University of Pennsylvania Law School
Penn Law: Legal Scholarship Repository

Faculty Scholarship at Penn Law

2018

Constructive Ambiguity and Judicial Development of Insider Trading

Jill E. Fisch
University of Pennsylvania Law School

Follow this and additional works at: https://scholarship.law.upenn.edu/faculty_scholarship

Part of the Business Law, Public Responsibility, and Ethics Commons, Courts Commons, Law and Economics Commons, Legal History Commons, Public Law and Legal Theory Commons, Securities Law Commons, and the Supreme Court of the United States Commons

Repository Citation
Fisch, Jill E., "Constructive Ambiguity and Judicial Development of Insider Trading" (2018). *Faculty Scholarship at Penn Law*. 2028.
https://scholarship.law.upenn.edu/faculty_scholarship/2028

This Article is brought to you for free and open access by Penn Law: Legal Scholarship Repository. It has been accepted for inclusion in Faculty Scholarship at Penn Law by an authorized administrator of Penn Law: Legal Scholarship Repository. For more information, please contact PennlawIR@law.upenn.edu.

Constructive Ambiguity and Judicial Development of Insider Trading

*Jill E. Fisch**

ABSTRACT

The Texas Gulf Sulphur *decision began what has become a fifty-year project of developing U.S. insider trading regulation through judicial law-making. During the course of that project, the courts developed a complex, fraud-based approach to determining the scope of liability. The approach has led, in many cases, to doctrinal uncertainty, a result that is reflected in the recent decisions in* Newman*,* Salman*, and* Martoma*.*

In the face of this uncertainty, many commentators have called for a legislative solution. This article argues, however, that the true challenge of insider trading regulation is a lack of consensus about the appropriate scope of the prohibition. On the one hand, insider trading regulation seeks to address the potential unfairness resulting from wealth and privileged access. On the other hand, it seeks to preserve sufficient incentives for research to promote market efficiency.

In the face of these competing policy concerns, a legislative definition is likely to be both under- and over-inclusive. Judicial lawmaking may offer a superior alternative because it, unlike legislation, can employ constructive ambiguity—deliberately vague standards that require contextual analysis. By enabling policymakers to maintain ambiguity about the permissible limits on the acquisition and use of market-sensitive information, judicial lawmaking helps to balance the competing concerns that animate the debate over insider trading.

TABLE OF CONTENTS

I. INTRODUCTION 750
II. JUDICIAL DEVELOPMENT OF THE LAW OF INSIDER TRADING 752
III. JUDICIAL LAWMAKING 757
IV. THE WAY FORWARD FOR INSIDER TRADING 761
V. CONCLUSION 766

* Perry Golkin Professor of Law, University of Pennsylvania Law School. I am grateful to Joan Heminway, Don Langevoort, Donna Nagy, and Frank Partnoy for helpful comments on an earlier draft.

I. INTRODUCTION

THIS symposium celebrates the fiftieth anniversary of the decision by the Second Circuit Court of Appeals in *SEC v. Texas Gulf Sulphur* (hereinafter referred to as *TGS*).[1] *TGS* was remarkable in that it was the first federal appellate court decision to accept the SEC's theory that insider trading constituted federal securities fraud.[2] *TGS* also started the courts on the fifty-year project of defining the scope of the insider trading prohibition—deciding what conduct is legal and what is not—with relatively limited input from Congress.[3] The federal law of insider trading is one of the most prominent examples of judicial lawmaking.[4]

I have written elsewhere that judicial lawmaking can be advantageous in several ways.[5] It provides flexibility, which is particularly important in the context of insider trading, since the methodologies by which those with privileged access can exploit informational advantages continue to evolve over time.[6] Many of the core components of today's insider trading—hedge funds,[7] expert networks,[8] and high tech tools for conveying information such as burner phones and self-destroying messages[9]—did not exist at the time of the *TGS* decision. Judicial lawmaking is also incre-

1. *See generally* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (en banc).

2. *See, e.g.*, Andrew Verstein, *Insider Trading in Commodities Markets*, 102 VA. L. REV. 447, 458–59 (2016) (observing that *TGS* was "the first federal court decision to address insider trading of securities under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5"); Roberta Karmel, *Outsider Trading on Confidential Information–a Breach in Search of a Duty*, 20 CARDOZO L. REV. 83, 88 (1998) (terming *TGS* "[T]he first major court case affirming the use of Rule 10b-5 in actions against those who trade on undisclosed, material corporate information").

3. *Cf.* Jill E. Fisch, *Federal Securities Fraud Litigation as a Lawmaking Partnership*, 93 WASH U. 453, 455 (2015) (explaining the respective contributions of Congress and the SEC to this project and terming the resulting collaboration a "lawmaking partnership").

4. *See, e.g.*, *id.* at 476–77 (explaining that the courts moved first to accept the premise that insider trading constituted federal securities fraud and to develop a theory as to why insider trading was fraudulent).

5. *See id.* at 454. For a more detailed analysis of the literature defending a common law approach to lawmaking, see Frank Partnoy, *Synthetic Common Law*, 53 KAN. L. REV. 281, 291–97 (2005).

6. *See* Fisch, *supra* note 3 at 484–85.

7. *See, e.g.*, Transcript of Oral Argument at 6, Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398 (2014) (No. 13-317) (describing emergence of new types of traders, including "hedge fund rapid-fire volatility traders, index fund investors, [and] sophisticated value investors").

8. *See, e.g.*, Andrew Ross Sorkin, *Knowledge Is Money, but the Peril Is Obvious*, N. Y. TIMES: DEALBOOK (Nov. 26, 2012), https://dealbook.nytimes.com/2012/11/26/knowledge-is-money-but-the-peril-is-obvious/ [https://perma.cc/4S4M-F8FS] (explaining the expert network business model).

9. *See, e.g.*, Kara Scannell, *Insider Trading Schemes Using Encrypted Apps Alarm FBI*, FIN. TIMES (Aug. 20, 2017), https://www.ft.com/content/7fad3fca-8438-11e7-94e2-c5b903247afd [https://perma.cc/8ZZD-HD9C] (reporting about insider trading case in which the defendant "used a phone messaging app to pass encrypted, self-destructing messages to three friends about confidential corporate takeovers").

mental and context specific.[10] In identifying the problems associated with a specific transaction, decisional law does not have to consider the challenges of extending the line to circumstances not before the court. Finally, judicial lawmaking may be less vulnerable to the political pressures faced by Congress and the SEC.[11]

On the other hand, judicial lawmaking has its weaknesses.[12] It can create uncertainty, relative to a statute or rule, about exactly what conduct is prohibited.[13] In turn, uncertainty can increase prosecutorial discretion. Judicial lawmaking can also stretch the limits of institutional competence with respect to issues like the impact of a particular rule on market efficiency.[14] Finally, and perhaps most important, judicial lawmaking reduces accountability.

