Printed in U.S.A.
Vol. 112, No. 4

INSIDER TAINTING: STRATEGIC TIPPING OF MATERIAL NONPUBLIC INFORMATION

Andrew Verstein

ABSTRACT—Insider trading law is meant to be a shield, protecting the market and investors from unscrupulous traders, but it can also be a sword. Insofar as we penalize trading on the basis of material, nonpublic information, it becomes possible to share information strategically in order to disable or constrain innocent investors. A hostile takeover can be averted, or a bidding war curtailed, because recipients of such information must then refrain from trading. This Article offers the first general account of "insider tainting," an increasingly pervasive phenomenon of weaponizing insider trading law.

AUTHOR—Associate Professor of Law, Wake Forest University School of Law; Visiting Associate Professor of Law, University of Chicago Law School. John Armour, Steven Bainbridge, Jack Coffee, Elizabeth de Fontenay, Jesse Fried, Zohar Goshen, Avery Katz, Donald Langevoort, Justin McCrary, Curtis Milhaupt, Joshua Mitts, Ed Morrison, Manesh Patel, Ariel Porat, Alex Raskolnikov, Gabriel Rauterberg, Roberta Romano, Eric Talley, and William Wang shared very helpful thoughts on drafts of this paper. The paper also benefited from conversations with Miriam Baer, Wulf Kaal, J. Mark Ramseyer, the participants at a September 2017 Columbia Law School faculty workshop, the Fifth Annual Workshop for Corporate and Securities Litigation, and the 2016 AALS Future of Insider Trading discussion group. Raymond Dunn provided helpful research assistance.

"The CEO prefaced the call by informing Cuban that he had confidential information to convey . . . . Cuban became very upset and angry during the conversation . . . . At the end of the call, Cuban told the CEO 'Well, now I'm screwed. I can't sell.'"[†]

A joke in the private fund space: The holders will know who each other are, who owns 2%. They'll say "Wise guys! Let's send this *[information] over to* them*!"*[‡]

INTRODUCTION

Across legal domains—from commodities to securities, contracts to property—we assume that everyone wants information. Yet, as Dallas Mavericks owner Mark Cuban discovered, knowledge can be a curse. American securities law prohibits trading on the basis of "inside information," such as an early tip about corporate strategy sure to presage a swing in the stock price.[1] Cuban became the subject of a nine-year-long SEC insider trading enforcement action because of one such tip. He sold his stake in Mamma.com soon after the CEO told him about a confidential

[†] Complaint ¶ 14, SEC v. Cuban, No. 3:08-CV-02050-D, 2008 WL 4901149 (N.D. Tex. Oct. 16, 2013).

[‡] Interview by Andrew Verstein with Anonymous Private Funds Attorney (Oct. 13, 2015).

[1] *See infra* Part II (describing just what sorts of information are, and are not, subject to restrictions, as well as what is meant by "on the basis of"). For more information on the various sorts of informed trading, see generally Merritt B. Fox et al., *The New Stock Market: Sense and Nonsense*, 65 DUKE L.J. 191 (2015).

plan to dilute the existing shareholders by issuing new shares. The sale may have saved Cuban $750,000.[2] But Cuban claimed that he had preexisting plans to sell his shares and that he did not need or want additional reasons to do so.[3] The CEO's tip put Cuban in a difficult position: either cancel the planned sale or endure almost a decade of costly and risky litigation.

From the CEO's perspective, discouraging Cuban's sale was not a bad thing. After all, Cuban was the company's largest shareholder with 6.3% of the stock.[4] A sale by such a major investor would have sent shock waves through the shares of the small company, frustrating the planned securities offering. Relatedly, Cuban's large stake might have been a sufficient toehold for an activist investor to agitate for change at Mamma.com. Cuban's sale of shares endangered the managers' plans and their jobs.

