading is "a scandal that has occupied a prominent place in virtually every newspaper, virtually every day since May, 1986." Pitt, 2 *INSIGHTS* 16 & n.12 (1988).

n2. Janvey, *SEC Investigation of Insider Trading*, 13 *SEC. REG. L.J.* 299 (1986). The zeal with which this offense is prosecuted has caused one critic to remark that the SEC has found a new "theology." H. KRIPKE, *THE SEC AND CORPORATE DISCLOSURE: REGULATION IN SEARCH OF A PURPOSE* 4 (1979). According to Kripke, many of the SEC regulations lack a demonstrable economic basis, and thus the only way to understand the "maze" of bureaucratic regulation is to see it as a theology. *Id.* See also Pitt, *supra* note 1, at 14 & n.1 (citing report of the *N.Y. Times* concerning a speech given by John Shad in 1980 when he became Chairman of the SEC).

n3. The SEC was created under the authority of the Securities Act of 1933, ch. 38, tit. I, 48 Stat. 74 (1933) (codified as amended at 15 *U.S.C.* §§ 77a-vvv (1982 & Supp. IV 1986)) [hereinafter the 1933 Act], and the Securities and Exchange Act of 1934, ch. 404, tit. I, 48 Stat. 881 (1934) (codified as amended at 15 *U.S.C.* §§

78 a-III (1982 & Supp. IV 1986)) [hereinafter the 1934 Act]. These acts represent legislative attempts to prevent a recurrence of the securities abuses of the 1920's and of the conditions that led to the Great Depression. See H. KRIPKE, *supra* note 2, at xvii.

n4. Neither the 1933 nor the 1934 acts mentions insider trading. See 15 U.S.C. §§ 77, 78 (1982 & Supp. IV 1986). The preamble to the 1934 Act gives as the purpose for its enactment the prevention of unfair and inequitable market trading. *Id.* at § 78b. Section 16(b) of the Securities and Exchange Act, a short-swing profit preclusion statute, explicitly was intended to curb insider trading. Ch. 404, tit. I, § 16, 48 Stat. 896 (1934) (codified as amended at 15 U.S.C. § 78 (p) (1982 & Supp. IV 1986)). The Insider Trading Sanctions Act, Pub. L. No. 98-376, 98 Stat. 1264 (1984) (codified at 15 U.S.C. 78u(d) (Supp. II 1984 & Supp. IV 1986)) [hereinafter ITSA], specifically addresses insider trading, but nowhere is the term given concrete definition. Congress has been unable to surmount an apparent legislative impasse in its search for a definition. Indeed, Congress dropped the search for a definition of insider trading under the Insider Trading Sanctions Act of 1984 in the interest of expeditiously passing the bill. *The Insider Trading Sanctions Act of 1983: Hearing on H.R. 559 Before the Subcomm. on Securities*, 98th Cong., 2d Sess. (1984). The latest attempt to define insider trading has been before Congress since 1987. S. 1380, 100th Cong., 1st Sess. (1987).

n5. Although insider trading is generally prosecuted under Sections 10(b) or 14(e) of the 1934 Act, and Rules 10b-5 and 14e-3 promulgated thereunder, these sections and rules do not use the term "insider trading." See 15 U.S.C. §§ 78j, 78n(e) (1982 & Supp. IV 1986); 17 C.F.R. §§ 240.10b-5, 240.14e-3 (1986). The term generally refers to trading by corporate insiders on corporate information that has not been publicly announced. Corporate insiders include directors, officers, controlling shareholders, or people who received the inside information from corporate insiders — tippees. R. CLARK, *CORPORATE LAW* 264 (1986). Many of the important insider trading cases of the last several years, however, have involved trading by persons who were not corporate insiders and who were trading on the basis of nonpublic information obtained from sources other than the corporations whose securities they were trading. Report of the Association of the Bar of the City of New York, Committee on Criminal Law, *FEDERAL CRIMINAL LIABILITY FOR INSIDER TRADING OF SECURITIES* 1 (1986).

n6. Report of the Association of the Bar of the City of New York, Committee on Criminal Law, *supra* note 5. Many of the cases currently prosecuted under the rubric of insider trading involve neither corporate insiders, nor inside information. Pitt, *supra* note 1, at 14 (1988). See *infra* note 75 and accompanying text. The case law is rife with examples of non-corporate insiders who have been prosecuted for trading on information that, although material and nonpublic, was not corporate inside information. A prime example occurred in *Carpenter v. United States*, 108 S. Ct. 316 (1987) (A newspaper reporter was prosecuted under securities and mail fraud statutes for trading on the advance knowledge of the contents of his own news column.).

n7. For example, *Business Week* found that "[t]he insider-trading scandal on Wall Street hasn't upset Americans." Jackson, *Business Week/Harris Poll: Insider Trading Isn't a Scandal*, BUS. WK., August 25, 1986, at 74. In fact, the Harris Poll cited in the article indicated that of those polled "a majority would buy stock based on an insider's tip — and more than a third of those who would not said they'd be afraid the tip was wrong." *Id.* SEC Chairman David Ruder remarked that "the ordinary average American citizen has not recognized the need to refrain from insider trading, despite the fact that it is a crime and a securities violation." 19 *Sec. Reg. & L. Rep. (BNA)* 1923 (December 18, 1987) [hereinafter Remarks of Ruder]. One explanation for the pervasiveness of insider trading activity may be the lack of statutory definition. Without clear guidelines, it may be difficult to tell what conduct is legal or illegal.

n8. *Id.*

n9. See, e.g., M. FRIEDMAN, *CAPITALISM AND FREEDOM* (1962); Carlton & Fischel, *The Regulation of Insider Trading*, 35 *STAN. L. REV.* 857 (1983); Fleischer, Mundheim & Murphy, *An Initial Inquiry into the Responsibility to Disclose Market Information*, 121 *U. PA. L. REV.* 798 (1973); Freedman & Sporkin, *The Securities and Exchange Commission's Enforcement Program: A Debate on the Enforcement Process*, 38 *WASH. & LEE L. REV.* 781 (1981); Friedman, *Efficient Market Theory and Rule 10b-5 Nondisclosure Claims: A Proposal for Reconciliation*, 47 *MO. L. REV.* 745 (1982) [hereinafter *Efficient Market Theory*]; Gordon & Kornhauser,

Efficient Markets, Costly Information, and Securities Research, 60 *N.Y.U. L. REV.* 761 (1985); Haddock & Macey, *A Coasian Model of Insider Trading*, 80 *NW. U.L. REV.* 1449 (1987) [hereinafter Haddock & Macey, *A Coasian Model*]; Haddock & Macey, *Regulation on Demand: A Private Interest Model, with an Application to Insider Trading Regulation*, 30 *J. LAW & ECON.* 311 (1987) [hereinafter Haddock & Macey, *Regulation on Demand*]; Langevoort, *Information Technology and the Structure of Securities Regulation*, 98 *HARV. L. REV.* 747 (1985); Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 *HOFSTRA L. REV.* 9 (1984); Wolfson, *A Critique of the Securities and Exchange Commission*, 30 *EMORY L.J.* 119 (1981).

n10. For a similar criticism of the SEC's regulatory policy vis-a-vis corporate disclosure regulation, see generally H. KRIPKE, *supra* note 2.

n11. The penalties for insider trading are severe. The mere investigation of suspected insider trading activity, even without prosecution, may result in irreparable damage to employment relationships and business goodwill as the result of the ensuing publicity. *Report of the Task Force on SEC Rules Relating to Investigations*, 42 *BUS. LAW.* 789, 790 (1987) [hereinafter *Report of the Task Force on SEC Rules*]. Criminal liability may result in jail terms as well as fines, and civil investigations nearly always result in harsh fines. Janvey, *supra* note 2, at 318-19 & n.49. Securities investigations overwhelmingly result in a consent decree in which the target of the investigation neither admits nor denies the charges, but agrees to a permanent injunction against future insider trading activity and a civil penalty, of up to three times the profits made or losses engendered, under the Insider Trading Sanctions Act of 1984 (ITSA), 15 *U.S.C.* § 78u(d) (Supp. II & Supp. IV 1986). Thus, there are compelling incentives for targets of SEC investigations to settle. In addition, the SEC's liability determination may open the floodgates to private litigants seeking damages. See, e.g., Chiang & Bottorff, *Boesky Scandal May Lead to Rush of Civil Lawsuits*, 99 *Los Angeles Daily J.*, Nov. 21, 1986, at 1, col. 6. This can have serious consequences, because findings of fact from SEC enforcement proceedings act as collateral estoppel in future litigation. Kerr & Stillman, *Collateral Estoppel Implications of SEC Adjudications*, 42 *BUS. LAW.* 441 (1987). The administrative proceedings may act as a bar, preventing the SEC's target from relitigating issues decided in the administrative proceedings. *Id.* A consent decree, however, has no such effect. *In Re Cenco, Inc. Securities Litigation*, 529 *F. Supp.* 411, 414-16 (N.D. Ill. 1982). Thus, litigants have compelling incentives to agree to a consent decree.

n12. This is a somewhat ironic result in light of the SEC's purported fairness concerns. See *infra* note 322.

n13. 107 *S. Ct.* 1831 (1987). For a discussion of *Tull*, see *infra* notes 29-71 and accompanying text.

n14. *Tull*, 107 *S. Ct.* at 1839.

n15. Pub. L. No. 95-217, 91 Stat. 1566 (1977) (codified as amended at 33 *U.S.C.* §§ 1251-1376 (1982 & Supp. IV 1986)).

n16. "The Seventh Amendment's guarantee applies to civil actions to collect a civil penalty." *Tull*, 107 *S. Ct.* at 1835-37.

n17. 15 *U.S.C.* 78u(d) (Supp. II 1984 & Supp. IV 1986). ITSA provides for a civil penalty of up to 300% for insider trading activity. See *infra* notes 76-77 and accompanying text. Criminal actions for insider trading, like other criminal actions, have traditionally been triable to a jury. See *U.S. CONST.* art. III, § 2; Jacobs, *Procedural Matters in Actions Brought Under Rule 10b-5*, 27 *N.Y.U. L. REV.* 361, 402 (1981); Report of the Association of the Bar of the City of New York, Committee on Criminal Law, *supra* note 5.

n18. The social dialogue is the process of society-creation in a democratic social system. Legislation is enacted by popularly-elected representatives responding to public pressure. That legislation is then interpreted by the courts, which apply the enacted legislation to specific factual situations. The courts' interpretation of enacted legislation, in turn, may engender public disagreement and force the legislature to enact clarifying amendments to previously enacted statutes. For an explanation of the role of constitutional adjudication as an on-going dialogue in democracy, see Cover, *The Bonds of Constitutional Interpretation: Of the Word, the Deed, the Role*, 20 *GA. L. REV.* 815 (1986).

This Comment asserts that the area of insider trading regulation is one of those open-textured areas of the law in which the indeterminacy of legal results requires a new weighing-up of social values. Of course, even this assertion involves a value judgment. "The very task of deciding whether we should reach a new weighing-up of social values involves . . . a weighing-up of the same values." Stotzky & Swan, *Due Process Methodology and Prisoner Exchange Treaties: Confronting an Uncertain Calculus*, 62 *MINN. L. REV.* 733, 759 n.70 (1978). The only meaningful approach to this dilemma is to recognize that "[t]he process is inevitable and continuous. It goes to the very heart of legal reasoning and cannot be confined but only disciplined." *Id.*

n19. See *infra* notes 336–83 and accompanying text. The presence of a jury opens the legal discourse by making explanations and justifications necessary, and then subjecting those explanations to questioning in the light of community values, thereby clarifying social policy. Cover, *The Uses of Jurisdictional Redundancy: Interest, Ideology, and Innovation*, 22 *WM. & MARY L. REV.* 639, 652 (1981). In each case, the jury as a "group of problem-solvers . . . bring[s], collectively, large amounts of information and experience to bear that a single individual would not." *Id.* (footnote omitted). This phenomenon is what Professor Cover refers to as "deliberative redundancy . . . a critical strategy in procedural systems for purposes of confirming the 'correct' [outcome] and establishing the areas of uncertainty." *Id.* at 652, 654. Because "[a] principle function of syntactic redundancy is the identification of problematic parts of a message," *id.*, the jury, with its deliberative redundancy, should be able to identify problematic areas of social policy regarding insider trading regulation. If, indeed, insider trading is the troubled area that this Comment postulates, the presence of a jury will help to identify the trouble spots.

n20. On its face, this concept may be rejected as iconoclastic. Upon reflection, however, it will become apparent that this idea is not as revolutionary as it may at first appear. Although the judge instructs the jury on the applicable rules of law, it is the jury that must apply these laws to the facts in order to arrive at a general verdict. Through the general verdict, the jury can achieve a result without specifying its reasoning. See *infra* notes 341–42 and accompanying text. In this process, the jury makes law in the individual case in order to achieve its vision of justice. See Green, *Juries and Justice — The Jury's Role in Personal Injury Cases*, 1962 *U. ILL. L.F.* 152, 157.

n21. See Green, *supra* note 20, at 165–66.

n22. In the common law tradition, the jury performs two simultaneous functions: dispute resolution, which refers to the jury's role in solving the controversy at hand, and norm articulation, which incorporates community mores into the decision making process. Thus,

[a]djudication in the common law mold entails two simultaneously performed functions: dispute resolution and norm articulation. . . . For example, the requirement of 'case and controversy' in the federal courts is a formal embodiment of the requirement that the norm articulation function not be performed apart from dispute resolution. The converse requirement may also be found. . . . [The] requirement of articulation, together with even a weak consistency requirement, over time, will necessarily entail the articulation of general norms.