A series of recent cases—*Newman*,[15] *Salman*,[16] and *Martoma*[17]—apply the Supreme Court's 1984 decision in *Dirks v. SEC*[18] to address the scope of liability associated with a tip of material nonpublic information. This "tipping trio" provides an example of the uncertainty associated with judge-made law.

One possible solution is for Congress to clarify the scope of insider trading liability through legislation, a solution many commentators have recommended.[19] A legislative fix is challenging, however, largely because of continued and widespread disagreement about the fundamental normative question—the appropriate breadth of the insider trading prohibition. The disagreement stems primarily from an ongoing disconnect between two themes that animate insider trading law. On the one hand,

---

10. *See* Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1076–78 (2000) (attributing similar advantages to judicial lawmaking with respect to Delaware corporate law).

11. *See, e.g.*, Andrew Ackerman & Aruna Viswanatha, *SEC Bickering Stalls Mary Jo White's Agenda*, WALL ST. J. (June 3, 2015, 9:55 PM), http://www.wsj.com/articles/sec-bickering-derailswhites-agenda-1433374702 [https://perma.cc/5JWH-X2C4] (describing politicization of SEC enforcement decisions).

12. *See, e.g.*, Partnoy, *supra* note 5 at 300–13 (identifying the limits to common law adjudication as a source of legal rules).

13. *See* Ben Protess & Matthew Goldstein, *Appeal Judges Hint at Doubts in Insider Case*, N.Y. TIMES: DEALBOOK (Apr. 22, 2014), https://dealbook.nytimes.com/2014/04/22/appeals-court-raises-doubts-about-governments-insider-trading-case/ [https://perma.cc/G2YL-79RQ] (citing concern expressed by Second Circuit Judge Barrington Parker during the oral argument in United States v. Newman, 773 F.3d 438 (2d Cir. 2014), that "an air of uncertainty hung over Wall Street without a 'bright line' to clarify what constituted illegal trading").

14. *See* Jeffrey A. Pojanowski, *Statutes in Common Law Courts*, 91 TEX. L. REV. 479, 504 (2013) (exploring how considerations of institutional competence may affect the courts' approach to statutory interpretation).

15. *Newman*, 773 F.3d at 442.

16. Salman v. United States, 137 S. Ct. 420, 429 (2016).

17. United States v. Martoma, 869 F.3d 58, 67 (2d Cir. 2017).

18. 463 U.S. 646 (1953).

19. *See, e.g.*, Robert Anello, *Letter on Insider Trading from a Confused Wall Streeter*, FORBES (Sept. 6, 2017), https://www.forbes.com/sites/insider/2017/09/06/letter-on-insider-trading-from-a-confused-wall-streeter/2/#4a6c13dd1c70 [https://perma.cc/2DQG-47UC] ("It is time for Congress to step up and straighten the insider trading mess out by passing clear legislation").

insider trading regulation has its origins in fraud and deception, which require a focus on the wrongfulness associated with acquiring or using information. On the other hand, public condemnation of insider trading appears largely rooted in perceptions about the unfairness of using privileged access to information for personal gain.

To the extent that commentators and policymakers continue to disagree as to the "right" scope of an insider trading prohibition, a deliberately ambiguous legal prohibition may be optimal. Here is where judicial lawmaking has the upper hand. Judge-made law can maintain greater ambiguity than legislation with respect to the potential scope of liability.[20] In the insider trading context, this enables the law to balance two key but conflicting policy concerns—perceptions about the potential unfairness resulting from informational advantages and preserving sufficient incentives for the acquisition and use of information to promote market efficiency.

II. JUDICIAL DEVELOPMENT OF THE LAW OF INSIDER TRADING

As the articles in this Issue highlight, *TGS* marked the beginning of the judicial process of developing U.S. insider trading law. It is important to recognize, however, that it was the SEC that first decided that trading on the basis of material nonpublic information should be illegal. In an administrative proceeding, *In re Cady, Roberts*, the SEC suspended a broker for executing discretionary trades in his customers' accounts on the basis of material nonpublic information.[21] As SEC Chairman Bill Cary explained, the case was "of first impression and one of signal importance in our administration of the federal securities acts."[22] Notably, neither the statute nor existing case law appeared to support a broad insider trading prohibition, leading one commentator to term the decision "a regulatory power-grab by the SEC."[23]

The *TGS* decision converted *Cady, Roberts* from a policy gamble to the law of the land.[24] *TGS* both accepted the SEC's broad parity of information view of insider trading[25] and accepted, for the courts, the responsibility of formulating the parameters for insider trading liability. The Supreme Court would not consider the question of whether insider trad-

---

20. Concededly, ambiguity is not limited to judicial lawmaking. Statutes can also be ambiguous, but various doctrines constrain the permissible scope of statutory ambiguity, such as the vagueness doctrine. *See, e.g.*, Mila Sohoni, *Notice and the New Deal*, 62 DUKE L.J. 1169, 1175–76 (2014) (explaining the vagueness doctrine and related limits on statutory ambiguity imposed by the Due Process Clause).

21. *In re* Cady, Roberts, 40 S.E.C. 907 (1961).

22. *Id.* at 1.

23. *See* Stephen M. Bainbridge, *Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud*, 52 SMU L. REV. 1589, 1595 (1999).

24. *See id.* at 1595 (explaining that "the Second Circuit vindicated and validated the Commission's action in [*TGS*]").

25. *See* Verstein, *supra* note 2 at 459 (stating that TGS "embraced an expansive theory of liability").

ing constituted federal securities fraud for a dozen years, and when it did, the Court cut back on the scope of liability articulated by the Second Circuit.[26] Nonetheless, in *Chiarella*, the Court agreed with the basic premise of *TGS*: that insider trading was, in appropriate circumstances, a violation of § 10(b).[27]

Subsequently, the law of insider trading was developed through a series of decisions in which the courts responded to SEC enforcement decisions by formulating appropriate policy guidelines to structure the scope of liability. Thus, for example, in *Dirks*, the Supreme Court explained that the personal benefit test was required to determine when a tippee was prohibited from using material nonpublic information. As the Court explained, "Imposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market."[28] Similarly in *O'Hagan*, the Court accepted the misappropriation theory of insider trading liability, finding it was "tuned to an animating purpose of the Exchange Act: to insure honest securities markets and thereby promote investor confidence."[29]

To be fair, the courts were not the exclusive source of insider trading law. Congress weighed in from time to time,[30] primarily by making minor adjustments to insider trading law while also confirming the parameters of the liability theories developed by the courts.[31] Importantly, Congress repeatedly declined to displace the judicial role by adopting a statute defining insider trading.[32] The SEC also played a role both through the en-

---

26. United States v. Chiarella, 445 U.S. 222, 229 (1980).

27. *See id.* at 230 ("[S]ilence in connection with the purchase or sale of securities may operate as a fraud actionable under § 10(b) despite the absence of statutory language or legislative history specifically addressing the legality of nondisclosure").