Thus the management of Mamma.com had several reasons to try to keep Cuban from selling shares, and the discussion of confidential stock offerings could have helped bind him in place. By tainting Cuban with inside information, the managers heaped risk into Cuban's exit path; more prudent investors would have relented and retained their shares.

The Mark Cuban case offers a glimpse into the secretive world of "insider tainting." Whereas most informational tips open doors, insider tainting closes doors. Rather than empowering and enriching the recipient, the tipper conveys information precisely in order to constrain the tippee. Tainted with inside information, the tippee faces legal risks to her preexisting or potential trading plans. By leveraging high-stakes public law to serve as a threat, insider tainting confers power over the trades of others.

It may seem surprising that tainting is possible. Criminal law is supposed to punish only the culpable, and even civil offenses in the securities world are supposed to require scienter (i.e., "intent to deceive, manipulate, or defraud"[5]). Moreover, familiar features of insider trading law would seem to protect innocent traders. It is usually lawful to trade on a hot tip unless you assumed a duty of trust and confidence or unless your source breaches such a duty by sharing the secret with you in order to secure a personal (often pecuniary) benefit.[6] Yet the victims of insider

---

[2] Complaint, *supra* note †, ¶ 24.

[3] Regardless of whether we believe Cuban's version of the story, we should believe in traders *like* Cuban. *See* Donald C. Langevoort, *"Fine Distinctions" in the Contemporary Law of Insider Trading*, 2013 COLUM. BUS. L. REV. 429, 445–46 (discussing a hypothetical based on the Mark Cuban case).

[4] Complaint, *supra* note †, ¶ 10.

[5] *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 (1976) (defining and requiring scienter in Rule 10b-5 actions); Morissette v. United States, 342 U.S. 246, 251 (1952) ("Crime, as a compound concept, [is] generally constituted only from concurrence of an evil-meaning mind with an evil-doing hand . . . .").

[6] *See infra* Part II.

tainting do not intend any wrongdoing, they do not promise confidentiality, and their antagonists act out of spite rather than to some kind of quid pro quo.

Nevertheless, insider tainting is viable. Some forms of insider trading are illegal even if the trader assumed no duty, conferred no benefit, and genuinely tried to avoid the tip.[7] More importantly, insider trading cases are characterized by expansive law and ambiguous facts, and so there are numerous circumstances where traders may rationally fear that trading could lead to trouble even when the law is on their side. Cuban escaped liability by proving that he never promised confidentiality, but it took nine years for him to establish his version of the facts, and he may only have succeeded because the accusing CEO refused to testify against him.[8] Even where a clear-sighted court would acquit, tainting forces a trader to worry that an aggressive plaintiff or prosecutor could pursue the case anyway.

Despite the secrecy associated with insider tainting, there is evidence that tainting occurs.[9] Tainting was deemed a serious enough problem that in 2014, Japan amended its securities laws to specifically account for tainting.[10] Securities attorneys report increasingly frequent questions from clients about the proper handling of a juicy text message, call, or email—sometimes anonymous and sometimes attributed to a competitor or issuer.[11] In a world in which law is increasingly part of investment strategy,[12] it should come as no surprise that tainting is part of the arsenal of sophisticated players.

This Article names, presents, and analyzes insider tainting for the first time.[13] It considers the contexts in which it can be deployed, techniques by which it can be achieved, and the responses the law can use to limit it. It

---

[7] Those privy to hostile takeover plans are generally forbidden from trading until the takeover begins—even if they did not ask for such knowledge or restrictions. *See* 17 C.F.R. § 240.14e-3 (2017); *see also infra* Section II.B. Providing certain traders with advance notice of a tender offer can place the targeted traders on the sidelines.

[8] Bradley J. Bondi, *How Cuban Scored a Home Court Win Against the SEC*, LAW360 (Nov. 14, 2013, 11:08 PM), https://www.law360.com/articles/488308/how-cuban-scored-a-home-court-win-against-the-sec [https://perma.cc/QR8Y-DGLK].