Cover, *supra* note 19, at 643 (footnote omitted). Although Professor Cover's point concerned jurisdictional redundancy, rather than jury function, the jury performs an analogous redundant function, and community norms are reflected in their determination.

n23. The political phenomenon of myopia occurs when people "refus[e] to engage in an activity with long-term benefits because of short-term costs." Sunstein, *Legal Interference with Private Preferences*, 53 *U. CHI. L. REV.* 1129, 1164 (1966). In the context of insider trading, the government's justification for regulation rests on the implicit assumption that the collective payoff in terms of the marketplace will be greater than the individual's costs in abstaining from such behavior. "In deciding whether government action can be justified, [however] one should ask whether consumers are ultimately worse off than they would have been" without the government interference. *Id.* at 1159. Because "[e]fforts to overcome myopia tend to be large intrusions" and the costs of reshaping preferences considerable, and because government action to overcome myopia "is likely to be skewed by irrelevant or invidious factors . . . government action to counteract myopia should be quite rare." *Id.* at 1165–66. In fact, because the regulations do not take cost benefit analysis into account, they are themselves myopic. Not only do the regulations attempt to restructure individual behavior that is pervasive in society, but in doing so, they unfairly disadvantage those whose trading conduct brings them within the SEC enforcement net by imposing upon

them unequal bargaining power and lack of procedural safeguards. *See infra* notes 89–105 and accompanying text. Furthermore, there is ample evidence that the regulations themselves are contraindicated by economic theory. *See infra* notes 286–328 and accompanying text. Although the legislature theoretically acts for the majority, "in a representative democracy, where citizens vote on candidates rather than on issues and do not have continuous control over representative processes, it is fanciful to say that government intrusion . . . is always responsive to electoral demand." Sunstein, *supra*, at 1144. Thus, permitting the community an added voice in the application of insider trading regulations by subjecting the regulations to jury scrutiny is a laudable development.

n24. The jury is a remarkable institution that has achieved a rare prominence in the American judicial system. H. KALVEN & H. ZEISEL, *THE AMERICAN JURY* 3 n.1 (1966). The judicial process reflects the "historic dualism between popular sovereignty and the doctrine of fundamental law that developed with the birth throes of the American political system." R. MCCLOSKEY, *THE AMERICAN SUPREME COURT* 14 (1960). This dualism is not only responsible for the characteristically strong role of the judiciary in the United States, it also establishes the principle that "public concurrence sets an outer boundary for judicial policy-making; that judicial ideas of the good society can never be too far removed from . . . popular ideas." *Id.* at 22.

n25. Professors Kalven and Zeisel's sociological studies show that the possibility of a jury trial alters litigant's decisionmaking calculus, whether or not they go to trial. H. KALVEN & H. ZEISEL, *supra* note 24, at 31–32.

n26. Although the people's voice is theoretically heard through the legislative branch, inclusion of the community voice in the judicial process further fine-tunes the system and adds a redundant dimension similar to the role Professor Cover asserts for jurisdictional redundancy. *See generally* Cover, *supra* note 19.

n27. The formation of social policy in this country results from the same complex interaction of normative and outcome specific dispute resolution that characterizes the common law tradition. Stotzky & Swan, *supra* note 18, at 757. Professors Stotzky and Swan believe that:

Social policies are a complex phenomenon. Descriptively, they consist of statements of desired outcomes associated with particular situations. As pure description, however, they are normatively neutral. Their normative content is dependent upon some underlying ethical postulate or value that may be more or less clearly expressed by the policymaker, whether legislative, executive, or judicial. This means that when a case thought to engage a particular social policy is decided, the policy functions in the nature of a principle.

Id. at 758 n.66. Because the jury's perception of justice in a particular case may differ from the judge's in precisely those cases in which the community norm differs from the official legal policy, the institution of the jury becomes an important check on unwise legislation. *See infra* notes 351–355 and accompanying text.

n28. *See supra* notes 24 & 25–27. The jury is a key feature of the separation of powers scheme, in which the power allocated among the judicial, legislative, and executive branches is diffused through a system of checks and balances. *See Note, United States v. Tull: The Right to Jury Trial Under the Clean Water Act — The Jury is Still Out*, 41 U. MIAMI L. REV. 665, 666, 688–89 (1987). The jury is able to function in this way because it acts as the only check — other than impeachment — on a potentially oppressive judiciary. *Id.* It also functions as a check on unwise legislation, and it was this characteristic functional combination that engendered the constitutional debates resulting in the ratification of the seventh amendment. *Id.* at 688.

n29. 107 S. Ct. 1831 (1987).

n30. The Clean Water Act, 33 U.S.C. §§ 1251–1376 (1982 & Supp. IV 1986), prohibits, among other things, dumping fill into wetlands adjacent to navigable waters. 33 U.S.C. §§ 1311, 1344, 1362; 33 C.F.R. § 323.2(a)(1)(7) (1986). Wetlands are defined as "swamps, marshes, bogs" and other frequently inundated areas. 33 C.F.R. § 323.2(c) (1986). Section 1319 provides for both injunctive relief, 33 U.S.C. § 1319(b), and civil penalties, 33 U.S.C. § 1319(d). The statute is silent, however, regarding the right to jury trial. Nonetheless, the Supreme Court interpreted the act's legislative history as indicating that Congress contemplated that the penalties would be assessed by the judge. *See Tull, 107 S. Ct. at 1839* (citing statement by Sen. Muskie that penalties would be assessed by judges in 123 CONG. REC. 39,190–91 (1977)).

n31. *Tull*, 107 S. Ct. at 1833–34.

n32. *Id.* at 1834.

n33. Although the government asked for an injunction, most of the developer's property had already been sold, making the requested injunction applicable to only a small proportion of the land in question. *Id.* at 1834.

n34. 615 F. Supp. 610, 626 (E.D. Va. 1983).

n35. *United States v. Tull*, 769 F.2d 182 (4th Cir. 1985). The Fourth Circuit based its denial of the right to jury trial on an historical analysis. *Id.* at 186. First, the court concluded that the Clean Water Act was an "equitable" statute. *Id.* at 186–87. Second, the court found that civil penalties under the Clean Water Act were not remedies "at law," but were within the court's equitable discretion. *Id.* at 187. Third, the court found that because the Clean Water Act offers a "package" of both legal and equitable remedies, the civil penalties lose whatever legal character they might otherwise have possessed. *Id.* at 187.

n36. *Tull*, 107 S. Ct. at 1835. The Supreme Court explicitly granted certiorari in order to resolve the question left open in *Atlas Roofing Co. v. Occupational Safety and Health Review Comm'n*, 430 U.S. 442, 449 n.6 (1977), of whether "the seventh amendment's guarantee of the right to jury trial applies to civil actions to collect a civil penalty." *Tull*, 107 S. Ct. at 1835.

n37. The Court found that although the seventh amendment applies to actions that are analogous to suits at common law, "those actions that are analogous to 18th-century cases tried in courts of equity or admiralty do not require a jury trial." *Tull*, 107 S. Ct. at 1835.

n38. U.S. CONST. amend. VII.

n39. *Tull*, 107 S. Ct. at 1835. The Court explicitly extended the definition of "at law" in the seventh amendment to congressionally-created causes of action, as well as to common law forms of action. *Id.*

n40. *Id.* Justice Scalia, although dissenting in part, found the majority's use of historical analysis correct. *Id.* at 1841 (Scalia, J., concurring in part and dissenting in part). Although far from lacking in precedent, this approach is inconsistent with the social underpinnings of the case. Courts have consistently applied a historical analysis to determine whether there exists a right to a jury trial in a civil action since *United States v. Wonson*, 28 F. Cas. 745 (C.C.D. Mass. 1812) (No. 16,750), was decided. More recent cases include *Parklane Hosiery v. Shore*, 439 U.S. 322 (1979) (Procedural changes occurring after 1791 do not affect seventh amendment rights.); *Pernell v. Southall Realty*, 416 U.S. 463 (1974) (The jury issue must be resolved on the basis of whether the action was historically at law or in equity.); *Dairy Queen v. Wood*, 369 U.S. 469 (1962) (The proper focus of the historical analysis is on the remedy.); *Beacon Theatres v. Westover*, 359 U.S. 500 (1959) (Each issue presented must be analyzed, and a historical analysis performed, to determine whether the issue is legal or equitable in nature, and hence, whether it would have been afforded a jury trial in 1791.).

The Court's historical approach, however, obscures the reality of modern jurisprudence, which has abandoned the distinction between courts of law and equity and merged them into a single system. The federal court's procedural merger of law and equity, *see FED. R. CIV. P. 1, 2*, occurred in 1938 with the promulgation of the Federal Rules of Civil Procedure, pursuant to congressional authorization. Enabling Act of June 19, 1934, ch. 651, §§ 1, 2, 48 Stat. 1064 (1934) (codified as amended at 28 U.S.C. § 2072 (1982 & Supp. IV 1986)). It seems irrational for modern courts deciding modern issues in a merged law and equity system to base their determinations of the right to jury trial on whether the 18th-century English judicial system would have found jurisdiction for problems that probably would not have arisen then in either law or in equity. Many of the cases raising the jury right question arise in contexts that could not have been contemplated in 18th-century England. The modern world vision has completely changed, however, and attempts to see the world through ancient glasses can only warp the vision. *See generally* R. UNGER, KNOWLEDGE AND POLITICS 19 *passim* (1984). For example, the decision as to whether to extend the right to a jury trial to insider trading actions, a problem Congress expressly left to judicial

resolution, *see* H.R. REP. NO. 355, 98th Cong., 1st Sess. 16 (1983), hardly could have arisen in the 18th-century because there was no contemporaneous analogue to our current stock market. *See* R. CLARK, *supra* note 5, at 11. Although civil penalties were familiar to 18th-century England and America, *see* Wolfram, *The Constitutional History of the Seventh Amendment*, 57 *MINN. L. REV.* 639, 670 (1973), attempts to discover whether a particular issue-remedy would have been decided at law or in equity is bound to yield highly indeterminate results. *See* Note, *supra* note 28, at 686. Equity evolved, at least partly, as an adjunct judicial system to relieve the harshness of the forms of action at law. F. MAITLAND, *THE CONSTITUTIONAL HISTORY OF ENGLAND* 123-37 (1908). Categorization of which cases could be brought in which system was often highly arbitrary. *See* Note, *supra* note 28, at 686. Furthermore, the categorizations were jurisdictionally based, and these jurisdictional distinctions have little relevancy since the procedural merger of the two systems. *See id.*

This analysis does not suggest that all constitutional historical analogy is inappropriate. Rather, in the context of deciding the seventh amendment right to jury trial, the determination of the law and equity distinction during the 18th-century, as perceived by a modern judicial system that has merged the two, seems inapt. A more reasoned analysis would assess the function of the jury in terms of its constitutional function — to assure a community voice in the judicial process, thus furthering the separation of powers principle of a participatory democracy. *See id. at 665-69, 685-91.*

n41. *Tull, 107 S. Ct. at 1835.*

n42. *Id. at 1837 n.6.* The Court found that the government's attempt to analyze the historical analogue of the action separately from the remedy was a "novel approach," and summarily rejected it. *Id.* Instead, the Court emphasized that the search must be for a single historical analogue, one that encompasses both the nature of the cause of action and the remedy as important factors. *Id.*

n43. *Id. at 1835.* First, the Court compared the statutory action for civil penalties under the Clean Water Act to analogous 18th-century actions to determine whether they were brought under the jurisdiction of the courts of law or equity. *Id. at 1835.* The remedy determination could then be made on a similar basis. *Id.* It is unclear, however, how one should proceed if the result points in two different directions. The government's argument that both remedy and action must have been within the jurisdiction of the courts of law in order for the right to jury trial to attach was summarily dismissed. *Id. at 1837 n.6.*

n44. *Id. at 1837.* The Court was persuaded that a civil penalty suit was within the jurisdiction of the courts of law prior to the enactment of the seventh amendment. *Id. at 1836.* After its adoption, the federal courts followed the English common law custom by treating civil penalty suits as actions in debt that required a jury trial. *Id.* The Court, therefore, held that under the historical analysis, actions brought by the government to recover civil penalties require a trial by jury. *Id.*

n45. The Court found this position "debatable." *Id. at 1837.*

n46. *Id.* Nonetheless, Justice Brennan, writing for the majority, stated that it is improper to divide "the Clean Water Act action for civil penalties into a cause of action and a remedy, and analyze[s] each component as if the other were irrelevant. . . . [Rather, the] search is for a single historical analogue, taking into consideration the nature of the cause of action and the remedy as two important factors." *Id. at 1837 n.6.* This reasoning may strike the reader as somewhat confusing, circular, result-oriented, and even vaguely akin to the Red Queen's discourse with Alice. *See* L. CARROLL, *ALICE IN WONDERLAND*, in *THE COMPLETE WORKS OF LEWIS CARROLL* 84-95 (Random House ed. 1937). The reader is asked to bear in mind that by insisting on a historical analysis, the Court is forced to labor under archaic concepts of the forms of action at common law and equity jurisdiction, concepts that are no longer familiar to a judicial system that merged the two over fifty years ago. For further discussion on this anomaly, *see supra* note 40.

n47. *Tull, 107 S. Ct. at 1838.* Interestingly, at this point in the opinion, the Court cited *Ross v. Bernhard*, 396 U.S. 531 (1970), to support the proposition that civil penalties actions are actions at law. *Tull, 107 S. Ct. at 1838.* *Ross* held that the treble damages remedy for securities violations is a penalty that constitutes legal relief. *Ross*,

396 U.S. at 536. Thus, under the Court's reasoning, civil penalties sought for securities violations should also be triable to a jury. The Court clearly analogized statutory civil penalties to the remedy of punitive damages. *Tull*, 107 S. Ct. at 1838. Therefore, civil penalties actions are within the seventh amendment right to jury trial. *Id.* The Court also based its assessment on the legislative history that suggested that "Congress wanted the district court to consider the need for retribution and deterrence, in addition to restitution, when it imposed civil penalties." *Id.*

n48. *Tull*, 107 S. Ct. at 1839.

n49. *Id.*

n50. *Id.*

n51. *Id.*

n52. This portion of the Court's holding may be especially important to actions for civil penalties under the securities laws. Under ITSA, the SEC normally seeks a permanent injunction, together with civil penalties. Levine, Mathews & Citera, *Insider Trading: Recent Enforcement Developments and Methods to Prevent Abuses*, in PRAC. L. INST., SECURITIES ENFORCEMENT INSTITUTE 243 (1987).

n53. *Tull*, 107 S. Ct. at 1839-40.

n54. *Id.* at 1841 (Scalia, J., concurring in part and dissenting in part); *see infra* note 61.