28. Dirks v. SEC, 463 U.S. 646, 658 (1953).

29. United States v. O'Hagan, 521 U.S. 642, 658 (1997).

30. Congress also included a prohibition on short swing trading in the original Securities Exchange Act of 1934 that arguably addresses insider trading directly, § 16(b). Securities Exchange Act of 1934, ch. 404, § 16(b), 48 Stat. 881, 896 (codified at 15 U.S.C. 78p(b) (2012)). Some commentators view § 16(b) as an important congressional restriction on insider trading. *See, e.g.*, Merritt Fox, *Insider Trading Deterrence Versus Managerial Incentives: A Unified Theory of Section 16(b)*, 92 MICH. L. REV. 2088, 2091–92 (1994) (arguing that Section 16(b) "probably plays a larger day-to-day role in constraining the behavior of America's corporate executives than Rule 10b-5's headline-grabbing, judge-made strictures against insider trading"). *But see* Steve Thel, *The Genius of Section 16: Regulating the Management of Publicly Held Companies*, 42 HASTINGS L.J. 391, 399 (1991) (arguing that the primary purpose of § 16(b) is not to regulate insider trading, but to deter insiders "from manipulating corporate affairs to create corporate opportunities to trade corporate stock profitably").

31. *See, e.g.*, Steve Thel, *Statutory Findings and Insider Trading Regulation*, 50 VAND. L. REV. 1091 (1997) (arguing that congressional findings made in connection with the Insider Trading and Securities Fraud Enforcement Act of 1988 can be read as an endorsement of the misappropriation theory).

32. *See* Fisch, *supra* note 3 at 478–79 (noting congressional opportunities and failures to define insider trading through legislation).

forcement theories that it pursued in the courts[33] and through formal rulemaking.[34] Again, the SEC's efforts did not displace the role of the courts; rather, the courts rejected enforcement efforts that, in their views, reflected excessive "enforcement zeal."[35]

The recent trio of cases involving the scope of tippee liability, *Newman, Salman,* and *Martoma*, did not deviate from this approach. All three cases sought addressed the appropriate application of the *Dirks* personal benefit test—which is the requirement that a tipper receive a personal benefit for his or her tip of material nonpublic information to constitute a breach of fiduciary duty—to varying factual contexts. In *Newman*, the context was that of remote tippees. The defendants, Newman and Chiasson, were third and fourth degree tippees who made millions of dollars trading the stock of Dell and NVIDIA. The information on which they traded came from corporate insiders and was relayed through two separate tipping chains consisting of various Wall Street analysts. Significantly, the *Newman* court found that neither of the corporate insiders tipped for direct monetary gain and that the "evidence established that NVIDIA and Dell's investor relations personnel routinely 'leaked' earnings data in advance of quarterly earnings."[36] Under these circumstances, the court concluded that the government had failed to meet its burden of establishing either that the information was leaked through a breach of fiduciary duty or that the defendants knew or reasonably could have known of the existence of such a breach.

Arguably *Newman* was a hard case because of the challenge of addressing the limits of information use in the complex world of today's hedge funds.[37] The Second Circuit's decision that the government had overreached generated extensive criticism.[38] *Salman* presented a far less novel set of facts.[39] A Citigroup insider, Maher Kara, provided material nonpublic information to his brother, Michael, with whom he enjoyed a close relationship. Michael provided the information to Salman, his close friend

33. *See, e.g.*, Harvey L. Pitt & Karen L. Shapiro, *Securities Regulation by Enforcement: A Look Ahead at the Next Decade*, 7 YALE J. ON REG. 149, 155–56 (1990) (critically describing this approach as "regulation by enforcement").

34. *See* Fisch, *supra* note 3 at 481–82 (describing SEC rule making addressed to insider trading).

35. *Id.* at 482.

36. United States v. Newman, 773 F.3d 438, 454–55 (2014).

37. *See, e.g.*, Roger Parloff, *The Gray Art of Not Quite Insider Trading*, FORTUNE (Aug. 15, 2013), http://fortune.com/2013/08/15/the-gray-art-of-not-quite-insider-trading/ [https://perma.cc/T4BM-AAZK] (describing "the layers of gray that wash over the world in which hedge fund portfolio managers and stock analysts operate").

38. The critical commentary is too extensive to list. For an example, see Matt Turner, *Sheriff of Wall Street: We're No Longer Able to Bring Certain Insider Trading Cases*, BUS. INSIDER (Jan. 17, 2016), http://www.businessinsider.com/preet-bharara-on-newman-case-2016-1 [https://perma.cc/MZ3A-EPKK] (describing Southern District U.S. Attorney Preet Bharara's criticisms of the *Newman* decision).

39. Salman v. United States, 137 S. Ct. 420, 423–24 (2016).

and Maher's brother-in-law.[40] As I have shown elsewhere,[41] insider trading has long recognized that a tip from a corporate insider to a family member qualifies as a breach of fiduciary duty under the *Dirks* test, and this result was sufficient to uphold Salman's conviction.[42]

Despite the difference in factual context between *Newman*, which involved tipping from corporate insiders to security analysts, and *Salman*, which involved tipping between family members,[43] Judge Rakoff, sitting by designation on the Ninth Circuit Court of Appeals,[44] went out of his way to address *Newman* in the *Salman* opinion. First, Judge Rakoff broadly read *Newman* to require that the government prove that the tipper received a "tangible benefit" in order to establish liability in all circumstances.[45] He then stated, "To the extent *Newman* can be read to go so far, we decline to follow it."[46] The Supreme Court affirmed Salman's conviction, explaining that *Dirks* "easily resolves the narrow issue presented here."[47] The opinion included a sentence, however, addressing Judge Rakoff's treatment of *Newman* and agreeing that his broad reading of *Newman*'s holding was inconsistent with *Dirks*.[48]

This sentence, in turn, led to further mischief. Matthew Martoma was criminally convicted of insider trading based on his use of non-public information he received about FDA drug trial results from Dr. Stuart Gilman. Dr. Gilman tipped Martoma for pay; he participated in approximately forty-three consultations with Martoma for which he received consulting fees of $1000 per hour.[49] Thus, as in *Salman*, *Martoma* was an

40. *Id.* at 423–24.

41. *See, e.g.*, Jill E. Fisch, *Family Ties: Salman and the Scope of Insider Trading Liability*, 69 STAN. L. REV. ONLINE 46, 54 (2016) ("The complexity of regulating insider trading appropriately in this market environment should not be confused with an easy case like *Salman*").

42. *See Salman*, 137 S. Ct. at 429 ("[T]his case involves 'precisely the "gift of confidential information to a trading relative" that *Dirks* envisioned'") (internal citations omitted).