[9] *Cf.* Alon Brav et. al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1757 (2008) (describing hedge fund tipping as "secretive" and challenging to substantiate).

[10] *See infra* note 181 and accompanying text.

[11] Several suggestive examples appear *infra. See, e.g.*, *infra* note 131 and accompanying text (describing plight of fund manager Leon Cooperman).

[12] *See, e.g.*, Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 WASH. U. L. REV. 1551, 1567–72 (2015) (documenting the "renaissance" of hedge funds investing to make use of the stockholder's appraisal remedy).

[13] Despite the depth of scholarship on insider trading, the literature has not yet taken stock of insider tainting.

shows that tainting is problematic: sometimes it operates as an antitakeover defense, robbing shareholders of valuable payments and protecting ineffective managers from the risk of replacement.[14] In other cases, it helps with takeovers by giving an unfair advantage to unscrupulous takeover artists[15] and by facilitating circumvention of shareholder-protective disclosure requirements.[16] This Article identifies features of the law that help make tainting possible, such as the fact that traders can be convicted for *possessing* certain information even if they do not set out to *use* it, and it notes the many challenges to eliminating insider tainting.

This Article also uses insider tainting as an opportunity to reflect on the law of securities in our society and the economics and regulation of information generally. Insider tainting serves as a useful lens to reflect on the vagueness and expansiveness that we have come to accept in insider trading law[17] and the chilling effect our law's "fine distinctions" may have on risk averse traders.

Apart from securities trading, insider tainting also informs our understanding of private information in transactions generally and the unintended effects of its regulation. Scholars focused on contracts and insider trading have drawn on Anthony Kronman's notion that the law can require disclosure of casually acquired information without discouraging production of deliberately acquired information.[18] Insider tainting underscores the instability of these informational categories; insider trading law can lead some traders to deliberately avoid information.[19]

The structure of this Article is as follows. The first two Parts introduce the relevant facts and law. Part I discusses three contexts in which individuals might wish to disable the trades of another person—in which insider tainting could come in handy if it were available. Managers might like to block potential acquires, potential acquirers might like to stave off competitors, and cooperating acquirers might like to prevent unauthorized trades (purchases or sales) by members of their coalition. Readers who find those propositions intuitive may save time by proceeding directly to Part II, which reviews insider trading law. Readers familiar with this body of law may skip or skim this Part without losing any important information.

14 *See infra* Section III.C.1.

15 *See infra* Section III.C.2.

16 *See infra* Section III.C.3.

17 *See infra* Section IV.B.

18 *See generally* Anthony T. Kronman, *Mistake, Disclosure, Information, and the Law of Contracts*, 7 J. LEG. STUD. 1 (1978).

19 *See infra* Section IV.B.2.

Part III begins the main analytic contribution of the Article: it shows that individuals can indeed use insider trading law to disable trades unamicable to their interests. Part IV presents and evaluates potential responses to insider tainting and then reflects on what insider tainting teaches us about securities, corporate law, and information generally.

I. CONTROLLING ANOTHER'S TRADES

Sometimes it would be nice to be able to veto another person's trades. This Part describes three contexts in which that is true in order to set the stage for Part III, in which insider tainting is shown to be useful. All three examples in this section concern mergers and acquisitions (M&A).[20] The three examples are takeover defenses, competitive bidding, and wolf pack activism. To summarize briefly, managers would sometimes like to stop acquirers, acquirers would sometimes like to stop other acquirers, and cooperating investors would sometimes like to stop their compatriots from trading in ways incompatible with their collective plans.

A. Takeover Defenses

Mergers and acquisitions are among the most momentous events in the life of a corporation. They can generate and transfer billions of dollars.[21]

---

[20] This focus on M&A is in part out of respect for the scale of the problem. The stakes are so high in acquisitions as to tempt all manner of wrongful behavior. Indeed, that is why the SEC has implemented a special insider trading regime just localized in the context of acquisitions. *See infra* Section III.A.2. The focus on M&A is also justified for reasons of analytic focus and clarity—it is sometimes better to take a deep dive into one topic rather than canvass all topics on the first look; subsequent work can examine tainting in other contexts.