n55. *Id.* at 1840. This rationale seems to assert that the jury is functionally incapable of complex determinations, a rationale that the empirical data on the jury does not support. *See, e.g.*, Kalven, *The Dignity of the Civil Jury*, 50 VA. L. REV. 1055, 1066 (1964) (Statistically, the disagreement pattern between judge and jury does not vary in more difficult cases.). For a discussion of the fallacy of the assumption that "traditionally" — historically — judges have been regarded as superior decision makers in complex cases, *see generally* Arnold, *A Historical Inquiry Into the Right to Trial by Jury in Complex Civil Litigation*, 128 U. PA. L. REV. 829 (1980) (There is no adequate historical foundation for denying a jury trial in complex cases.).

n56. *Tull*, 107 S. Ct. at 1840.

n57. *Id.* at 1841.

n58. *Id.* at 1840.

n59. *Id.*

n60. To legitimate its removing the quantity determination from the jury, the Court used a statement in the legislative history that does not address the issue of the assignment of penalty determinations either to the judge or to the jury, but merely assumes that judges will make the amount determination. *Id.* at 1839. The statement read: "Penalties assessed by judges should be sufficiently higher than penalties to which the Agency would have agreed in settlement to encourage violators to settle." 123 CONG. REC. 39,190-91 (1971) (remarks of Senator Muskie). From this isolated statement alone, the Court inferred that "Congress intended that trial judges perform the highly discretionary calculations necessary to award civil penalties *after* liability is found." *Tull*, 107 S. Ct. at 1839 (emphasis added).

n61. *Id.* at 1841 (Scalia, J., concurring in part and dissenting in part). Justice Scalia cited no precedent himself. *Id.* Rather, he asserted that punitive damages, which the majority analogized to civil penalties, were assessed by the jury. *Id.* Further, Justice Scalia pointed out that there is "no precedent for judgment of civil liability by a jury but assessment of amount by the court." *Id.* at 1840-41. Indeed, the majority cited no precedent for this proposition, concluding instead that "no evidence [exists] that the Framers meant to extend the right to a jury to the remedy phase of a civil trial." *Id.* at 1840. This is a rather incongruous position for the Court to take, in light of the admittedly

sparse evidence of the framers' intent regarding the analysis of actions contemplated to fall within the rubric of the seventh amendment's protection, apart from the words of the amendment itself that to be accorded the right, the actions should be "at law."

n62. Justice Scalia argued that if criminal trials are the model, the liability determination should use the higher standard of guilt beyond a reasonable doubt applicable to criminal trials, rather than the civil standard of a preponderance of the evidence. *Id. at 1841* (Scalia, J., concurring in part and dissenting in part).

n63. *Id. at 1840.*

n64. *Id.*

n65. In *USFL v. NFL*, 842 F.2d 1335 (2d Cir. 1988), for example, the jury found that the defendants were liable for breach of contract, but assessed damages at only one dollar. *Id. at 1376-77*. Thus, the jury was able to fine-tune its determination to achieve a just result. By removing the penalties determination, the *Tull* Court removed an important area of jury discretion.

n66. The Court addressed the general statutory remedy of civil penalties and determined that the seventh amendment applied to actions seeking such a remedy. *Tull*, 107 S. Ct. at 1835.

n67. *Id. at 1836.*

n68. *Id. at 1838.*

n69. In addition to environmental actions, such as those brought under the Comprehensive Environmental Response Compensation and Liability Act, Pub. L. No. 96-510, 94 Stat. 2767 (1980) (codified as amended at 42 U.S.C. § 9601 (1982 & Supp. IV 1986)), examples of statutes that provide for civil penalties actions, that presumably now include the right to jury trial are: Immigration Reform and Control Act, Pub. L. No. 99-603, 100 Stat. 3359 (1986) (codified at 8 U.S.C. §§ 1101, 1824 (Supp. IV 1986)); Insider Trading Sanctions Act, Pub. L. No. 98-376, 98 Stat. 1264 (1984) (codified at 15 U.S.C. § 78u (Supp. II 1984 & Supp. IV 1986)); and the Occupational Safety and Health Act, Pub. L. No. 91-596, 84 Stat. 1606 (1970) (codified as amended at 29 U.S.C. § 666 (1982 & Supp. IV 1986)).

n70. Diver, *The Assessment and Mitigation of Civil Money Penalties by Federal Administrative Agencies*, 79 COLUM. L. REV. 1435, 1437-38 (1979).

n71. The Supreme Court held that government civil penalties actions are analogous to actions in debt requiring trial by jury. *Tull*, 107 S. Ct. at 1836. Although the *Tull* Court decided only the case before it — civil penalties brought under the Clean Water Act — because the Court based its holding on constitutional interpretation, and not merely statutory construction, it implicitly extended the seventh amendment right to jury trial to other civil penalties actions.

n72. 15 U.S.C. § 78u(d)(2)(A)-(D) (Supp. II 1984 & Supp. IV 1986). As this article goes to press, ITSA has been strengthened, and its remedial provisions enhanced, by the enactment of new law. The Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (1988) (to be codified at scattered sections of 15 U.S.C.). This new law not only "expose[s] Wall Street firms to greater liability in insider trading cases but will provide bounty payments to informers and require brokerage firms to police their employees." Nash, *Stiffer Penalties on Insider Trades and Rewards for Informers Voted*, N.Y. Times, Oct. 23, 1988, at 1, col. 4. Under the criminal provisions of the new law, individuals can be jailed for 10 years for each violation, and criminal fines are increased to \$1 million. 15 U.S.C. § 78ff(a) (as amended); see 134 CONG. REC. S17218-01 (daily ed. October 21, 1988) (statement of Sen. Proxmire). But one of the most dramatic effects that the bill is intended to have — and for this article, the most pertinent — is the imposition of civil penalties under ITSA. "H.R. 5133 expands the category of persons subject to ITSA civil penalties. It permits actions for penalties against controlling persons who fail to take appropriate steps to prevent or detect insider trading violations by their employees or controlled

persons." *Id.* (statement of Sen. Heinz). Thus, this bill represents the first time that liability has been extended to securities firms and their controlling persons who "knowingly and recklessly fail to supervise their employees." Nash, *supra*, at 15, col. 6. The new legislation, therefore, significantly enhances the regulatory scheme of ITSA.

n73. H.R. REP. NO. 355, 98th Cong., 1st Sess. 8 (1983).

n74. 15 U.S.C. § 78u(d)(2)(A) (Supp. II 1984 & Supp. IV 1986).

n75. ITSA "should have been labeled the 'Outsider Trading Sanctions Act' since it was primarily inspired by the trading of persons with advance knowledge of takeover attempts or 'market information' . . . and not by any increase in trading by 'insiders.'" R. JENNINGS & H. MARSH, JR., SECURITIES REGULATION 1053-54 (6th ed. 1987).

n76. 15 U.S.C. § 78u(d)(2)(A) (Supp. II 1984 & Supp. IV 1986).

n77. Section 3 of ITSA amended Section 32(a) of the 1934 Act, and increased the maximum criminal penalties for insider trading violations to \$100,000. H.R. REP. NO. 355, 98th Cong., 1st Sess. 17 (1983).

n78. Although the House Committee refused to provide a right to jury trial under the Act, *see* H.R. REP. NO. 355, 98th Cong., 1st Sess. 16 (1983), the decision of the Supreme Court, in *Tull*, mandates application of the seventh amendment right to jury trial in government civil penalties actions. *See Tull, 107 S. Ct. at 1835 n.3.* "Nothing in the language of the Clean Water Act or its legislative history implies any Congressional intent to grant defendants the right of a jury trial." *Id.* Thus, because Congress did not expressly grant the right to jury trial in the Clean Water Act, the Court had to reach the constitutional question of whether a right to jury trial must be provided, *id.*, a question that it answered in the affirmative. *Id.* Similarly, congressional failure to grant a jury trial for the civil penalties determination under ITSA is not dispositive on the issue of whether the right to jury trial is implicit in the action. Rather, as a matter of constitutional law, a jury trial must be provided.

n79. H.R. REP. NO. 355, 98th Cong., 1st Sess. 16 (1983). Thus, because the Supreme Court determined, in *Tull*, that as a matter of constitutional law, civil penalties actions, such as those brought under the Clean Water Act, must be tried to a jury, *Tull, 107 S. Ct. at 1839*, civil actions brought under ITSA must also be tried to a jury.

n80. H.R. REP. NO. 355, 98th Cong., 1st Sess. 16 (1983). Although the Committee expressly declined to express a view on the proper resolution of the constitutional issue, *id.*, it did note that "any right to a jury trial would not extend to a determination of the amount of the penalty to be assessed." *Id.* This corresponds closely to the Supreme Court's conclusion, in *Tull*, that the liability determination was triable to a jury, but that the penalty assessment was not. *Tull, 107 S. Ct. at 1840.*

n81. H.R. REP. NO. 355, 98th Cong., 1st Sess. 16 (1983). The congressional section-by-section analysis states:

Section 2 of the bill amends section 21(d) of the Exchange Act by adding a new subparagraph (d)(2)(A) to give the commission authority to seek from a U.S. district court a civil penalty of *up to* three times the amount of profit gained or loss avoided by a person who violates or aids and abets a violation of, the federal securities laws by purchasing or selling a security while in possession of material nonpublic information.

Id. (emphasis added). This limitation, however, may be illusory. The defendant in an insider trading case may also be subject to an additional 300% penalty in a civil RICO action under 18 U.S.C. §§ 1961-1968 (1982 & Supp. IV 1986) brought by either the Department of Justice or by private parties. 18 U.S.C. § 1964(c) (1982 & Supp. IV 1986). *See* J. SCHNOPP, H. PITT, D. JOHNSON & G. COST, RICO LIABILITY 8 (1988) [hereinafter RICO LIABILITY] (Racketeering activity under § 1961 includes securities fraud.).

n82. RICO LIABILITY, *supra* note 81, at 17.

n83. Langevoort, *The Insider Trading Sanctions Act of 1984 and its Effect on Existing Law*, 1986-87 CORP. PRAC. COMM. 87, 94 (1985). The SEC has not provided any guidelines as to when it will seek a civil penalty under ITSA or how much it will seek. ITSA only specifies that the amount should be calculated "in light of the

facts and circumstances." 15 U.S.C. § 78u(d)(2)(D) (Supp. II 1984 & Supp. IV 1986). To date, there has been no judicial development of the facts and circumstances that a court should consider before imposing the penalty. Thus, disgorgement may be sought at the same time as the 300% penalty, raising the amount of the fine to 400%. In addition, penalties under other sections of the 1934 Act may be sought in tandem with ITSA penalties. For a discussion of this problem, see Levine, Mathews & Citera, *supra* note 52, at 286.

n84. H.R. REP. NO. 355, 98th Cong., 1st Sess. 8 (1983). The Act does not "bar or limit" any actions under any other provision "of this chapter." 15 U.S.C. § 78u(d)(2)(D) (Supp. II & Supp. IV 1986). This provision may involve liability under other sections of the 1934 Act, such as § 16; it may also include criminal sanctions. See Langevoort, *supra* note 83. The statute provides a five year statute of limitations. 15 U.S.C. § 78u(d)(2)(D). See Levine, Mathews & Citera, *supra* note 52, at 288 (The SEC may seek an injunction, ancillary relief including disgorgement, a civil penalty, or any combination of these remedies.).

n85. 130 CONG. REC. H7758 (daily ed. July 25, 1984) (floor statement by Rep. Dingell clarifying the Senate amendments to which the House agreed).

n86. See Levine, Mathews & Citera, *supra* note 52, at 286.

n87. Pitt, Ain & Snyder, *Liability for Insider Trading under the Federal Securities Laws*, in PRAC. L. INST., SECURITIES ENFORCEMENT INSTITUTE 171 (1987). Agency discretion in setting the fine may be a critical piece of leverage that the SEC can use to achieve a quick settlement. For example, many of the cases settled via a consent decree were settled for less than the 300% maximum. See, e.g., SEC v. Cochran, No. C87-1352 (W.D. Wash. October 9, 1987), Litigation Release No. 11572 (Vice president of subsidiary who traded on material nonpublic information that subsidiary would be spun off from parent consented to an injunction, disgorgement of \$24,498, and an ITSA civil penalty of \$24,498.); SEC v. Chestman and Loeb, No. 87 Civ. 7148 (RJW) (S.D.N.Y. October 6, 1987), Litigation Release No. 11571 (Broker-dealer and businessman faced with insider trading charges in connection with A & P's tender offer for Waldbaum consented, without admission or denial of allegations, to a permanent injunction, disgorgement of \$22,653, and an ITSA civil penalty of \$22,653.); SEC v. Kidder Peabody, Civil Action No. 3869 (RO) (S.D.N.Y. June 4, 1987), Litigation Release No. 11452 (Investment bank alleged to have traded in securities while in possession of material nonpublic information and parking securities for entities controlled by Ivan Boesky, consented, without admission or denial of allegations, to a permanent injunction, disgorgement of \$13,676,101 and an ITSA civil penalty of \$11,618,674 — twice the profits the SEC claimed it had made from the transactions.); SEC v. Moore, Civil Action No. N 86 PCD (D. Conn. filed March 3, 1986) (Psychiatrist was accused of trading on information obtained from patient who was the spouse of a takeover target official. The psychiatrist consented, without admission or denial of allegations, to a permanent injunction, disgorgement of \$26,933, and an ITSA civil penalty of \$26,933.); SEC v. Elliot, No. 86 Civ. 10184 (N.D. Ill. filed December 30, 1986), Litigation Release No. 11335 (Partner of Chicago law firm charged with entering six transactions while in possession of information misappropriated from clients of law firm consented, without admission or denial of allegations, to a permanent injunction, disgorgement of \$271,312, and an ITSA civil penalty of \$228,688.); SEC v. Pomerantz, No. 86 Civ. 9499 (PNL) (S.D.N.Y. filed December 11, 1986), Litigation Release No. 11305 (Texas businessman was charged with misappropriating information from a person involved in a buyout and passing the information to his mother-in-law, consented to a permanent injunction, disgorgement of his and his mother-in-law's profits of \$39,925, and an ITSA civil penalty of \$79,850.); SEC v. David, No. 86 Civ. 9462 (DNE) (S.D.N.Y. filed December 8, 1986), Litigation Release No. 11334 (Attorney with Paul, Weiss, Rifkind, Wharton and Garrison admitted to disclosure of material nonpublic information obtained from law firm and consented to a permanent injunction, disgorgement of \$50,000, and an ITSA civil penalty of up to \$100,000, depending on his future income.); SEC v. Boesky, No. 86 Civ. 8767 (S.D.N.Y. filed November 14, 1986), Litigation Release No. 11288 (Arbitrageur charged with violating Sections 10(b) and 14(e) and Rules 10b-5 and 14e-3 by trading in material nonpublic information obtained in exchange for \$2.4 million consented to a permanent injunction, disgorgement of \$50 million, and an ITSA civil penalty of \$50 million.); SEC v. Sokolow, No. 86 Civ. 5193 (S.D.N.Y. filed July 1, 1986) (Vice president of investment banking firm, charged with leaking material nonpublic information regarding clients to Dennis Levine in return for \$120,000, consented to a permanent injunction, disgorgement of \$120,000, and an ITSA civil penalty of \$90,000.); SEC v. Wilkis, No. 86 Civ. 5182 (S.D.N.Y. filed July 1, 1986), Litigation Release No. 11605 (Former investment banker with Lazard Freres and