43. *See* Miriam Baer, *Insider Trading's Legality Problem*, 127 YALE L.J. F. 129, 140 (2017) ("*Salman* depicted a contrasting set of facts [from *Newman*]").

44. Ironically, by writing the opinion in *Salman*, Judge Rakoff was able to create a "one-man circuit split." Had Rakoff been sitting in his regular courtroom in the Southern District of New York, he would have been obligated to follow the *Newman* decision. *See* Pete Brush, *How Jed Rakoff, One-Man Circuit Split, Saved Bharara's Bacon*, LAW360 (Jan. 15, 2017) (terming the *Salman* opinion a "West Coast end-run around the Second Circuit's *Newman* insider trading decision.").

45. *See* United States v. Salman, 792 F.3d 1087, 1093 (2016).

46. *Id.*

47. *Salman*, 137 S. Ct. at 427.

48. "To the extent the Second Circuit held that the tipper must also receive something of a 'pecuniary or similarly valuable nature' in exchange for a gift to family or friends, *Newman*, 773 F. 3d, at 452, we agree with the Ninth Circuit that this requirement is inconsistent with *Dirks*." *Salman*, 137 S. Ct. at 428.

49. United States v. Martoma, 869 F.3d 58, 61 (2017). Martoma met with a second doctor, Dr. Joel Ross, whom he paid $1500 per hour. *Id.* at 62. *See also* James B. Stewart, *On Insider Trading, an Appeals Court Comes to Its Senses*, N.Y. TIMES (Sept. 14, 2017), https://www.nytimes.com/2017/09/14/business/insider-trading-court.html?_r=0 [https://perma.cc/8QEH-P4FC] (reporting that Dr. Gilman "earned hundreds of thousands of dollars in consulting fees from Mr. Martoma").

easy case under the *Dirks* test.[50] Accordingly, the Court of Appeals affirmed Martoma's conviction, finding that Martoma and Dr. Gilman had an "ongoing 'relationship of quid pro quo.'"[51] Nonetheless, the *Martoma* panel chose not only to address the *Newman* decision, but to overrule it,[52] despite the irregularity of one panel overruling rather than seeking to have the entire Circuit consider the matter through an en banc hearing.[53] Apart from the issue of whether Martoma's treatment of *Newman* was necessary, the *Martoma* court offered yet another interpretation of *Dirks*, one that finds a personal benefit even in the absence of a relationship between tipper and tippee.[54] The *Martoma* decision thus leaves the scope of tipping liability, even in the Second Circuit, in a state of confusion.

Reactions to these decisions have been mixed. As Donna Nagy explains, both courts and securities law scholars hold "divergent views" as to the appropriate scope of tippee liability.[55] Importantly, the scope of the disagreement is broader than ascertaining what the Supreme Court meant in *Dirks* with respect to the personal benefit test. Courts and scholars appear to vary as to whether they view the type of communications at issue in *Dirks* as "normal industry activity,"[56] or an unfair trading advantage available to those who have access to a privileged network.[57]

Importantly, although *Newman, Salman*, and *Martoma* address tippee liability, the scope of the personal benefit test has important implications for tipper liability as well. These implications are critical even though government prosecutions have not prioritized the corporate insiders who are the source of inside information. This was an issue that concerned the

50. *See, e.g.*, Stewart, *supra* note 49 (quoting John C. Coffee, Jr. describing *Martoma* as "one of the easiest insider-trading cases I've ever seen").

51. *Martoma*, 869 F.3d at 67.

52. *See id.* at 69 (concluding that *Newman*'s "'meaningfully close personal relationship' requirement is no longer good law").

53. *See id.* at 68 (acknowledging that "it would ordinarily be neither appropriate nor possible for [a panel] to reverse an existing Circuit precedent").

54. *See Martoma*, 869 F.3d at 81 (Pooler, J., dissenting) (explaining that "[t]he majority today articulates a rule that permits inference of a personal benefit whenever an insider makes a 'gift' of information to anyone"). *See also* Editorial, *The Second Circuit's Insider-Trading Feud*, WALL ST. J. (Sept. 17, 2017), https://www.wsj.com/articles/the-second-circuits-insider-trading-feud-1505677304?mg=prod/accounts-wsj [https://perma.cc/FX7P-XYVW] (explaining that "[a]las, the two judges misconstrued *Salman*").

55. *See* Donna Nagy, *Beyond* Dirks*: Gratuitous Tipping and Insider Trading*, 42 IOWA J. CORP. L. 1, 6 (2016).

56. Brief for Law Professors Stephen Bainbridge, M. Todd Henderson, and Jonathan Macey as Amici Curiae in Opposition to the United States of America's Petition for Rehearing or Rehearing En Banc at 1–2, United States v. Newman (2014), (No. 13-1837-cr(L)), 2015 WL 1064409.

57. *See, e.g.*, Sara Almousa, Comment, *Friends with Benefits? Clarifying the Role Relationships Play in Satisfying the Personal Benefit Requirement Under Tipper-Tippee Liability*, 23 GEO. MASON L. REV. 1251, 1265 (2016) (observing that "[b]etween 2009 and 2013, insider trading networks generated an estimated $928 million in illegal trading profits").

court in *Newman*[58] and that I have raised elsewhere.[59] A narrow reading of the personal benefit test increases the incentives for tippers to create vast information asymmetries that undermine market integrity.[60] As Jim Cox puts it, such a reading throws "the truly dirty culprit, the tipper, out with the bathwater."[61]

III. JUDICIAL LAWMAKING

Insider trading is an example of judicial lawmaking.[62] Concededly, the federal courts are not truly common law courts, and, in this case, they are making law in the guise of interpreting a federal statute—§ 10(b).[63] Nonetheless, because § 10(b) is an "open-textured statute," its interpretation requires the courts to engage in the more expansive interpretive exercise associated with common law adjudication.[64]

Judicial lawmaking offers several advantages over traditional legislation, particularly where, as here, the courts are making law through a partnership with Congress and the SEC. First, judicial lawmaking is flexible and incremental.[65] The courts can offer a definition or theory of insider trading that is specific to the facts of the case at bar without the need, at that time, to consider other hypothetical factual scenarios. This allows the courts to defer considerations about the breadth of its approach until they have the benefit of assessing the effect of their initial efforts. Evaluating the costs and benefits of a prospective rule without the

---

58. *See* United States v. Newman, 773 F.3d 438, 443 (2d Cir. 2014) (observing that, as of the date of the court's decision, neither Ray nor Choi had been charged with insider trading).

59. *See* Fisch, *supra* note 41, at 54 (observing that "corporate officials are in the best position to prevent these situations by avoiding the selective disclosures that give professional traders advantages over other investors").