The focus on M&A should not be taken as a concession that these issues are limited to M&A. Indeed, both quotations at the start of this Article refer to non-M&A cases of possible insider tainting. The Mark Cuban quotation plausibly concerned efforts to protect the share price against Cuban's departure.

The second quotation concerned competition among market makers. Where only a few firms make a market in a security, it is a joke among financial professionals that one market maker might taint another in order to secure a temporary monopoly on the security. Disabling another trader could thus create an anticompetitive and cartelizing influence in trading markets, even where no one has any interest in acquiring control of portfolio companies.

[21] *E.g.*, Sydney Ember & Michael J. de la Merced, *Sinclair Unveils Tribune Deal, Raising Worries It Will Be Too Powerful*, N.Y. TIMES (May 8, 2017), https://www.nytimes.com/2017/05/08/business/media/sinclair-tribune-media-sale.html [https://perma.cc/8END-EN2D] (reporting a proposed $3.9 billion merger). There is widespread agreement that the target company shareholders usually gain substantially due to mergers. Gregor Andrade et al., *New Evidence and Perspectives on Mergers*, 15 J. ECON. PERSP. 103, 103 (2001); Gregg A. Jarrell et al., *The Market for Corporate Control: The Empirical Evidence Since 1980*, 2 J. ECON. PERSP. 49, 49, 51 (1988). The scale of these gains can be monumental: typical takeover premiums exceed 15–20%, instantly generating millions or billions in value. *See* Andrade et al., *supra*, at 110. Acquirers, for their part, sometimes do very well too. *See* Jarrell et al., *supra*, at 53. Takeover artists and serial acquirers, such as private equity firms, make enough money from the periodic purchase and sale of firms to keep themselves in comfort. *See* Vipal

One powerful rationale for corporate combinations is as a tool for increasing efficiency by disciplining incompetent or self-serving managers.[22] When acquisitions take place, the target company's existing executives and board stand a good chance of losing their perch. Therefore, managers face an existential threat from unwelcome acquirers and so have a powerful interest in constraining the market for corporate control.

Considerable energy has therefore been devoted to protecting incumbent managers from unwanted takeovers—but only within certain limits. For example, Delaware courts have vindicated the use of poison pills, which are a legal tool that penalizes unwelcome acquirers.[23]

Monga, *Serial Acquirers Benefit Most from M&A: McKinsey*, WALL ST. J. (Jan. 23, 2012, 12:41 AM), https://blogs.wsj.com/cfo/2012/01/23/serial-acquirers-benefit-most-from-ma-mckinsey [https://perma.cc/BUK2-PKKU] ("Companies that had regular M&A programs that represented 19% or more of their market capitalization performed better on average than those relying on organic growth or large-scale M&A."); *see also* Benn Protess & Michael Corkery, *Just How Much Do the Top Private Equity Earners Make?*, N.Y. TIMES (Dec. 10, 2016), https://www.nytimes.com/2016/12/10/business/dealbook/just-how-much-do-the-top-private-equity-earners-make.html [https://perma.cc/6BCL-GJRD] (discussing the high compensation of private equity managers).

22 *See* Michael C. Jensen, *Takeovers: Their Causes and Consequences*, 2 J. ECON. PERSP. 21, 22 (1988); Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112–13 (1965). This can be true even in cases where the acquisition does not occur. The threat of a takeover disciplines managers. Anup Agrawal & Jeffrey F. Jaffe, *Do Takeover Targets Underperform? Evidence from Operating and Stock Returns*, 38 J. FIN. & QUANTITATIVE ANALYSIS 721, 744 (2003).