Co., later vice president of mergers and acquisitions at E. F. Hutton & Co., charged with trading on information either misappropriated from employers or received from Dennis Levine, consented to a permanent injunction, disgorgement of \$3 million, and an ITSA civil penalty of \$300,000.); *SEC v. Levine*, No. 86 Civ. 3726 (RO) (S.D.N.Y. filed May 12, 1986), Litigation Release No. 11605 (Director of Drexel Burnham Lambert, Inc., and his accountant, were charged with insider trading; director consented to a permanent injunction and disgorgement of \$11.6 million, and the accountant was ordered to disgorge illegal profits and pay an ITSA civil penalty.). Although the accused inside trader in each of the above cases neither admitted nor denied the allegations brought by the SEC, all consented to permanent injunctions, to disgorgement of "profits," and to the payment of civil penalties that were highly variable in amount.

n88. In civil insider trading, the SEC imposes sanctions after a civil enforcement proceeding that is conducted "without the full panoply of protections offered a criminal defendant." Silver, *Penalizing Insider Trading: A Critical Assessment of the Insider Trading Sanctions Act of 1984*, 1985 *DUKE L.J.* 960, 962. In criminal insider trading actions, after the SEC has conducted an investigation and has alleged conduct that may give rise to criminal liability, the Department of Justice must file formal charges and submit the case for trial. *Id.* Although the SEC may conduct criminal investigations, the Department of Justice retains authority over the criminal indictment process. *Id.* A notable difference between criminal and civil insider trading cases is the higher burden of proof required for conviction in criminal cases. In criminal prosecutions, the insider trader must be proven guilty beyond a reasonable doubt; while in civil actions, only a preponderance of the evidence is necessary for a finding of civil liability. *Id.* In either the civil or the criminal context, however, circumstantial evidence is all that is required for a liability determination. See *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983) (Circumstantial evidence was sufficient for liability in a private action under 10b-5.).

n89. The Commission may bring an action to seek a civil penalty when it believes insider trading violations have occurred. 15 U.S.C. § 78u(d)(2) (Supp. II 1984 & Supp. IV 1986). Before Congress enacted ITSA, only the Department of Justice could bring an action seeking monetary fines for securities violations. See Silver, *supra* note 88, at 962.

n90. See, e.g., *Report of the Task Force on SEC Rules*, *supra* note 11.

n91. *Id.* at 791.

n92. *Id.* Publicity, of course, may not be the fault of the SEC; rather, it may result either from information leaks or from the target's own actions. In any event, such publicity may trigger private suits — a result that may have severe consequences for the target.

n93. There is a private right of action under Rule 10b-5. See, e.g., *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380-81 n.10 (1983); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 733-34 (1975); 17 C.F.R. § 240.10b-5 (1986). This private right of action under the securities fraud provisions has been called "illogical" because it allows people who would have traded anyway and who have not been injured to litigate and possibly recover large damage awards. See, e.g., Morgan, *Insider Trading and the Infringement of Property Rights*, 48 *OHIO ST. L.J.* 79, 105 (1987); Chiang & Bottorff, *Boesky Scandal May Lead to Rush of Civil Lawsuits*, *Los Angeles Daily J.*, Nov. 21, 1986, at 1, col. 6 (Boesky scandal may lead to rush of civil lawsuits and class actions.). The threat of draconian damages from private litigation adds considerably to the SEC's leverage in obtaining consent decrees. See, e.g., Wolfson, *A Critique of the Securities and Exchange Commission*, 30 *EMORY L.J.* 119, 161 *passim* (1981).

n94. A consent decree is a form of remedy used by the SEC in which the "defendant," who neither admits nor denies the charges that the SEC has brought against him, agrees to an injunction barring him from further illicit activity and to the payment of fines. See Kronstein, *SEC Practice*, 11 *SEC. REG. L.J.* 284 (1983) (A large majority of SEC actions are settled by the entry of consent injunctions.).

n95. See, e.g., Kerr & Stillman, *supra* note 11, at 485 (A victory by the SEC in an enforcement proceeding will have collateral estoppel consequences in a later private damages action.). The Commission's determination in the enforcement proceedings, if unsuccessfully defended in the district court, can bar the defendant from relitigating

issues decided in the enforcement proceedings. The inherent impossibility of predicting in advance how the estoppel issue will look to a court in a subsequent action enhances this problem. *Id.*

n96. *Report of the Task Force on SEC Rules, supra* note 11, at 791 (The investigation is generally the only opportunity the defendant has to present his side because most enforcement actions are settled.).

n97. The current rules do not provide adequate assurance that the defendant or his counsel will have sufficient information about the staff's view of the factual or legal bases of the case. Furthermore, in spite of consistent rhetoric to the effect that SEC investigative proceedings are not adversarial, these proceedings have significant ramifications to the targets of an investigation. *Id.* at 769. Therefore, the task force concluded that targets should be given advance warning that they are the subject of an investigation. *Id.*

n98. *See, e.g., Report of the Task Force on SEC Rules, supra* note 11, at 791. The Task Force noted many inconsistencies between SEC investigations and notions of due process. *Id.* One of the due process insufficiencies noted was an infringement upon the right to counsel. *Id.* at 795. The current SEC rules limit the role and activities of an attorney present at the examination of a witness to taking notes and briefly questioning the witness at the conclusion of the examination for clarification of any answers given. *Id.* The rules further provide for the sequestration and disciplining of counsel for any dilatory or obstructive conduct. *Id.* The Task Force pointed out that these disciplinary provisions may have a substantial chilling effect on the vigorous representation of counsel. *Id.* Some authorities take the position that these rules are not enforced, although they are on the books, and that they, therefore, should not be considered as troubling as they would be if enforced with regularity. *See* Letter of Harvey L. Pitt, at 9 (on file at the University of Miami Law Review). It is potentially chilling, nonetheless, to have bad law on the books, even if the practical consequences are not as serious as the theoretical ones.

n99. Although the SEC staff routinely advises witnesses and counsel that there are no targets in SEC investigations, the reality is that such proceedings are adversarial, and therefore, the targets should be given ample warning. *Report of the Task Force on SEC Rules, supra* note 11, at 796.

n100. *Id.* at 791.

n101. SEC investigations are sufficiently adversarial to make abuse of prosecutorial authority a valid concern, especially since the "SEC investigative process lacks sufficient procedures to assure that all subjects and witnesses are treated fairly." *Id.*

n102. The SEC conducts two types of investigation, formal and informal. In informal investigations, the SEC requests "voluntary" cooperation, rather than issuing subpoenas as it does in formal investigations. *Id.* at 792. Only formal investigations are currently subject to the rules relating to investigations. *Id.*

n103. *Id.* at 813. The SEC has the power to withhold transcripts and to require the target's attorney to read them in the office of the SEC. *Id.* Although the SEC rarely withholds transcripts in practice, this power could be abused by a less enlightened staff and is, therefore, troubling in theory, if not in practice.

n104. Kerr & Stillman, *supra* note 11, at 441.

n105. *Id.* at 485.

n106. Section 5 of ITSA amended Section 20 of the 1934 Act, and extended liability to include tipping or trading in the options market. Pub. L. No. 98-376, § 2, 98 Stat. 1264 (codified at 15 U.S.C. § 78u (Supp. II 1984 & Supp. IV 1986)). *See* Levine, Matthews & Citera, *supra* note 52, at 288. Tipping is defined in ITSA's legislative history as communicating material nonpublic information. H.R. REP. NO. 355, 98th Cong., 1st Sess. 9 (1983).

n107. 15 U.S.C. § 78u(d) (Supp. II 1984 & Supp. IV 1986).

n108. *Id.* The rationale for this provision is that deterrence in addition to that already imposed under the 1934

Act was not necessary in face-to-face transactions or public offerings. H.R. REP. NO. 355, 98th Cong., 1st Sess. 19, 26 (1983).

n109. H.R. REP. NO. 355, 98th Cong., 1st Sess. 19, 26 (1983).

n110. 15 U.S.C. § 78u(d) (Supp. II 1984 & Supp. IV 1986).

n111. 15 U.S.C. § 78u(d)(2)(B).

n112. 130 CONG. REC. H7758 (daily ed. July 25, 1984) (statement of Rep. Dingell).

n113. 130 CONG. REC. H7759 (daily ed. July 25, 1984) (statement of Rep. Wirth).

n114. Langevoort, *supra* note 83, at 90. See Note, *A Critique of the Insider Trading Sanctions Act of 1984*, 71 VA. L. REV. 455 (1985) (Reliance on case law in the legislative history of ITSA suggests an implied endorsement of judicial interpretation of securities fraud.).

n115. 15 U.S.C. § 78j (1982 & Supp. IV 1986).

n116. 15 U.S.C. § 78n(e).

n117. 17 C.F.R. § 240.10b-5 (1986).

n118. 17 C.F.R. § 240.14e-3.

n119. Langevoort, *supra* note 83, at 95.

n120. For a discussion of the implications of this provision, see *id.*

n121. Section 10(b) prohibits the use of manipulative or deceptive devices in connection with the purchase or sale of any security. 15 U.S.C. § 78j (1982 & Supp. IV 1986). Section 10(b) does not operate to prohibit any conduct unless the SEC has adopted special rules prohibiting such conduct. *Id.* Rule 10b-5 provides:

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

17 C.F.R. § 240.10b-5 (1986). One problem with Rule 10b-5 is that it has been held to implement Section 10(b), including manipulative behavior, although Rule 10b-5 does not mention the word manipulation. See *infra* note 122 and accompanying text.

n122. *Ward La France Truck Corp.*, 13 S.E.C. 373 (1943), was the first case in which the SEC addressed Rule 10b-5. Two controlling officers bought shares in their own corporation when they knew that a proposed merger would take place. *Id.* at 374-75. The SEC concluded that the officers had violated Rule 10b-5 by their actions. *Id.* at 381. *Kardon v. National Gypsum*, 73 F. Supp. 798 (E.D. Pa. 1947), was the first judicial decision on Rule 10b-5. Two of four equal shareholders brought a private action against the other two co-equal shareholders, alleging failure to disclose that the corporate assets had been sold pursuant to an agreement made before the plaintiffs had sold their stock to the defendants. *Id.* at 800-01. The district court held that that these actions constituted Rule 10b-5 securities violations for which the two participating co-equal shareholders were liable. *Id.* at 802-03. An early leading case is *Speed v. Transamerica Corp.*, 99 F. Supp. 808 (D. Del. 1951), *reaff'd*, 100 F. Supp. 461 (D. Del. 1951), 103 F. Supp. 47 (D. Del. 1952), *op. on damages*, 135 F. Supp. 176 (D. Del. 1955), *modified*, 235 F.2d 369 (3d Cir. 1956). In *Speed*, a majority shareholder was alleged to have traded on information that the value of

the corporation's inventory was greater than its published book value. *Id.* at 812, 820. The shareholder was found liable for violating Rule 10b-5. *Id.* at 843. There were also a number of early SEC injunctive actions. L. LOSS, SECURITIES REGULATION 1449 (1961). The consensus, however, is that *In re Cady Roberts*, 40 S.E.C. 907 (1961), was the seminal case regarding insider trading, and it is so cited in ITSA's legislative history. H.R. REP. NO. 355, 98th Cong., 1st Sess. 14 (1983).

n123. 40 S.E.C. 907 (1961).

n124. *Id.* at 911.

n125. *Id.* at 908.

n126. *Id.*

n127. *Id.* at 911.

n128. *Id.* at 912.

n129. 401 F.2d 833 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969).

n130. *Id.* at 848.

n131. *Chiarella v. United States*, 445 U.S. 222 (1980).

n132. Although *Chiarella* was the Supreme Court's first explicit pronouncement on the subject of insider trading, it was by no means the first time that the Court had dealt with cases involving some form of insider trading. See, e.g. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) (When an accounting firm failed to detect and disclose an insider's fraud to the SEC, the Court found that scienter was required for liability.); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) (A private cause of action under Rule 10b-5 may only be brought by an actual purchaser or seller.); *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972) (Market maker who induced trades by maintaining the market was found to be liable for violating Rule 10b-5 when he failed to disclose this material information.); *Superintendent of Insurance v. Bankers Life and Cas. Co.*, 404 U.S. 6 (1971) (Corporate insiders were found to have defrauded the corporation where they engaged in an elaborate looting scheme in which the corporation's United States Treasury Bonds were sold at full price and the proceeds were used by the defendants to purchase the corporation's stock.); *SEC v. Capital Gains Research Bureau*, 375 U.S. 180 (1963) (Construing § 206(2) of the Investment Advisors Act, 15 U.S.C. § 80b-6(2), the Court held that an investment advisor, who purchased stocks for his own account prior to recommending them to his clients and then immediately sold the shares at a profit upon the rise in market price following his recommendation, was liable for fraud under the statute.); *Surowitz v. Hilton Hotels Corp.*, 342 F.2d 596 (7th Cir. 1965), cert. granted, 382 U.S. 809 (1965), rev'd, 383 U.S. 363 (1966) (Stockholder who filed derivative action against hotel corporation for fraud on the basis of the corporation's purchase of its own stock at inflated prices from corporate officers and directors was found to have no valid cause of action because the verification of her complaint was false.).

n133. *Chiarella*, 445 U.S. at 224-25.

n134. *Id.* at 224.

n135. *Id.* at 225.

n136. The jury had been instructed that *Chiarella* could be convicted if the jury found he used information that was not available to other participants in the market. See *id.* at 236.

n137. *United States v. Chiarella*, 588 F.2d 1358, 1368 n.15 (2d Cir. 1978).