60. Although the SEC adopted Regulation FD in an effort to limit those incentives, the SEC has been unsuccessful in its effort to enforce Regulation FD aggressively. *See, e.g.*, Jill Fisch, *Regulation FD: An Alternative Approach to Addressing Information Asymmetry*, in RESEARCH HANDBOOK ON INSIDER TRADING 121 (Stephen M. Bainbridge ed., 2013) (describing SEC's "cautious" approach to enforcement of Regulation FD following its defeat in *Siebel Systems*).

61. James D. Cox, *Giving Tippers a Pass: U.S. v. Newman*, CLS BLUE SKY BLOG (Jan. 27, 2015), http://clsbluesky.law.columbia.edu/2015/01/27/giving-tippers-a-pass-u-s-v-newman-3/ [https://perma.cc/87XA-WCG2].

62. *See, e.g.*, Thomas W. Merrill, *The Common Law Powers of Federal Courts,* 52 U. CHI. L. REV. 1, 21 (1985) (describing the lawmaking role of the federal courts).

63. Congressional delegation of lawmaking power to the courts through the use of an open-ended statute is not unique to the federal securities laws. *See* Cass R. Sunstein, *Interpreting Statutes in the Regulatory State*, 103 HARV. L. REV. 405, 421–22 (1989) (describing this phenomenon and citing the Sherman Act as an example of Congress "delegat[ing] power to make common law" to the courts).

64. *See, e.g.*, John F. Manning, *Chevron and Legislative History*, 82 GEO. WASH. L. REV. 1517, 1546–48 (2014).

65. In other contexts, judicial lawmaking has also been defended as efficient. *See, e.g.*, William M. Landes & Richard A. Posner, *Adjudication as a Private Good*, 8 J. LEGAL STUD. 235 (1979); George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65 (1977). The efficiency claims have been disputed. *See, e.g.*, Partnoy, *supra* note 5 at 293 n.45. Moreover, the claims about efficiency are grounded largely in the litigation incentives of private parties, and their applicability to enforcement litigation is less clear.

experience of seeing that rule applied is also challenging. The SEC has struggled with the task of trying to identify the effects of rules that contemplate policies with which the market has no experience.[66] Legislation can be sticky and difficult to adjust if it has unintended consequences, but incremental interpretive decisions are more easily refined.

The insider trading context is particularly appropriate for judicial lawmaking. Many commentators have observed that it is difficult to create a precise definition for insider trading. Indeed, the government articulated this rationale for judicial lawmaking in *TGS* itself. As SEC Assistant General Counsel Frank E. Kennamer, Jr. told Federal District Judge Dudley B. Bonsal during the *TGS* trial, it is "'nearly impossible . . . to define a rule fitting all situations' in which corporate insiders may or may not trade in their companies' stock."[67] The definitional challenge is the product of several factors—the continued evolution of the market, shifting norms about the appropriate legal and moral response to information disparities, and the ability of traders to develop new products, practices, and strategies. As an example, in *SEC v. Dorozhko*, the Second Circuit considered the extent to which someone who hacked into a computer system to obtain nonpublic information could be prosecuted for insider trading.[68] A statutory definition of insider trading promulgated when Congress adopted § 10(b) in 1934 would have been challenged to provide better guidance on this question than the existing statute.

A second advantage of judicial lawmaking is the insulation of federal judges, at least relative to the SEC and Congress, from political pressure. Members of Congress are prone to introducing legislation in response to high profile scandals. Financial regulation is complex, however, and a hastily drafted statute can have adverse effects on the capital markets and the economy. Government enforcement officials are subject to a range of political pressures stemming from both the public and Congress. On the one hand, these political pressures can cause prosecutors to fail in holding wrongdoers accountable, especially if those wrongdoers are high-level corporate officials.[69] On the other hand, they can lead regulators to pursue cases that produce headline-generating fines and penalties, but where the nature of the wrongdoing is ambiguous.[70] Such cases are particularly palatable when the defendants are frequently criticized as amoral and

66. *See, e.g.*, Jill E. Fisch, *Leave it to Delaware: Why Congress Should Stay Out of Corporate Governance*, 37 DEL. J. CORP. L. 731, 768 (2013) (criticizing the SEC for adopting a "mandatory one-size-fits-all rule" for proxy access despite its lack of experience with such a rule and the inability to predict its effects).

67. Richard Phalon, *S.E.C. Aide Says Insider Curb Is Varied from 'Case to Case'*, N. Y. TIMES June 22, 1966, at B63.

68. *See* SEC v. Dorozhko, 574 F.3d 42, 43–44 (2d Cir. 2009).

69. Jesse Eisinger has explored the reasons for this behavior extensively. *See* JESSE EISINGER, THE CHICKENSHIT CLUB: WHY THE JUSTICE DEPARTMENT FAILS TO PROSECUTE EXECUTIVES (Simon Schuster 2017).

70. *See, e.g.*, Urska Velikonja, *Reporting Agency Performance: Behind the SEC's Enforcement Statistics*, 101 CORNELL L. REV. 901 (2016) (identifying metrics used by agencies to report their enforcement efforts and the incentives for reporting high numbers of actions and high levels of fines imposed).

selfish. Hedge fund managers offer a prime example, as they are portrayed by corporate executives as predators who destroy corporate value and by the media who claim they make billions of dollars for "basically doing nothing."[71] Accordingly, political pressures might lead to a government enforcement policy that takes an expansive view of tippee liability in order to target wealthy hedge fund managers for insider trading.

Of course judicial lawmaking is not an effective constraint against all political pressure. In particular, judicial lawmaking is necessarily reactive. While courts can constrain instances of prosecutorial overreaching, they cannot readily expand the scope of liability in the absence of political will from the executive branch. The tipping cases illustrate this problem. Although the *Newman* court arguably responded to its perception that the SEC and the Department of Justice had pursued hedge funds too aggressively, it could not correct for enforcement shortfalls, such as the failure to prosecute the tippers who breach confidences to provide inside information.

In addition, the flip side of political insulation is the absence of accountability. Courts are simply less accountable for their policy judgments with respect to the appropriate scope of insider trading liability than Congress or the SEC.[72] This lack of accountability is particularly problematic when the courts cut back on the SEC's expansive enforcement efforts because, as Don Langevoort has observed, these efforts "tap into images of power, greed and hubris" and as such, generate substantial popular support.[73]

Highlighting the foregoing advantages to judicial lawmaking does not mean that it is a panacea. The biggest problem with using the courts to develop insider trading law is that the process increases uncertainty with respect to the legality of information gathering and trading activity. If the line between legitimate and illegitimate information-gathering efforts is unclear or shifts over time, law-abiding traders will be deterred from aggressive but legal research efforts for fear of liability exposure. As the Fortune letter-writer put it, ambiguous insider trading law risks leaving such traders "afraid that diligent review, analysis, and investigation on behalf of my clients will land me before the SEC or worse yet a defendant in a criminal case."[74]

---

71. *See* Mark Gongloff, *Piketty Is Right: These Wealthy Men Make Billions For Basically Doing Nothing*, HUFFINGTON POST (Dec. 6, 2017), https://www.huffingtonpost.com/2014/05/06/hedge-fund-managers-billions_n_5273307.html [https://perma.cc/KST3-B2VW].