Numerous other motivations can drive one company to acquire another. Optimally, corporate combinations create synergistic links between complementary assets. *See* Elazar Berkovitch & M.P. Narayanan, *Motives for Takeovers: An Empirical Investigation*, 28 J. FIN. & QUANTITATIVE ANALYSIS, 347, 347 (1993).

Some acquisitions may *constitute or aggravate* agency costs, as managers seek to draw greater perquisites from a larger corporate empire. *See* Yakov Amihud & Baruch Lev, *Risk Reduction as a Managerial Motive for Conglomerate Mergers*, 12 BELL J. ECON. 605, 605–07 (1981) (identifying risk-muting diversification as a managerial motive for expansion); Richard Roll, *The Hubris Hypothesis of Corporate Takeovers*, 59 J. BUS. 197, 197, 212 (1986) (arguing that managers overestimate their ability to run diversified firms). *But see* Sanjai Bhagat et al., *Hostile Takeovers in the 1980s: The Return to Corporate Specialization*, 1990 BROOKINGS PAPERS ON ECON. ACTIVITY: MICROECONOMICS 1, 2 (finding a tendency to use acquisitions to increase specialization rather than diversification). Acquisitions can serve as a pretext for breaching implicit contracts with nonshareholder constituents, such as workers and bondholders. Andrei Shleifer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers*, *in* CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 33, 34 (Alan J. Auerbach ed., 1988). *But see* Bhagat et al., *supra*, at 19–34 (arguing that blue-collar workers do not tend to lose jobs after acquisitions); Jarrell et al, *supra* note 21, at 56–57 (discussing contrary evidence). Combinations can increase market power and reduce competition. *See, e.g.*, George J. Stigler, *A Theory of Oligopoly*, 72 J. POL. ECON. 44, 45 (1964) (describing mergers as "the most comprehensive" form of collusion). *But see* B. Espen Eckbo, *Horizontal Mergers, Collusion, and Stockholder Wealth*, 11 J. FIN. ECON 241, 242 (1983) (rejecting this hypothesis after reviewing merger data).

23 The simplest variant of the poison pill distributes to shareholders a large number of warrants—essentially, stock options—exercisable only if some arriviste acquires a controlling block. The diluting effect of these warrants, enriching all existing shareholders at the expense of the acquirer, greatly discourages acquisition efforts. Another technique for protecting manager incumbency is the use of classified or staggered boards, which have been a flashpoint for controversy for most of the twentieth

Delaware courts have blessed poison pills on the theory that managers may need some leverage in order to negotiate with acquirers to secure a better deal for shareholders than they would have gotten from a unilateral ultimatum.[24] But there are limits on judicial acceptance of defensive techniques.

Any defensive technique must respond to an objectively reasonable belief about a threat to corporate policy and effectiveness.[25] Defenses must be reasonable in relation to the threat.[26] Therefore, a poison pill cannot itself be preclusive or coercive.[27] The board must meet similar standards whenever a shareholder requests a waiver of part of an existing poison pill.[28] Whatever defensive technique is adopted, boards must disclose the defensive device and the motives for its adoption.[29] Above all, the poison

century. Classified boards typically cycle their membership only every three years, preserving board continuity but also significantly slowing any effort to clean house. *Compare* Lucian Bebchuk et al., *What Matters in Corporate Governance?*, 22 REV. FIN. STUD. 783, 791 (2009) (discussing evidence that classification reduces firm value), *with* K. J. Martijn Cremers et al., *Staggered Boards and Long-Term Firm Value, Revisited*, 126 J. FIN. ECON. 422, 423–24 (2017) (finding no evidence that classification reduces firm value). For a recent case vindicating the use of classified boards alongside poison pills, see Air Products & Chemicals, Inc. v. Airgas, Inc., 16 A.3d 48 (Del. Ch. 2011).