n138. *Id.* at 1368 n.14.

n139. *Id.* at 235.

n140. Justice Stevens' concurrence is often cited as support for the misappropriation theory. *See, e.g.,* Langevoort, *supra* note 83, at 110. Justice Stevens found that "[a]rguably, when petitioner [Chiarella] bought securities in the open market, he violated (a) a duty to disclose owed to the sellers from whom he purchased target company stock and (b) a duty of silence owed to the acquiring companies." *Chiarella*, 445 U.S. at 237 (Stevens, J., concurring).

n141. *Chiarella*, 445 U.S. at 235, 237.

n142. *Id.* at 232.

n143. *Id.* at 233.

n144. *Id.* at 236. Justice Powell, writing for the majority, found that the jury was not instructed on the elements of the tort of misappropriation, and that the jury instructions did not suggest that Chiarella must be found to have had a confidential position. *Id.* at 237 n.21. Therefore, the majority concluded that the misappropriation theory was not included in the jury instructions. *Id.*

n145. Chief Justice Burger found the misappropriation theory appropriate to 10b-5 violations, and that it had been properly presented to the jury. *Id.* at 239-45 (Burger, C.J., dissenting).

n146. *Id.* at 240-41.

n147. *Id.* at 241.

n148. *Id.* at 238-39 (Brennan and Stevens, J.J., concurring).

n149. *Id.* *See Report of the Task Force on Regulation of Insider Trading, Part I*, 41 BUS. LAW. 223, 235-37 (1985) [hereinafter *Report of the Task Force on Insider Trading, Part I*] (The misappropriation theory extends insider trading liability to people who trade in violation of a duty owed to someone other than purchasers or sellers of securities.).

n150. *Chiarella*, 445 U.S. at 237-38 (Stevens, J., concurring).

n151. *Id.* at 238-39 (Brennan, J., concurring).

n152. *Id.* at 239-45 (Burger, C.J., dissenting).

n153. 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983).

n154. *Newman*, 664 F.2d at 15.

n155. *Id.*

n156. *Id.* at 13.

n157. *Id.* at 17.

n158. *Id.*

n159. *Id.*

n160. *Moss v. Morgan Stanley, Inc.*, 719 F.2d 5, 8 (2d Cir. 1983), cert. denied, 465 U.S. 1025 (1984).

n161. 719 F.2d 5 (2d Cir. 1983), cert. denied, 465 U.S. 1025 (1984).

n162. *Id.* at 8.

n163. *Id.*

n164. *Id.* at 14.

n165. *Id.* at 13, 15-16.

n166. The *Moss* court, however, did not explicitly discuss the basis for this difference. It merely stated that none of the defendants owed the plaintiff a duty. *Id.* at 15.

n167. 463 U.S. 646 (1983).

n168. *Id.* at 657 & n.16.

n169. *Id.* at 648-49.

n170. *Id.* at 649-50.

n171. *Id.* at 649.

n172. *Id.*

n173. *Id.* at 650-52.

n174. *Dirks v. SEC*, 681 F.2d 824, 829, 840, 846 (D.C. Cir. 1982).

n175. *Dirks*, 463 U.S. at 667.

n176. *Id.* at 665.

n177. *Id.* at 657.

n178. *Id.* at 660.

n179. *Id.* at 661.

n180. *Id.* at 667.

n181. 108 S. Ct. 316 (1987).

n182. *Id.* at 319. Winans' disclosure violated the paper's policy of confidentiality. *United States v. Winans*, 612 F. Supp. 827, 830 (S.D.N.Y. 1985). An additional party to the Winans trading venture was Peter Brant, the government's key witness. *Id.* at 829. Brant, who was a top broker at Kidder, Peabody, was involved in the scheme from its inception and was, according to Winans' testimony, its instigator. *Id.* at 832-33.

n183. *Winans*, 612 F. Supp. at 832-33. Winans' column often had "a perceptible effect on the stock prices of the companies" that were the subject of the column. Pitt, *The Limits of Fraud: An Analysis of the Winans Case*, 2 INSIGHTS 15 (1988). Thus, the traders' advance knowledge of the column's contents enabled them to take advantage of the anticipated market reaction — which they did, to the tune of \$700,000. *Id.* at 834.

n184. *Winans*, 612 F. Supp. at 837-38. This confession led to the entry of a consent decree, in which Winans disgorged the small amount of profits he had made and was enjoined from further violations. SEC v. Brant, No. 84 Civ. 3470 (CBM) (S.D.N.Y. filed Oct. 21, 1985).

n185. *Winans*, 612 F. Supp. at 829.

n186. *Id.*

n187. *United States v. Carpenter*, 791 F.2d 1024, 1026 (2d Cir. 1986).

n188. *Id.* at 1031. The Second Circuit cited Chief Justice Burger's dissenting opinion in *Chiarella*, 445 U.S. at 245, to hold that "Winans misappropriated — stole, to put it bluntly — valuable nonpublic information entrusted to him in the utmost confidence." *Carpenter*, 791 F.2d at 1031.

n189. *Carpenter*, 791 F.2d at 1032-33.

n190. *Carpenter v. United States*, 108 S. Ct. 316, 320 (1987).

n191. *Id.*

n192. *See id.* at 320-22. This split had the procedural effect of affirming the securities fraud conviction. Pitt, *supra* note 183, at 17.

n193. Some commentators worry that the case will have an adverse effect on the SEC's ability to prosecute civil insider trading cases and facilitate criminal prosecutions of insider trading under the mail and wire fraud statutes. *See, e.g.*, Pitt, *supra* note 183, at 18 (In the absence of new legislation, the *Winans* decision leaves the SEC's ability to prosecute civil insider trading cases under the misappropriation theory in jeopardy.).

n194. Although *Carpenter* was decided after the promulgation of ITSA and, therefore, is not part of the judicial background of the statute, Congress left the definition of insider trading to the courts. H.R. REP. NO. 355, 98th Cong., 1st Sess. 16 (1983). Thus, *Carpenter* is important to understanding the violation.

n195. *See, e.g., In re Cady Roberts & Co.*, 40 S.E.C. 907 (1961).

n196. *Id.* at 911.

n197. *Texas Gulf Sulphur*, 401 F.2d at 848.

n198. *Chiarella*, 445 U.S. at 235.

n199. *Newman*, 664 F.2d at 16-17.

n200. *Dirks*, 463 U.S. at 659-65.

n201. *Id.* at 655 n.14.

n202. The *Dirks* Court discussed this problem in footnote 14, in which it acknowledged that in the case of corporate outsiders who become fiduciaries of the shareholders by virtue of their employment by the corporation, a fiduciary duty could only be imposed when the relationship between the corporation and the outsider was such as to imply a duty to keep the disclosed nonpublic information confidential. *Id.* In those cases, there can be no duty to disclose. The Court further acknowledged that "mere possession of nonpublic information does not give rise to a duty to disclose or abstain; only a specific relationship does that." *Id.* at 656 n.15.

n203. *See Dirks*, 463 U.S. at 659-64.

n204. See *Carpenter*, 108 S. Ct. at 321. Of course, because the Supreme Court discussed only mail and wire fraud, but not securities fraud, *Carpenter* may not have answered or undermined any analysis, and may be a mere sidelight in the on-going judicial discourse.

n205. 15 U.S.C. § 78n (1982 & Supp. IV 1986). Section 14(e) provides that "fraudulent, deceptive, or manipulative acts or practices" in connection with tender offers are securities violations. *Id.* Rule 14e-3 provides that once a substantial step has been taken toward the commencement of a tender offer, or other extraordinary transaction, anyone with material nonpublic information concerning the tender offer must wait "a reasonable time" after the information is made public before trading. 17 C.F.R. § 240.14e-3 (1986). Further, Rule 14e-3 imposes a duty on anyone with material nonpublic information about a tender offer either to disclose or to abstain from trading, and not to cause others to trade in the securities subject to the tender offer, but only if the person knows, or has reason to know, that the information was obtained from the offeror, target, or insiders. *Report of the Task Force on Regulation of Insider Trading, Part I, supra* note 149, at 248. Also, Rule 14e-3 prohibits tipping of information whether or not trading occurs and eliminates the need for the tipper or trader to have achieved a personal benefit. *Id.* Finally, Rule 14e-3 predicates liability on the fact that the tipper knows, or has reason to know, that the information came from insiders on the deal. *Id.*

An apparently anomalous result is that except under Rule 14e-3, which is limited to tender offers — in which possession of material nonpublic information is enough to give rise to a duty to abstain from trading, and except under the misappropriation theory, it appears as though the insiders of one corporation may use material nonpublic information to trade in the securities of another. *Id.* at 247. Multiservice financial institutions with an effective Chinese Wall — an internal policy preventing information from an institution's investment banking or research department from leaking into its trading department — are exempted from liability under Rule 14e-3, as are sales to the tender offeror. *Id.* at 248-52.

n206. Tipping occurs when any person in possession of material nonpublic information communicates that information to a third person. See, e.g., *Dirks v. SEC*, 463 U.S. 646, 648 (1982).

n207. Haddock & Macey, *Regulation on Demand, supra* note 9, at 327. These authors argue that "by promptly issuing Rule 14e-3, the SEC quickly restored a part of the [opportunity] set [excised by *Chiarella*]. The SEC could not restore the set entirely. So, the restoration had to proceed with circumspection." *Id.* The authors argue that the promulgation of ITSA was a logical next step. *Id.* at 330.

n208. See Lowenstein, *Section 14(e) of the Williams Act and the Rule 10b-5 Comparisons*, 71 GEO. L.J. 1311 (1983) (arguing that the judicial reliance on Rule 10b-5 precedents to set the bounds of the Section 14(e) cause of action is unwarranted).

n209. *Id.* at 1356.

n210. 15 U.S.C. § 78j(b) (1982 & Supp. IV 1986) makes it unlawful to employ "any manipulative or deceptive device or contrivance." *Id.* See Pitt, *supra* note 183, at 18 (Rule 10b-5 is directed at fraud, not unfair trading.).

n211. *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977).

n212. 15 U.S.C. § 78u(d)(2)(A) (Supp. II 1984 & Supp. IV 1986).

n213. Huss & Leete, *Insider Trading Regulations: A Comparison of Judicial and Statutory Sanctions*, 25 AM. BUS. L.J. 301, 309 (1987).

n214. For a discussion of the question of who is actually harmed by insider trading, see R. CLARK, *supra* note 5, at 265-75.

n215. Pitt, *supra* note 183, at 16. As Pitt points out, *Chiarella*'s discovery of prospective takeover target identities without inducing sellers to part with stock, and without any entitlement of the victims to the information,

is a victimless crime. *Id.*

n216. R. CLARK, *supra* note 5, at 101.

n217. *See* Note, *supra* note 28, at 100.

n218. *Id.* at 109.

n219. H.R. REP. NO. 355, 98th Cong., 1st Sess. 2 (1983). The Supreme Court has recently defined "material" as it pertains to Section 10(b) and Rule 10b-5, by adopting the standard promulgated by *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), in the proxy-solicitation context. *Basic, Inc. v. Levinson*, 108 S. Ct. 978 (1988). The definition finds facts material if "there is a substantial likelihood a reasonable shareholder would consider it important . . . [or if a reasonable investor would think it] significantly altered the total mix of information available." *Id.* at 983.

n220. H.R. REP. NO. 355, 98th Cong., 1st Sess. 2 (1983).

n221. *Dirks v. SEC*, 463 U.S. 646, 661 n.21.

n222. H.R. REP. NO. 355, 98th Cong., 1st Sess. 5 (1983).

n223. *Dirks*, 463 U.S. at 646.

n224. *Chiarella*, 445 U.S. at 232-35.

n225. *See* H.R. REP. NO. 355, 98th Cong., 1st Sess. (1983).

n226. *Id.* at 14-15 (1983).

n227. *Chiarella*, 445 U.S. at 230.

n228. H.R. REP. NO. 355, 98th Cong., 1st Sess. 14 (1983).

n229. *Id.* at 4.

n230. *Id.* at 5.

n231. Although Senator D'Amato of New York originally sought a definition of insider trading, he dropped his search in the interest of expeditiously passing the bill. *The Insider Trading Sanctions Act of 1983: Hearing on H.R. 559 Before the Subcomm. on Securities*, 98th Cong., 2d Sess. (1984).

n232. *Id.*

n233. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969).

n234. 570 F. Supp. 1397 (C.D. Cal. 1983).

n235. 664 F.2d 12 (2d Cir. 1981). *See* H.R. REP. NO. 355, 98th Cong., 1st Sess. 13 & n.20 (1983).

n236. 17 C.F.R. § 240.14e-3 (1986).

n237. H.R. REP. NO. 355, 98th Cong., 1st Sess. 4 (1983).

n238. *See supra* notes 129-30 & 153-66 and accompanying text.

n239. *Texas Gulf Sulphur*, 401 F.2d at 848.

n240. *Newman*, 664 F.2d at 17.

n241. *Langevoort*, *supra* note 83, at 111.

n242. *See SEC v. Lund*, 570 F. Supp. 1399, 1403 (C.D. Cal. 1983).

n243. *Id.* at 1402-03.

n244. *Id.* at 1400-01.

n245. *Id.* at 1402.

n246. *Id.*

n247. *Id.* at 1403.

n248. *Id.*

n249. 463 U.S. at 655 n.14. In *Dirks*, the Court found that because the corporate insiders breached no duty to the corporation in exposing a fraud, the trading tipper-analyst had no derivative duty to disclose or abstain. *Id.* at 657-58.

n250. For an illuminating discussion of the implications of the citation to *Lund* rather than to *Dirks* or *Chiarella* in the legislative history of ITSA, see *Langevoort*, *supra* note 83, at 105. According to Professor *Langevoort*, the drafters actively considered addressing prevailing law, but decided not to do so. *Id.* at 90. Instead, they "strongly expressed an intention that the legal doctrine of insider trading restrictions be inventive and result oriented — flexible enough to reach a wide range of abuses." *Id.* at 90-91. The broad *Lund* theory of liability also ignores the earlier *Chiarella* limitation, in which, for tippers and tippees, the breach of a fiduciary duty by a corporate insider, either a traditional insider or an insider by virtue of a fiduciary relationship to the corporation, is a necessary precondition to tippee liability. *Id.* at 107.