72. In the context of insider trading, this lack of accountability is mitigated, in part, by the fact that Congress has repeatedly ratified and built upon the framework of insider trading regulation developed by the courts. *See* Fisch, *supra* note 3, at 479 (documenting legislative endorsements of the courts' insider trading liability regime).

73. Donald Langevoort, *Reading Cady, Roberts: The Ideology and Practice of Insider Trading Regulation*, 99 COLUM. L. REV. 1319, 1329 (1999).

74. Anello, *supra* note 19, at 1–2 (asking "[i]f federal judges struggle with drawing a line between proper and improper trading activity, how are those of us on Wall Street supposed to do so?").

The potential chilling effect of legal uncertainty is exacerbated in the context of insider trading for two reasons. First, insider trading is one of the few areas of securities law that is subject to extensive criminal as well as civil enforcement. Although the standard of proof is higher in a criminal case, the potential that a trader will go to jail for conduct that the government determines is illegal insider trading makes the potential cost of such trading higher than in cases in which the liability exposure is purely civil.[75] Toward that end, it is worth noting that the government has not confined itself to bringing criminal charges only after courts have confirmed the applicable legal theory in the civil context. *Chiarella*, *O'Hagan*, *Newman*, *Salman* and *Martoma* were all criminal cases. As the *Newman* court observed, "The Government has not cited, nor have we found, a single case in which tippees as remote as Newman and Chiasson have been held criminally liable for insider trading."[76]

Second, a flexible standard can have the effect of giving the government a tremendous amount of prosecutorial discretion.[77] It can also lead to biased enforcement efforts.[78] The high cost of taking the government to trial and the substantial stakes involved also put enormous pressure on insider trading defendants to settle.[79]

The chilling effect of legal uncertainty may be somewhat less problematic in the context of insider trading because the legal uncertainty arguably reduces the potential for opportunism by market participants.[80] If it is difficult to determine the precise behavior that will subject a trader to insider trading liability, it will be more difficult for a trader who would skirt the law to identify the precise limits on his or her behavior. For this

75. *See, e.g.*, Pitt & Shapiro, *supra* note 33, at 295 ("[W]hile defendants may not care excessively about the adverse publicity that normally accompanies a court order requiring them to obey the law, they normally do, and will, care about serving time in jail, or about paying substantial monetary fines").

76. United States v. Newman, 773 F.3d 438, 448 (2d Cir. 2014).

77. *See, e.g.*, Dave Michaels, *No Law Needed on Insider Trading, SEC Chief Says*, WALL ST. J. (Sept. 6, 2017), https://www.wsj.com/articles/no-law-needed-on-insider-trading-sec-chief-says-1504733816 [https://perma.cc/F2WB-JJCJ] (explaining that a system in which the courts determine the scope of permissible conduct "grants huge discretion to law enforcement").

78. *See* Joan Heminway, *Just Do It! Specific Rulemaking on Materiality Guidance in Insider Trading*, 72 LOUISIANA L. REV. 1000, 1010–11 (2012) (warning that "the vagueness of aspects of the legal standard for insider trading liability . . . when paired with the broad enforcement discretion available in the insider trading enforcement process, invites the introduction of enforcement biases").

79. The high cost of defending oneself against insider trading charges is illustrated by the example of Mark Cuban, who, although he ultimately prevailed against the SEC, paid more than $8 million in legal fees to do so. *See* Natalie Posgate & Mark Curriden, *Jury Finds No Proof Mark Cuban Engaged in Insider Trading*, DALLAS NEWS (Oct. 16, 2013), https://www.dallasnews.com/business/business/2013/10/16/jury-finds-no-proof-mark-cuban-engaged-in-insider-trading [https://perma.cc/4Q6R-T978].

80. *See, e.g.*, Ted Kamman & Rory T. Hood, *With the Spotlight on the Financial Crisis, Regulatory Loopholes and Hedge Funds, How should Hedge Funds Comply with the Insider Trading Laws?*, 2009 COLUM. BUS. L. REV. 357, 404 (2009) (identifying various loopholes in existing insider trading regulation but suggesting that hedge funds would be "ill-advised" to take advantage of them because of "the time and expense of defending themselves from an SEC investigation").

reason, some commentators have resisted a statutory definition on the theory that, defining the precise boundaries of liability would create "a roadmap for fraud."[81]

IV. THE WAY FORWARD FOR INSIDER TRADING

As noted above, the continued uncertainty about the scope of insider trading liability has repeatedly prompted commentators to call for legislation or the adoption of an SEC rule that would provide clarification.[82] The problem, however, is that the increased precision of a statute or rule would require policymakers to reach consensus on the appropriate scope of the prohibition. Such consensus has consistently proved difficult. Although most commentators agree that federal law should prohibit some trading on the basis of material nonpublic information, the appropriate scope of liability remains hotly contested.[83]

Consider, for example, the three bills introduced into Congress in 2015 in response to the *Newman* decision.[84] The broadest prohibition, outlined in the Reed–Menendez Bill, proposed to make it unlawful to trade "on the basis of material information that the person knows or has reason to know is not publicly available."[85] The bill thus incorporated a parity of information standard similar to that reflected in the *TGS* decision.[86] Some other jurisdictions take an analogous approach. The advantage of the standard is that it "alleviates any inconsistencies in determining whether one is in a fiduciary or similar relationship, whether one receives or intended to receive a personal benefit, and the motive behind the disclosure. A consistent application of the rule will result in prohibiting indi-

---

81. *See* Stuart J. Kaswell, *An Insider's View of the Insider Trading and Securities Fraud Enforcement Act of 1988*, 45 Bus. Law. 145, 150 (1989) (recounting concern by congressional lawmakers during the drafting of the Insider Trading and Securities Fraud Enforcement Act of 1988 that providing a statutory definition of insider trading "might be underinclusive and constitute what many have called a 'roadmap for fraud'").

82. *See, e.g.*, Carmen Germaine, *Rakoff Urges Securities Bar To Write Insider Trading Law*, Law360 (Mar. 1, 2017), https://www.law360.com/articles/897188/rakoff-urges-securities-bar-to-write-insider-trading-law [https://perma.cc/27E9-5YDJ] (quoting Judge Rakoff as stating "The United States, by failing to recognize, unlike most other developed countries, that a meaningful effective straightforward, simple ban on insider trading is best achieved through statute rather than judge made law, has created unnecessary uncertainty and difficulty in dealing with the problem of insider trading").

83. *See* Langevoort, *supra* note 73, at 1339 ("While there might be a fairly broad political consensus that there should be some sort of insider trading prohibition, there is no consensus whatsoever about where the line should be drawn on the specifics"); *cf.* Henry Manne, *Insider Trading: Hayek, Virtual Markets, and the Dog that Did Not Bark*, 31 Iowa J. Corp. L. 167, 183–85 (2005) (reviewing and updating his arguments in support of legalized insider trading).

84. For detailed descriptions of all three bills see Brett T. Atanasio, Comment, *"I'll Know It When I See It . . . I Think":* United States v. Newman *and Insider Trading Legislation*, 121 Penn St. L. Rev. 221, 238–50 (2016).

85. Stop Illegal Insider Trading Act, S. 702, 114th Cong., § 2 (2015) (inserting § 10(d)(1)(A)).

86. *See* Kenneth R. Davis, *The Equality Principle: How Title VII Can Save Insider Trading Laws*, 39 Cardozo L. Rev. 199, 202 (2017) (defending an equal access approach as based on an equality principle).

viduals from capitalizing on material, nonpublic information."[87]

The problem with a parity of information standard is that it imposes liability on anyone who is able to obtain an informational advantage, regardless of the manner in which the informational advantage was obtained.[88] Specifically, it discourages legitimate research.[89] Although reasonable minds may disagree about how to draw the line between legitimate and wrongful efforts to obtain an informational advantage, there is little question that investor research increases the efficiency of trading prices and improves the effectiveness of capital markets discipline.

The Himes Bill focused its ban on trading on the use of information that was obtained wrongfully.[90] This approach is similar to that advocated by many commentators. For example, Donna Nagy has proposed a "fraud on contemporaneous traders" theory that, without requiring a breach of fiduciary duty, would apply "when a person knowingly or recklessly uses wrongfully obtained material nonpublic information in connection with a securities transaction, or wrongfully communicates such information."[91]

Although the Himes bill can be understood as an attempt to define insider trading by codifying the wrongfulness standard, the challenge for this approach is delineating what kind of conduct is considered wrongful. As a Fortune magazine article observes, the analysis of wrongfulness is both context-specific and can evolve over time.[92] As a result, the Himes Bill may not significantly reduce the ambiguity inherent in the existing judge-made standard. Of course, legislation could add precision to the concept of wrongfulness. Nagy suggests one way to do so by observing that the SEC's adoption of Regulation FD,[93] by prohibiting selective disclosure of material nonpublic information by corporations and corporate officials, makes a hedge fund's acquisition of information in violation of Reg FD wrongful, even in the absence of a personal benefit to the tipper.[94]

The Lynch Bill sought to offer more precision by defining as "inside" information, information that is (1) "nonpublic and obtained 'illegally'"; (2) from an issuer with an "expectation of confidentiality" or for use only for legitimate business purposes; or (3) "in violation of a fiduciary

87. Laura Palk, *Ignorance is Bliss: Should Lack of Personal Benefit Knowledge Immunize Insider Trading?*, 13 BERKELEY BUS. L.J. 101, 147 (2016).

88. A parity of information standard would also significantly extend the scope of the prohibition beyond existing law. As Mercer Bullard has explained, for example, the government routinely allows the sale of material nonpublic information, a policy that appears to be based on "a conscious decision to permit insider trading on nonpublic information that is available in a free market, while prosecuting insider trading on nonpublic information that is not." Mercer Bullard, *Insider Trading in a Mannean Marketplace*, 88 TEMP. L. REV. 223, 262 (2016).

89. *See* Parloff, *supra* note 37.

90. Insider Trading Prohibition Act, H.R. 1625, 114th Cong., § 16A(a) (2015).

91. Nagy, *supra* note 55, at 57.

92. Parloff, *supra* note 37, at 6–12.

93. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,738–39 (Aug. 24, 2000) (codified as 17 C.F.R. 243.100–.103).

94. Nagy, *supra* note 55, at 41.

duty."[95] The challenge for these definitions is twofold. First, to the extent that the existence and violation of a fiduciary duty has proven to be a difficult concept to apply, especially in the tipping cases, the Lynch Bill fails to remedy that problem, again, retaining to some extent the ambiguity of existing law. Second, the Bill does not appear to reach actions that many commentators would view as clearly wrongful, such as Martoma's payments to Dr. Gilman for confidential information about FDA drug trial results.

It is also important to recognize that part of the challenge in defining insider trading is an ongoing disconnect between its origins in fraud and deception[96] and the moral overtones that appear to motivate both government enforcement actions and public condemnation. Specifically, as Donald Langevoort has observed, "[O]ur intuitive understanding of what insider trading is . . . reflects the belief that insider trading is a manifestation of greed on the part of the privileged."[97] Langevoort's insight may explain the government's preference for pursuing insider trading prosecutions against wealthy hedge funds that trade on insider information rather than the sources of that information. Yet, as John Anderson explains, moral and ethical principles do not supply clear guidance about the extent to which parties to a commercial transaction can take advantage of information asymmetries.[98]

At the same time, courts and commentators, dating back to the *Dirks* Court, have recognized the competing policy considerations that limit the practicality of banning all trading on the basis of an information advantage. The capital markets create high-powered incentives to encourage market participants to seek out information and to incorporate that information into their trading decisions. Informed trading increases price efficiency and market discipline. Price efficiency increases the efficiency of capital allocation. The resulting feedback loop and its effects on firm performance produces societal value that extends beyond the capital markets.[99]

In light of the absence of consensus on the appropriate scope of insider trading liability and the competing policy considerations that underlie the debate, a legislative definition is likely to be both under- and over-inclusive. Responding to an audience question at a New York forum asking

95. Ban Insider Trading Act of 2015, H.R. 1173, 114th Cong., § 2(a) (2015); H.R. 1625 § 2.

96. *See* Donald C. Langevoort, *"Fine Distinctions" in the Contemporary Law of Insider Trading*, 2013 COLUM. BUS. L. REV. 429, 440 (2013) (explaining that insider trading "is not really fraud").

97. *Id.* at 439–40.

98. *See* JOHN ANDERSON, INSIDER TRADING: LAW, ETHICS AND REFORM (forthcoming 2018) (exploring ethical and moral constraints on the use of informational advantages).

99. *See, e.g.*, Andy Kessler, *Unicorns need IPOs*, WALL ST. J. (Jan. 7, 2018), https://www.wsj.com/articles/unicorns-need-ipos-1515361043 [https://perma.cc/8WRF-XLUY] (observing that "[t]he more companies are publicly traded, the more information quickly gets into the market [and that] [c]apitalism can't perform at its highest potential with large opaque companies").

whether Congress should adopt insider trading legislation, SEC Chairman Jay Clayton responded, "[S]ome places that have a code-based insider-trading regime, my sense is [that] it doesn't work any better and in fact it's probably not as effective as our regime."[100] Clayton's observation is grounded in an untouted advantage of using the courts to develop insider trading doctrine—the ability of judicial lawmaking to retain a level of deliberate, and I argue constructive, ambiguity.