n251. *Lund*, 570 F. Supp. at 1403.

n252. *See Langevoort*, *supra* note 83, at 90-91 (ITSA, although purporting to endorse judicial construction of insider trading rules, actually expanded insider trading liability.).

n253. The legislative history of ITSA indicates the congressional concern with the widespread public disregard for insider trading prohibitions. H.R. REP. NO. 355, 98th Cong., 1st Sess. (1983). The pervasiveness of insider trading activity despite its illegality is apparent from the numerous cases in which the traders were not members of the traditional professional investment community. These traders were not necessarily financially sophisticated, and the sums they gained or lost from trading were often quite modest. For example, in *SEC v. Musella*, 678 F. Supp. 1060 (S.D.N.Y. 1988), the district court granted a preliminary injunction against two policemen who violated the securities laws when they traded on inside information obtained from a source with whom they had no direct contact. *Id.* at 1062. The policemen testified that they thought the information could have been inside information, and did not investigate further because they did not want to know. *Id.* A plausible inference from that statement is that although they recognized that insider trading was illegal, trading on the basis of knowledge not known to the general public was not itself "wrong," as long as they did not know that the information was "misappropriated." *Id.* The court found that the policemen, nevertheless, were liable and that conscious avoidance of knowledge is not sufficient to defeat scienter. *Id.* at 1063. One commentator remarked that there will probably not be much testimony like that in the future. 20 Sec. Reg. & Law Rep. (BNA) 148 (1988) (remarks attributed to Harvey Pitt). The point is not that it was a particularly forceful argument; rather, the point is that the concept of unfair advantage does not appear to have been part of the policemen's logic. Of course, it may also be that Chairman Ruder is correct, and

they simply did not think they would be caught. *See infra* note 259.

n254. *See* 130 CONG. REC. H7757 (daily ed. July 25, 1984).

n255. Langevoort, *supra* note 83, at 95 n.26.

n256. *Id.* at 98–102 (discussing secondary liability).

n257. This concern is underscored by the recent unanimous passage by Congress of new insider trading legislation. The Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100–704, 102 Stat. 4677 (1988) (to be codified at scattered sections of 15 U.S.C.). This legislation contained no definition of insider trading, despite the fact that an insider trading definition bill has been before Congress for over a year. S. 1380, 100th Cong., 1st Sess. (1987). The bill would "clarify the application of the proposed insider trading prohibitions to market information, the scope of derivative liability, and the application of the proposal to communications to and from investment analysts." Securities Law Daily (BNA) (February 19, 1988). Despite a congressional disclaimer that it was not attempting to create a "parity of information standard that would prohibit persons from gaining informational advantages through legitimate activities," the legislative language in a draft the SEC proposed is very broad. *Id.* Nevertheless, no definition was included in the most recent law. Pub. L. No. 100–704 (1988).

n258. For example:

[SEC Chairman David] Ruder commented that he was struck by the fact that the ordinary, average American citizen has not recognized the need to refrain from insider trading, despite that fact that it is a crime and a securities violation. He cited family connection cases where one member of a family readily passed on illegal information to other relatives who traded and illegally profited from the information. . . . [Furthermore, Ruder added] there is, and always will be, substantial amounts of insider trading.

19 Sec. Reg. & Law Rep. (BNA) 1923 (Dec. 18, 1987) [hereinafter Remarks of Ruder]. The case law is full of instances of insiders and "constructive insiders" passing on "misappropriated" information to their friends and loved ones. *See, e.g.,* SEC v. Thayer, No. 84 Civ. 0066 (S.D.N.Y. 1984) (The *Dirks* personal gain test was expanded to include friendship and sexual favors.). Congress placed the blame squarely on a public that feels it can get away with such activities. *Id.* It is possible that the explanation for the widespread disregard for insider trading prohibitions rests on the public perception that there is nothing wrong with using an informational advantage. Because it is difficult to articulate what is intrinsically unfair about using an informational advantage in a capitalist financial system in which informational and other advantages are consistently rewarded with a bigger slice of the pie, penalizing the use of such advantages in the context of trading resonates as hypocritical.

n259. *See* Remarks of Ruder, *supra* note 258. Certainly the legal press appears to agree with Ruder. *See, e.g.,* Report of The Association of the Bar of the City of New York, Committee on Criminal Law, *supra* note 5, at 2 (Claiming a "widespread belief that 'everyone is doing it' — or at least that everyone who has the opportunity to do it is doing it.").

n260. Before the Supreme Court's decision in *Tull*, a jury trial was not available when the SEC sought an injunction from the court, even if it also sought monetary disgorgement. *See, e.g.,* Jacobs, *Procedural Matters in Actions Brought Under Rule 10b-5*, 27 N.Y.U. L. REV. 361, 402 (1981).

n261. Even though there is no right to a jury trial in an administrative proceeding before the SEC, Jacobs, *supra* note 260, at 402, and only a small fraction of SEC actions are litigated, *see* Kronstein, *SEC Practice*, 11 SEC. REG. L.J. 284 (1983), the possible addition of the jury's voice will affect the parties' bargaining positions. This is the phenomenon noted by Green as the "mythical jury." Green, *supra* note 20, at 158. According to Green, all negotiations are tested against the presumed reactions of "the spectral jury in the background which would have materialized had the case been tried." *Id.*

n262. For a discussion of cognitive processes and their application to legal decisionmaking, see Edwards & Von Winterfeldt, *Cognitive Illusions and Their Implications for the Law*, 59 S. CAL. L. REV. 225, 270 (1986) (The

most fundamental operational principle of decision analysis is that the iteration of repeated consideration of an issue, from multiple viewpoints, leads to wisdom.). For a discussion of the poor foundation on which regulation of insider trading is based, see generally Wolfson, *A Critique of the Securities and Exchange Commission*, 30 *EMORY L.J.* 119 (1981). By all accounts, insider trading continues to flourish despite heightened prosecution. See, e.g., Morgan, *Insider Trading and the Infringement of Property Rights*, 48 *OHIO ST. L.J.* 79 (1987). Nonetheless, the SEC proclaims its enforcement efforts a success. See Goeltzer, *Symposium on Insider Trading — Introduction*, 13 *HOFSTRA L. REV.* 1, 7 n.16 (1984).

n263. See generally Edwards & Von Winterfeldt, *supra* note 262; Scott, *Error and Rationality in Individual Decisionmaking: An Essay on the Relationship Between Cognitive Illusions and the Management of Choices*, 59 *S. CAL. L. REV.* 329 (1986); Sunstein, *Legal Interference with Private Preferences*, 53 *U. CHI. L. REV.* 1129 (1986).

n264. L. FESTINGER, *CONFLICT, DECISION AND DISSONANCE* 5 (1964).

n265. The conflict between what a person experiences as reality and the justifications for his choice of action results in the psychic distress of cognitive dissonance, a distress that the person will attempt to assuage by polarizing the attractiveness of the alternatives. *Id.* at 6. This distortion is increased when a particular group within society has an interest in maintaining the alternative because the group's power and prestige are at stake. Sunstein, *supra* note 263, at 1139.

n266. This increasing disparity between theory and reality is a key indicator of cognitive dissonance. L. FESTINGER, *supra* note 264, at 5–6.

n267. Some disagree with the notion that insider trading is legitimate compensation for corporate contributions. Pitt, *supra* note 98, at 21. Others, including this author, would align themselves with state law principles in which only the corporate owner of the information has a cause of action against the insider trader. See Remarks of Ruder, *supra* note 258.

n268. Kripke's remark that the only way to understand the SEC "mind-set" is to view it as a theology supports this personal observation, at least in part. See H. KRIPKE, *supra* note 2, at 4; see also Memorandum of the Securities and Exchange Commission in Support of the Insider Trading Sanctions Act, in H.R. REP. NO. 355, 98th Cong., 1st Sess. 21, 27 (1983) (SEC sees itself as charged with protecting "investor confidence in the fairness and integrity [of] the best securities markets the world has ever known."). Moreover, "[t]he SEC's feelings of its own importance lend a deadly seriousness to its efforts at enlarging the scope of the statutes it administers." H. KRIPKE, *supra* note 2, at 37.

n269. 130 CONG. REC. H7759 (daily ed. July 25, 1984) (statement of Rep. Wirth).

n270. See *supra* notes 7, 8 and accompanying text.

n271. For a discussion and assessment of the judicial debate over the use of "macroeconomic free market perspective," see *The Report of the Task Force on Regulation of Insider Trading, Part I*, *supra* note 149, at 224–26.

n272. Langevoort, *supra* note 9, at 748. Professor Langevoort suggests that new technology has radically altered the structure and function of the securities markets and proposes that this factor mandates a reexamination of securities regulation. *Id.* at 749.

n273. The price of securities that are widely traded — those with highly liquid and efficient markets — reflect all available information almost instantaneously. Langevoort, *supra* note 84, at 96. See Patell & Wolfson, *The Intraday Speed of Adjustment of Stock Prices to Earnings and Dividend Announcements*, 13 *J. FIN. ECON.* 223 (1984) (The reflection of information in stock prices occurs within hours, if not minutes.).

n274. Langevoort, *supra* note 9, at 751, 755.

n275. *Id.* at 751.

n276. *Id.* at 757.

n277. *Id.* at 759.

n278. This assumption is quite clearly the basis for the promulgation of ITSA and the Insider Trading and Securities Fraud Enforcement Act of 1988, as it was for the securities acts of 1933 and 1934. *See, e.g.,* H. R. REP. NO. 355, 98th Cong., 1st Sess. 2 (1983) (Capital formation and our nation's economic growth depend on investor confidence in the fairness of our markets.). The theory of market fairness, or parity of access to information, to the extent that it is valid at all in the computer age, departs from the underlying assumption of a competitive economy, which is that those who have acquired a superior market position should be rewarded. Friedman, *Efficient Market Theory and Rule 10b-5 Nondisclosure Claims: A Proposal for Reconciliation*, 47 *MO. L. REV.* 745, 753 (1982). Arguably, insider trading is legitimate compensation for corporate contributions and, thus, should be within the discretion of the corporation. *See, e.g., Morgan, supra* note 93, at 108-09 (arguing for a property theory of insider trading liability in which only the corporate owner of the information has a right of action).

The Supreme Court gave the property theory of insider trading an unexpected boost in *Carpenter v. United States*, 108 S. Ct. 316, 320 (1987). In *Carpenter*, the Court predicated the defendants' liability on the theory that the *Wall Street Journal* owned the property rights to any ideas that Winans developed for publication in his article. *Id.* The Court held that anyone acquiring "special knowledge or information by virtue of a confidential or fiduciary relationship with another is not free to exploit that knowledge for his own personal benefit, but must account to his principal for any profits derived therefrom. *Id.* One commentator has noted that the Court's language suggests that the *Journal* might have its own cause of action against Winans. Pitt, *supra* note 183, at 18.

n279. *See* H.R. REP. NO. 355, 98th Cong., 1st Sess. 1, 2 (1983).

n280. Langevoort, *supra* note 9, at 759.

n281. *Id.*

n282. *Id.* *See* Cohen, *The Suitability Rule and Economic Theory*, 80 *YALE L.J.* 1604, 1607-11 (1971) (Because the marketplace is efficient, stock is fairly valued, and the investment decision should depend only on the risk preferences of the individual investor.); Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities*, 38 *BUS. LAW.* 1, 3-5 (1982) (Equalizing investor access to information is unnecessary in light of capital market efficiency.). The Supreme Court's decision in *Basic, Inc. v. Levinson*, 108 S. Ct. 978 (1988), appears to endorse the efficient market hypothesis. In *Basic*, rather than requiring each investor claiming damages for securities fraud under Rule 10b-5 to prove reliance on corporate statements, the Court applied a presumption of reliance based on a fraud-on-the-market theory. *Id.* at 988-93. This theory contemplates investor reliance on the price set by an impersonal market as reflecting all available information. *Id.* at 988-89. The Court expressly based its presumption of reliance on the fact that "[a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price." *Id.* at 991-92. Whatever theory one espouses, it is clear that the regulatory scheme should facilitate information reaching the market, rather than requiring people to forego trading opportunities. *See* Letter of Harvey L. Pitt, *supra* note 98, at 21.

n283. Pitt, Ain & Snyder, *Liability for Insider Trading Under the Federal Securities Laws*, PRAC. L. INST., SECURITIES ENFORCEMENT INSTITUTE 190 (1987).

n284. H.R. REP. NO. 355, 98th Cong., 1st Sess. 5 (1983). For a discussion of the problems that the adoption of the fairness approach causes, see Fleischer, Mundheim & Murphy, *An Initial Inquiry into the Responsibility to Disclose Market Information*, 121 *U. PA. L. REV.* 798, 816-17.

n285. H.R. REP. NO. 355, 98th Cong., 1st Sess. 5 (1983). The emphasis is troubling precisely because the market makers and specialists do not represent the public, but are a discrete interest group. For an explanation of

the role of market makers and specialists, see generally Haddock & Macey, *supra* note 9.

n286. The Senate Report, in fact, dismissed the efficient market theory as "rubbish" without further discussion. 130 CONG. REC. H7759 (daily ed. July 25, 1984) (appending editorial Longstreth, *Halting Insider Trading*, N.Y. Times, Apr. 12, 1984, at A27, col. 1-3). One explanation for this neglect may be an inability of the regulators or legislators to assess the validity of the theory. As one commentator remarked: "Economic theory has never been the long suit of either the Securities and Exchange Commission (SEC) or the courts in the administration and interpretation of the federal securities laws. Nor has concern about theoretical consistency in achieving pragmatic results under the various securities statutes." Friedman, *Efficient Market Theory*, *supra* note 9, at 299. It would seem logical, however, to require regulators to develop such an understanding before commencing interference with the economics of market function.

n287. Voluminous empirical evidence supports the efficient market hypothesis and its special case corollary the random walk hypothesis. See, e.g., Schwert, *Using Financial Data to Measure Effects of Regulation*, J. LAW & ECON. 121, 125 (1985). These theories assume stock prices reflect all available relevant information, leaving no opportunity to make economic profits because returns are constant over time for each asset, although expected returns can differ among assets. *Id.* at 124-25. Thus, while market investors will occasionally make profits, the profits will be strictly random and will be offset by the same or other investors' market losses. *Id.*

n288. Gordon & Kornhauser, *supra* note 9, at 770. These authors question the applicability of the efficient market hypothesis in a complex world in which accurate testing may be impossible. *Id.* at 761. This premise is questionable, however, for two reasons. First, the authors discredited the random walk hypothesis based on a single study in which analysts' forecasts were able to achieve superior risk adjusted returns of 1.7%. *Id.* at 845-46. This conclusion seems premature based on a single study of 35 stockbrokers and one institutional investor in the United Kingdom. *Id.* at 845 n.242. Second, they suggest that because the market reacts slowly to analysts' forecasts, the assimilation of information may not be instantaneous. *Id.* at 846. This conclusion does not take into account the primary assumption of the efficient market theory — that the market would have assimilated the information that the analysts uncovered well before they could publicly announce it.

n289. *Id.* at 771.

n290. Friedman, *supra* note 9, at 758. Because luck is the most democratic of phenomena, benefitting people without regard to wealth, social status or inherent merit, it is intrinsically fair. *Id.*

n291. Insider trading provides

[B]enefits to the marketplace, by providing an indirect means of information regarding corporate developments; to investors, by moving the prevailing market prices in the proper direction; to corporate managers, by providing them with a means of extraordinary compensation for their developmental efforts on behalf of the enterprise; and to the corporation, by providing corporate shareholders and managers with [these] benefits.

Morgan, *supra* note 93, at 82.

n292. *Id.* at 105.

n293. See *id.* at 106. For example, corporate officer insider reports, filed with the SEC on Forms 3 and 4, are frequently filed late. Pitt, *Inside Information*, BARRON'S 50, 53 (Aug. 18, 1988). In attempting to address this problem, one securities expert has called for immediate announcement of any purchase of more than 5% of a company's stock, followed by filing within two days. *Id.* (proposal attributed to former SEC Commissioner Roberta Carmel). Another expert finds this plan unworkable because there will be "a lot of things lost in transmission if you're relying on the announcement process." *Id.* (remarks of Harvey L. Pitt). Rather, he suggests requiring that such information be filed within two days. *Id.*

n294. *Morgan*, *supra* note 93, at 106.

n295. "[U]nlike misrepresentations or misleading statements (which move the market in the direction opposite to the true information), trading on undisclosed, accurate information moves the market in the proper direction." *Id.* at 107.

n296. *See* Remarks of Ruder, *supra* note 7.

n297. Of course, this assertion depends to some extent on what Friedman calls "the observer's theology." Friedman, *supra* note 9, at 753. Friedman points out that:

One school believes that it is impossible for a corporation to keep the market constantly informed about significant changes in corporate affairs, so efficient markets are furthered by insider trading which operates to channel additional information to the market less directly. Apostates [of securities regulation], however, suggest that full information dissemination is possible and that insider trading merely impedes dissemination by creating incentives for delay or nondisclosure.

Id. (footnotes omitted). Although Professor Friedman acknowledges that "[e]mpirical evidence is inconclusive as to the possibility of full information dissemination," *id.*, the stronger position appears to be that insider trading furthers efficient markets by driving prices in the correct direction. *See, e.g.,* R. CLARK, *supra* note 5, at 280.

n298. Friedman, *supra* note 9, at 753.

n299. *Report of the Task Force on Regulation of Insider Trading, Part I, supra* note 149, at 226.

n300. *Id.*

n301. *Id.*

n302. *See, e.g.,* Report of the Association of the Bar of the City of New York, Committee on Criminal Law, *supra* note 5, at 16 (1984) (asserting that the substantial decrease in individual trading on the stock exchanges is probably due to the public perception that the stock market is an insider's game).

n303. *But see* Langevoort, *supra* note 9, at 760 (asserting that the large savings in transactions costs that institutional investors currently enjoy, and that give them their market preeminence, may be decreased by automation).

n304. *See, e.g., id.* at 759.

n305. In a market in which the individual investor accounts for only 10% of the trading, any assertion that the confidence of the individual investor makes a real difference is questionable.

n306. The number of individual investors has actually risen from approximately 30.8 million in 1970 to 42.4 million in 1983. STATISTICAL ABSTRACT OF THE UNITED STATES 509 (106th ed. 1986).

n307. *Morgan, supra* note 93, at 82.

n308. "[I]t is not at all clear that insider trading is an evil from which *investors* need to be protected. If insider trading is in fact beneficial (or at least not harmful) to investors, then . . . they need no protection." *Morgan, supra* note 93, at 102 (emphasis in original). For a view that "the enforcement work of the Commission, at best, reflects an over-zealous insensitivity to individual liberties and the values of a free society; and at worst, a deliberate pattern of serious and inexcusable violations of fundamental rights and elementary notions of fairness," see Freedman & Sporkin, *supra* note 9, at 781.

n309. H.R. REP. NO. 355, 98th Cong., 1st Sess. 5 (1983).

n310. *See, e.g.,* Haddock & Macey, *Regulation on Demand, supra* note 9.

n311. For a cogent explanation of public choice theory, see *id.* at 312.

n312. *Id.*

n313. *Id.*

n314. *Id.*

n315. Shareholders would benefit from insiders' trades because these trades would move the stock price in the proper, more accurate, direction. See *supra* notes 286–98 and accompanying text. Of course, this point is highly controversial, and many commentators would disagree. See Pitt, *supra* note 98, at 23. For example, one expert in the area of securities law feels that the true gravamen of insider trading is stealing, and that even if the thief may make more efficient use of the information than the general market place, the conduct should be prohibited even if that conduct does not harm anyone. *Id.* at 24. The others, including this author, disagree, and propose granting the entitlement to prosecuting insider trading to those it may harm — the corporations. See Friedman, *supra* note 278, at 760–61 (proposing that the entitlement to prosecution of insider traders should be with the corporations rather than with a regulatory agency); Morgan, *supra* note 93, at 103–09 (arguing property rights analysis will help distinguish helpful from harmful insider trading).

n316. For an in–depth explication of this theory, see generally Haddock & Macey, *Regulation on Demand*, *supra* note 9.

n317. Market professionals systematically profit from trades with less informed outsiders. *Id.* at 331.

n318. *Id.* at 332.

n319. *Id.* at 331. According to Haddock and Macey, "[i]t is no accident that enforcement of bans on insider trading moved to the top of the SEC agenda in 1980, the year of the *Chiarella* decision." *Id.* at 332. The reason the authors give for this phenomenon is that before *Chiarella*, the broad *Texas Gulf Sulphur* theory of liability, see *supra* notes 129–31 and accompanying text, disadvantaged the two groups equally, making the SEC's enforcement efforts too expensive to pursue. Haddock & Macey, *Regulation on Demand*, *supra* note 9, at 332–33. After *Chiarella*, however, the market professionals were "liberated" from the ban because, generally, they did not have a fiduciary duty. *Id.* at 333. Thus, the scale of marginal value of political support for regulations tipped in favor of the market professionals, who then made their services available to the enforcement efforts of the SEC. *Id.* at 333. This theory would suggest that the number of insider trading cases brought against market professionals should approach zero. When some market professionals are penalized, this is the result of both interest groups benefitting from the market professional being sanctioned for trading on information gained through a confidential relationship with an enterprise. *Id.*

n320. The public is the most disfavored of the three groups because it has the least cohesion and the least access to informational advantage. *Id.* at 333.

n321. *Id.* at 323–24. This may appear to be an unjustifiably harsh statement. According to cognitive theory, however, people find it increasingly important to justify a chosen course of action when there is conflict between the ostensible reasons for the choice and the experienced reality. See *supra* notes 265–67 and accompanying text. An example of this mechanism is the propaganda that accompanies the perpetuation of gender roles through legal rules. See Sunstein, *supra* note 263, at 1139. Even women adversely affected by those rules may accept the propaganda as true and convince themselves that they are satisfied with a tyrannical status quo, in order to reduce cognitive dissonance. *Id.*

A similar mechanism is evident in the insider trading regulation situation. See Haddock & Macey, *Regulation on Demand*, *supra* note 9, at 317–18. The primary justification that regulatory proponents cite for insider trading is fair play in the marketplace. See, e.g., H.R. REP. NO. 355, 98th Cong., 1st Sess. 2 (1983). The rhetoric of fair play has enormous political appeal and was a major factor motivating the promulgation of ITSA, as well as the 1934

Act. *See Langevoort supra* note 83, at 91. While the rhetoric of fairness of the markets was similar in the two acts, the emphasis was not. In the 1934 Act, Congress was concerned with the perceived abuses of traditional insiders:

Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities. Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others.

Report of the Association of the Bar of the City of New York, Committee on Criminal Law, *supra* note 5, at 5 (1984) (quoting SENATE COMM. ON BANKING AND CURRENCY, STOCK EXCHANGE PRACTICE, S. REP. NO. 1455, 73d Cong., 2d Sess. 55 (1934)).

The current emphasis is on an entirely different set of traders, those who are not fiduciaries to corporations trading on the exchanges, but who have been able to obtain information that is not generally known, and to profit by it. *See supra* notes 255–61 and accompanying text. But none of these developments were discussed by the legislators in the promulgation of ITSA. Rather, Congress, capitulated to the SEC's agenda of making insider trading an enforcement priority without examining the validity of such a priority. ITSA's legislative history demonstrates this kind of general support for the current increase in SEC enforcement actions:

The current Commission has made the prosecution of insider trading a priority, and has brought more such cases during the past four years than in all previous years combined. Although the Commission's visible enforcement program against insider trading has raised the level of awareness of the public, there remains a public perception that the risk of detection is slight.

H.R. REP. NO. 355, 98th Cong., 1st Sess. (1983). *See Janvey, SEC Investigation of Insider Trading*, 13 SEC. REG. L.J. 299 (1986). As a possible justification for this priority, Janvey cites *The Epidemic of Insider Trading*, BUS. WK., April 29, 1985, at 75, for the proposition that 72% of the stock prices of companies involved in takeovers, mergers and leveraged buyouts increased, whereas if the stock prices had followed general trends, only 52% would have risen in price. Janvey, *supra*, at 299 n.1. That justification, however, misses the economic point that in an efficient market, in which prices reflect all available information immediately, the reasonable investor will watch the market carefully in order to take advantage of such information. Furthermore, the "SEC has rarely engaged in any empirical studies to determine whether current or proposed regulations are necessary to cut abuses in the securities industry." Wolfson, *supra* note 9, at 120. It is hard to justify ITSA regulation without performing an empirical documentation of its validity. The rhetoric of fairness in the market, thus, is mere propaganda, according to Haddock & Macey, and deliberately is aimed at misinforming the most disadvantaged of the three groups interested in insider trading regulation, the public investor. *See Haddock & Macey, Regulation on Demand*, *supra* note 9, at 323.

n322. "Insider trading threatens these markets by undermining the public's expectations of honest and fair securities markets where all participants play by the same rules." H.R. REP. NO. 355, 98th Cong., 1st Sess. 2 (1983). The Committee on Federal Regulation of Securities believed that even in the face of current economic theory and despite radical market changes between 1934 and the present policy bases for insider trading regulation — fair play and the integrity of the markets — are still sound. *Report of the Task Force on Regulation of Insider Trading, Part I*, *supra* note 149, at 225. The Committee was concerned that the increased incidence of hostile tender offers, the decreased financial risk through use of options, and the absence of clear guidelines on prohibited conduct combined to create incentives for insiders to impede the flow of information originating within the corporation to the market in order to speculate and profit. *Id.* at 227–29. Note that the Committee's position assumes that there is no efficient market instantly reflecting information that forms the basis for trading, even before it is announced. The Committee further opined that even when only market information originating outside the corporation is involved, and even if the economic value of the information is reflected in market prices before the announcement, this is fundamentally unfair to initial trades. It did not, however, analyze why this should be so. The Committee appears to base its rationale on what it calls a societal abhorrence of cheaters and sneaks. *Id.* at 227–29. Again, no empirical evidence is presented.

n323. The House Report asserted that the use of an informational advantage is unfair because all participants should play by the same rules. H.R. REP. NO. 355, 98th Cong., 1st Sess. 5 (1983). Although, in *Dirks*, the Supreme Court expressly found that both the parity of information standard and the parity of access to information standard were inapplicable, the SEC's use of the misappropriation theory implies just such a standard. *See Morgan, supra* note 93, at 88–89. Morgan notes that the Supreme Court has contributed to the uncertainty concerning the underlying justification for insider trading rules by refusing to consider the underlying premises of the rules. *Id. at 90*. He notes that "even if one accepts the notion that insider trading should be regulated, it is very hard to tell which transactions will be subject to that regulation" because the standards used are ill-defined and highly subjective. *Id. at 90*.

n324. Haddock & Macey, *Regulation on Demand, supra* note 9, at 323. The authors remark that:

[T]he barrage of public statements and news stories emanating from the SEC are intended in part to discredit and deflect ordinary citizens' attention from the ongoing academic debate about insider trading. Consequently, few ordinary shareholders understand, or even monitor, the behavior of the SEC, meaning that the informed support or opposition the SEC can expect from ordinary shareholders is trivial.

Id. at 324. The market professionals' incentives to lobby for increased liability are greatest because they have the greatest comparative advantage at trading and are most harmed by insider trading. *Id. at 336*.

n325. *Id. at 329*.

n326. *Id. at 329*.

n327. *See, e.g., id. at 338*.

n328. *See id.* Congress makes the assertion in the legislative history of ITSA that "[m]arket makers and specialists, so necessary to the liquidity of the market, have suffered extreme financial losses in such [insider trading] situations." H.R. REP. NO. 355, 98th Cong., 1st Sess. 5 (1983). The SEC's general counsel makes a similar assertion that insider trading "threatens the orderliness and stability of markets by exposing market professionals to substantial losses." Goelzer, *supra* note 262, at 3.

n329. Higginbotham, *Continuing the Dialogue: Civil Juries and the Allocation of Judicial Power*, 56 TEX. L. REV. 47, 58 (1977).

n330. A strong concern for possible judicial and legislative tyranny informed the debates over the inclusion of the seventh amendment in the Bill of Rights. *See* B. SCHWARTZ, *THE BILL OF RIGHTS: A DOCUMENTARY HISTORY* 983–1167 (1971); Wolfram, *supra* note 40, at 695. The framers included a constitutional right to jury trial in order to provide a bulwark against government oppression. *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 343 (1979) (Rhenquist, J., dissenting). The jury, therefore, is an essential part of the constitutional structure of government. *Byrd v. Blue Ridge Rural Elec. Co-Op.*, 356 U.S. 525, 535–36 (1958).

n331. Reasons given by the antifederalists for expressly including the right to jury trial in the Bill of Rights included the frustration of unwise legislation, the vindication of the interests of private citizens in litigation with the government, and the protection of litigants against an oppressive judiciary. *See* Wolfram, *supra* note 40, 667–725.

n332. *Compare* H. KALVEN & H. ZEISEL, *supra* note 24 (arguing that the jury is a vital and irreplaceable part of the American judicial process) *and* Arnold, *A Historical Inquiry Into the Right to Trial by Jury in Complex Civil Litigation*, 128 U. PA. L. REV. 829 (1980) (discussing the judicial encroachment on the jury's terrain in complex antitrust actions) *with* Devlin, *Jury Trials in Complex Cases: English Practice at the Time of the Seventh Amendment*, 80 COLUM. L. REV. 43 (1979) (arguing that the jury is functionally disabled in complex litigation).

n333. H. KALVEN & H. ZEISEL, *supra* note 24, at 219 (1966).

n334. Juries are just as tough as judges; however, their response is non-rule minded, focusing on the equities. P.