This article argues that the judge-made law of insider trading derives part of its value from its ability to employ constructive ambiguity. The term, as used here, is based on Michal Shur-Ofry and Ofer Tur-Sinai's use of the concept in analyzing intellectual property licenses.[101] The idea of constructive ambiguity has its roots in contract law and refers to situations in which the parties to a contract deliberately choose vague, incomplete, or inconsistent contract provisions rather than more precise terms. As Shur-Ofry and Tur-Sinai explain, contract scholars generally view ambiguity as undesirable.[102] They explain, however, that ambiguous contracts offer the parties a number of advantages, including increased flexibility, adaptability, and lower transaction costs. In addition, ambiguity allows parties, in some cases, to "get the deal done" by allowing them to avoid addressing material issues on which they are unlikely to reach agreement.[103] Shur-Ofry and Tur-Sinai highlight the particular value of ambiguity in commercial contracts that involve "the unpredictability and opacity inherent in complex economic and social systems."[104] To support this claim, they cite the work of Nassim Nicholas Taleb, who uses the term "anti-fragility" to describe the ability to adapt to uncertainty and unpredictability.[105] Shur-Ofry and Tur-Sinai argue that anti-fragility is one advantage of ambiguous contracts.[106]

The deliberate choice to retain ambiguity in preference to precision can be a useful approach in areas other than contract law. Joe Grundfest and Adam Pritchard have observed that legislators may choose to adopt an ambiguous statute in order to maintain consensus or achieve a compro-

---

100. Dave Michaels, *No Law Needed on Insider Trading, SEC Chief Says*, WALL ST. J. (Sept. 6, 2017), https://www.wsj.com/articles/no-law-needed-on-insider-trading-sec-chief-says-1504733816?cx_= &cx_=&cx_artPos=0&cx_tag=collabctx&cx_navSource=News Reel#cxrecs_s [https://perma.cc/KTD2-2KQ3].

101. Michal Shur-Ofry & Ofer Tur-Sinai, *Constructive Ambiguity: IP Licenses as a Case Study*, 48 U. MICH. J.L. REFORM 391, 391 (2015). There is a body of work in contract law that addresses deliberate ambiguity and related concepts. *See id.* at 392 n.3 (citing literature). For an important related concept, see Gregory M. Duhl, *Conscious Ambiguity: Slaying Cerberus in the Interpretation of Contractual Inconsistencies*, 71 U. PITT. L. REV. 71, 72–79 (2009).

102. Shur-Ofry & Tur-Sinai, *supra* note 101, at 403.

103. *Id.* at 407. *Cf.* Duhl, *supra* note 101, at 77 (criticizing conscious ambiguity and arguing that "courts should discourage lawyers from drafting intentionally ambiguous contracts in the rush to get a deal done").

104. Shur-Ofry & Tur-Sinai, *supra* note 101, at 411–12.

105. *Id.* at 411; *see also* NASSIM NICHOLAS TALEB, ANTIFRAGILE: THINGS THAT GAIN FROM DISORDER 137 (Random House 2012).

106. Shur-Ofry & Tur-Sinai, *supra* note 101, at 412.

mise.[107] To the extent that Congress has consented to judicial development of insider trading law and failed to adopt a statutory definition that would make the scope of liability more precise, § 10(b) can be seen as the choice of legislative ambiguity within the framework described by Grundfest and Pritchard. This article argues that regardless of the contours of the statute, courts have had fifty years to refine the parameters of insider trading law since the *TGS* decision. Their failure to do so should be understood as deliberate ambiguity.

As in contract law, ambiguity with respect to insider trading has advantages and disadvantages. This article argues that the latent uncertainty associated with an ambiguous legal standard is, in the context of insider trading, advantageous. In particular, by enabling policymakers to maintain ambiguity about the permissible limits on the acquisition and use of market-sensitive information, judicial lawmaking is able to balance the competing concerns that animate the debate over insider trading in a way that a code-based approach could not. As shown by the examples of the 2015 bills, a legislative approach that attempted to define illegal insider trading with greater precision would, in light of the inherent tension in the animating policy considerations, be both under- and over-inclusive.[108]

By retaining ambiguity, courts are able to preserve the scope and flexibility of the insider trading ban. An ambiguous standard also furthers the objectives of the moral indignation that fuels enforcement efforts by discouraging market participants from structuring their conduct in ways that fall too close to the line, as it is more difficult to skirt the edges of a vague boundary between legal and illegal activity.[109] At the same time, an ambiguous approach enables the courts both to police enforcement overreaching and to adjust the liability standard to respond to evolving market practices.[110] In short, the ambiguity in the scope of insider trading liability that has persisted since the *TGS* case should be understood as constructive, and calls for legislative intervention should consider the benefits of uncertainty and its costs.

---

107. Joseph Grundfest & A.C. Pritchard, *Statutes with Multiple Personality Disorders: The Value of Ambiguity in Statutory Design and Interpretation*, 54 STAN. L. REV. 627, 628 (2002). Grundfest and Pritchard recognize that "judges also practice conscious ambiguity as part of the art of judging." *Id.* at 629.

108. This is not to argue against legislation as a way of choosing between competing claims about the appropriate structure and scope of insider trading regulation. I proposed this type of statutory fix more than twenty-five years ago. *See* Jill E. Fisch, *Start Making Sense: An Analysis and Proposal for Insider Trading Regulation*, 26 GA. L. REV. 179, 202 (1991) (proposing legislation that shifts enforcement from criminal to civil and places greater responsibility on tippers).

109. An ambiguous standard also reduces the potential for regulatory arbitrage. *See, e.g.*, Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227, 239 (2010) (explaining regulatory arbitrage as the ability to exploit "gaps between legal form and economic substance").

110. In addition, as I have noted elsewhere, because insider trading law reflects a lawmaking partnership between the courts, Congress, and the SEC, in which the courts have taken the lead, Congress can oversee the courts' judgments in this regard, and intervene if necessary. Fisch, *supra* note 3, at 453.

V. CONCLUSION

In the *TGS* decision, the federal courts accepted the role of developing U.S. insider trading policy. Recent insider trading decisions, in which courts have disagreed about the application of the judicially-developed principles, offer reasons to question whether judicial lawmaking was desirable and have caused commentators to renew their calls for clarifying legislation. A fundamental impediment to a legislative solution is the challenging normative question presented—determining the appropriate limits on the use of material nonpublic information in the public trading markets.

Judicial lawmaking offers a solution to the intractability of reaching consensus on a definition of insider trading by allowing insider trading law to retain a degree of deliberate ambiguity. This article suggests reasons why that ambiguity may, in the context of insider trading regulation, be constructive.