DIPERNA, *JURIES ON TRIAL* 31 (1984) (citing H. KALVEN & H. ZEISEL, *THE AMERICAN JURY* (1966)). "The fact that [the] deliberation process cannot be brought under control as neatly as the trial, puts it beyond reach of the judge and attorneys, a frustration that may account for continuing jury system criticism." *Id.* at 56. The Kalven/Zeisel study concludes that the jury "must rank as a daring effort in human arrangement to work out a solution to the tensions between law and equity and anarchy." H. KALVEN & H. ZEISEL, *supra* note 24, at 499. "Not the least of the advantages is that the jury, relieved of the burdens of creating precedent, can bend the law without breaking it." *Id.* at 498.

n335. The common law tradition has been "cherished by Americans with peculiar tenacity." R. MCCLOSKEY, *supra* note 24, at 11. Part and parcel of that common law tradition is the role of the jury in the judicial process. The very first legislation enacted in Massachusetts concerned the right to trial by jury. Thus, "all that is extant of the legislation of Plymouth colony for the first five years consists of the single regulation: 'That all criminal facts and also all manner of trespasses and debts between man and man shall be tried by the verdict of twelve honest men, to be impanelled by authority in form of a jury upon their oath.'" J. PROFFATT, *A TREATISE ON TRIAL BY JURY* 121-22 (1877). Also, "[t]he strong and emphatic language in reference to the right of trial by jury in some of our early state Constitutions shows further the great estimation in which the privilege was held." *Id.* at 122.

n336. The jury will do this by asserting its sense of community values in the legal decisionmaking process. "In many ways the jury is the law's most interesting critic." J. PROFFATT, *supra* note 335, at 219. One commentator has suggested that:

The jury has the power to ignore the law, either consciously or unconsciously; once it begins deliberating behind closed doors, it is free to do what it wants. That is one of the essential criticisms of the jury system. Yet, there are those who argue that the jury has that power by more than implication, that it has the absolute right to nullify when it sees fit.

P. DIPERNA, *supra* note 334, at 183 (1984).

n337. H. KALVEN & H. ZEISEL, *supra* note 24, at 56.

n338. *Id.* at 56-65.

n339. *Id.*

n340. *Id.* at 378. The jury gives recognition to values that fall outside the official rules. *Id.* at 495. The jury becomes more willing to convict than the judge would have been when the defendant's conduct so outraged the jury's sensibilities that even though the defendant's conduct fell short of the legal definition of the crime, the jury's sensibilities overrode legal distinctions. *Id.* at 395-97. An example of this phenomenon occurs with sex crimes committed against children, in which the evidence clearly shows an assault, but in which there may not have been the sexual penetration technically necessary to complete the crime. *Id.* at 396. It takes a heinous crime for the jury to have a stricter standard of liability than the judge, however. *Id.*

n341. Scholars who have studied the jury have widely recognized that the jury does not merely decide fact. *See, e.g., Green, supra* note 20, at 157. The jury is more than the fact-finding arm of the court; it applies the law in order to arrive at a verdict. *Id.*

n342. J. FRANK, *LAW AND THE MODERN MIND* 184-85 (Smith ed. 1970). No fan of the jury system, Frank thought that jury trials "created a government of often ignorant and prejudiced men . . . [leading] to a capriciousness that is unnecessary and socially harmful." *Id.* at 191-92. Frank was equally hostile to the concept of certain rules of law, however, and opined that "the widespread notion that law either is or can be made approximately stationary and certain is irrational and should be classed as an illusion or a myth." *Id.* at 13. Furthermore, Frank acknowledged that the fact/law distinction was problematic at best, and that one can "not nicely separate his belief as to the 'facts' from his conclusion as to the 'law.'" *Id.* at 125.

n343. H. KALVEN & H. ZEISEL, *supra* note 24, at 111. Contrary to the conventional wisdom that the jury is

the trier of fact, not law, Kalven and Zeisel found that:

[I]n only one third of the cases is the jury's fact-finding the sole source of judge-jury disagreement; in the remaining two thirds of the cases the sources of disagreement are to be seen fully only by looking beyond the official role of the jury. . . . [Rather] in exactly 45 percent of the cases, the jury in disagreeing with the judge is neither simply deciding a question of fact nor simply yielding to a sentiment or a value; it is doing both.

Id. at 116. Although this is the single reason for judge and jury disagreement only 22% of the time, that finding is true of all reasons, indicating that there are often multiple factors involved in the jury determination. *Id.* at 113. This was true of all factors, however, and by assigning weights to the major categories, Professors Kalven and Zeisel were able to conclude that "[a]part from evidence factors, the explanation for disagreements resides principally in jury sentiments on the law or jury sentiments about the defendant." *Id.* at 115.

n344. *Id.* at 58-59.

n345. *Id.*

n346. *Id.* at 63-64.

n347. This figure should be contrasted with the 78% agreement rate for criminal trials. *See supra* note 344 and accompanying text.

n348. H. KALVEN & H. ZEISEL, *supra* note 24, at 73.

n349. *Id.*

n350. *See supra* notes 213-18 and accompanying text.

n351. A judge and a jury require a different threshold for the amount of evidence needed to meet the burden of proof, due to a difference between the judge's and the jury's "normative or value judgment." H. KALVEN & H. ZEISEL, *supra* note 24, at 189. "The jury may find the evidence as credible as does the judge and may weigh it the same as the judge, and yet may disagree and find the evidence wanting because in its view it falls below the required threshold." *Id.* at 166.

n352. *Id.*

n353. *Hearing on H.R. 559 Before the Subcomm. on Telecommunications, Consumer Protection, and Finance of the House Comm. on Energy and Commerce, 98th Cong., 1st Sess. 95 (1983) (The standard of proof for actions brought under Section 10(b) of the 1934 Act is a preponderance of the evidence.). See Steadman v. SEC, 450 U.S. 91, 92-93 (1981) (The SEC must demonstrate merely a preponderance of the evidence, rather than clear and convincing evidence.).*

n354. *See supra* notes 7 & 260 and accompanying text. Certainly, insider trading violations do not outrage community mores the same way that, for example, sexual crimes against children do. Moreover, sexual crimes against children were one of the few instances in which the Kalven/Zeisel study found that the jury was stricter in assessing guilt than the judge would have been. *See supra* note 340 and accompanying text.

n355. H. KALVEN & H. ZEISEL, *supra* note 24, at 86-87.

n356. The jury may be influential even though a case is pled or settled. Decisions about whether to request a jury, indeed, whether to go to trial at all, are informed by expectations of what the jury will do. *Id.* at 33-34.

n357. Insider trading cases "often bristle with questions of material fact," making them appropriate for jury determination. Jacobs, *Procedural Matters in Actions Brought Under Rule 10b-5*, 27 *N.Y.U. L. REV.* 361, 401 (1981).

n358. H. KALVEN & H. ZEISEL, *supra* note 24, at 287. "[S]ince almost everybody is doing it, it seems a violation of the principle of evenhanded justice to single out this particular defendant for prosecution." *Id.* Admittedly, it may be an overstatement with regard to insider trading to claim that "almost everybody is doing it" since it requires at least access to information and trading and, hence, financial status above the threshold of poverty. Nonetheless, as these cases increasingly come into court and the population is increasingly exposed to such cases through news reporting, it is likely that the jury will perceive this offense as widespread. Certainly that is the perception of the SEC. *See* Remarks of Ruder, *supra* note 7 and accompanying text.

n359. *Id.* at 291.

n360. The jury evolved historically as the fact-finding arm of the court at common law. *Green, supra* note 20, at 157.

n361. *See supra* notes 341-43 and accompanying text.

n362. "The power to nullify or at least the choice to nullify is the jury's essential power." P. DIPERNA, *supra* note 334, at 196.

n363. H. KALVEN & H. ZEISEL, *supra* note 24, at 289-91.

n364. *Id.* at 290.

n365. "The historic role of the jury as a bulwark against grave official tyranny is at best only dimly evident in its contemporary role as a moderate corrective against undue prosecutions for gambling, game, and liquor violations and, to some extent, drunken driving." *Id.* at 296.

n366. Professors Kalven and Zeisel point out that there is no current crime in which the jury is at war with the law, so as to cause widespread jury nullification, such as occurred during Prohibition and during the colonial period for the crime of seditious libel. H. KALVEN & H. ZEISEL, *supra* note 24, at 76.

n367. *Id.* at 289-90.

n368. The problem of uneven prosecution may be exacerbated by the recent passage by Congress of new insider trading legislation. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (1988) (to be codified at scattered sections of 15 U.S.C.). This legislation provides the SEC with authority to award informants a bounty of up to 10% of any civil penalties later imposed. *Id.* at § 3(a), 15 U.S.C. § 21A(2)(e). This legislation will enhance the already great incentives to turn in one's trading partners at the first hint of an SEC investigation. *See infra* note 371 and accompanying text.

n369. The concern for appropriateness of the punishment is what Kalven and Zeisel term a concern for "preferential treatment." H. KALVEN & H. ZEISEL, *supra* note 24, at 313.

n370. *Id.*

n371. SEC v. Kidder Peabody, Civil Action No. 3869 (RO) (S.D.N.Y. filed June 4, 1987), Litigation Release No. 11452 (Investment bank alleged to have traded in securities while in possession of material nonpublic information, and alleged to have parked securities for entities controlled by Ivan Boesky, consented to a permanent injunction, without admission or denial of allegations, disgorgement of \$13,676,101, and an ITSA civil penalty \$11,618,674.); SEC v. Boesky, No. 86 Civ. 8767 (S.D.N.Y. filed Nov. 14, 1986), Litigation Release No. 11288 (Arbitrageur charged with violating Sections 10(b) and 14(e) of the 1934 Act and Rules 10b-5 and 14e-3 by trading in material nonpublic information obtained in exchange for \$2.4 million, consented to a permanent injunction, disgorgement of \$50 million, and an ITSA civil penalty \$50 million.); SEC v. Sokolow, No. 86 Civ. 5193 (S.D.N.Y. filed July 1, 1986) (Vice president of investment banking firm charged with leaking material nonpublic information regarding its clients to Dennis Levine in return for \$120,000, consented to a permanent injunction, disgorgement of \$120,000,

and an ITSA civil penalty of \$90,000.); SEC v. Wilkis, No. 86 Civ. 5182 (S.D.N.Y. filed July 1, 1986), Litigation Release No. 11605 (Former investment banker with Lazard Freres & Co., and later vice president of mergers and acquisitions at E.F. Hutton & Co., charged with trading on information either misappropriated from his employers or received from Dennis Levine, consented to a permanent injunction, disgorgement of \$3 million, and an ITSA civil penalty of \$300,000.); SEC v. Levine, No. 86 Civ. 3726 (RO) (S.D.N.Y. filed May 12, 1986), Litigation Release No. 11605 (A Drexel Burnham Lambert, Inc. director who was charged with insider trading consented to a permanent injunction and a disgorgement of \$11.6 million of the more than \$12.6 million profit he had made from his transactions, and his accountant was ordered to disgorge illegal profits and pay an ITSA civil penalty.).

n372. One cannot help but speculate what verdict a jury would have come to had it decided the fate of Ilan Reich, a young partner in a New York law firm who apparently made no profits on the tips he was alleged to have given the investment banker, Dennis Levine. SEC v. Ilan K. Reich, No. 86 Civ. 7775 (S.D.N.Y. filed Oct. 9, 1986), Litigation Release No. 11246 (entering consent decree for permanent injunction and ITSA fine of \$485,000). See 8 American Lawyer 1(7) (December 1986). Reich was sentenced to one year and one day, although his co-defendants were sentenced to comparatively lighter sentences. *United States v. Reich*, 661 F. Supp. 371, 372 (S.D.N.Y. 1987). Reich later moved to reduce his sentence, but his motion was denied. *Id.*

n373. H. KALVEN & H. ZEISEL, *supra* note 24, at 313.

n374. *Id.* at 316.

n375. Although this assertion makes intuitive sense, the Kalven/Zeisel study was unable to corroborate the hypothesis with empirical data. *Id.* at 311 & n.8.

n376. See *supra* notes 61–64 and accompanying text.

n377. H. KALVEN & H. ZEISEL, *supra* note 24, at 293–95.

n378. *Id.* at 293.

n379. *Id.* at 310–12.

n380. *Id.* at 310 & n.6.

n381. *Id.* at 310–11.

n382. *Id.*

n383. The possibility of having a jury trial affects even the vast majority of cases that settle. See *Green, supra* note 20, at 158. The "mythical jury" enters the calculus because the "strengths and weaknesses of the case are tested against the presumed reactions of the mythical jury . . . in the venue of the case." *Id.*

n384. For a discussion of the dangers that the unremitting growth in the SEC's power poses, see H. KRIPKE, *supra* note 2, at 37–58.

n385. For a discussion of this institutional problem, see Wolfson, *supra* note 9, at 120–34.

n386. See *supra* note 370 and accompanying text.

n387. Professor Green quoted **Judge Ulman** as remarking, "[I]t is a social safety-valve which helps to keep the engine of the legal machine from blowing up." *Green, supra* note 20, at 165 (quoting J. ULMAN, **A JUDGE TAKES THE STAND** 34 (1933)).