24 *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 175–76, 180 (Del. 1986) (recognizing that a poison pill was lawful under a Delaware statute); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1357 (Del. 1985) (upholding a modern poison pill); Goggin v. Vermillion, Inc., No. 6465-VCN, 2011 WL 2347704, at *5 (Del. Ch. June 3, 2011) ("Delaware courts have repeatedly approved of the adoption of a rights plan.").

25 *See* Unocal Corp v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (noting that "a defensive measure to thwart or impede a takeover [must be] motivated by a good faith concern for the welfare of the corporation and its stockholders").

26 *See Revlon*, 506 A.2d at 181; *Unocal*, 493 A.2d at 955.

27 Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1378 (Del. 1995) ("[T]his Court has recognized . . . the unreasonableness and non-proportionality of responding defensively to a takeover bid with a coercive and preclusive partial self-tender offer.").

28 Third Point LLC v. Ruprecht, C.A. No. 9469-VCP, 2014 WL 1922029, at *21 (Del. Ch. May 2, 2014) (holding that plaintiffs did not establish likely success on the merits that the board breached its fiduciary duty by failing to waive the 10% poison pill threshold, which would have let the shareholder buy up to 20% of the firm).

29 *See* Red Oak Fund, L.P. v. Digirad Corp., C.A. No. 8559-VCN, 2013 WL 5740103, at *12 (Del. Ch. Oct. 23, 2013) (recognizing a duty to disclose relevant information in a proxy contest context, but finding no breach in the instant case because there were no conclusive poison pill plans to disclose at the time of the challenged vote). *But see* Lewis v. Chrysler Corp., 949 F.2d 644, 651 (3d Cir. 1991) (holding that Chrysler's failure to disclose that the poison pill might be used to maintain manager control was not an actionable omission because investors are charged with the knowledge of "the 'universal' interest of corporate officers and directors in maintaining corporate control" (quoting Warner Commc'ns Inc. v. Murdoch, 581 F. Supp. 1482, 1492 (D. Del. 1984))).

Failure to disclose poison pill information could also expose the adopting firm to liability under federal securities laws, namely Section 14(e) of the Williams Act, 15 U.S.C. §78n.(e) (2012), which forbids fraudulent, deceptive, or manipulative acts, including misleading omissions in connection with tender offers. *See infra* note 163 and accompanying text. Some scholars have identified disclosure as crucial in protecting poison pills from being characterized as manipulative or deceptive. *See, e.g.*, pill may never be used primarily to entrench existing managers and prevent shareholders from having electoral control over the corporation—even if they might use that control to elect new and potentially inferior directors.[30]

These constraints are meaningful. Plaintiffs routinely challenge board actions as unreasonable or disproportionate, and courts entertain these challenges. For example, the pharmaceutical company Allergan adopted a "pretty customary" poison pill in response to takeover efforts by rival Valeant and its ally, activist hedge fund Pershing Square.[31] Although the plaintiffs conceded that the pill was "very customary,"[32] the court nevertheless determined that it gave rise to a colorable claim and the possibility of irreparable injury.[33] That is because even a customary pill could illegally frustrate the shareholders' franchise rights in conjunction with other facts.[34]

Therefore, the court granted the plaintiff's motion for expedition. The case settled before the court could give its final word on the poison pill,[35] but the litigation constituted an important reminder that the law imposes meaningful constraints on takeover defenses.

And legal constraints are not the only constraints. Institutional investors and proxy advisors are wary of supporting firms with robust poison pills.[36]

Note, *Protecting Shareholders Against Partial and Two-Tiered Takeovers: The "Poison Pill" Preferred*, 97 HARV. L. REV. 1964, 1980 (1984); *cf.* Martin M. Cohen, *"Poison Pills" as a Negotiating Tool: Seeking a Cease-Fire in the Corporate Takeover Wars*, 1987 COLUM. BUS. L. REV. 459, 505 (stating that poison pill plans provide shareholders with a "plethora of information" rather than deceive them).

30 *See* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 29–30 (Del. Ch. 2010) (nothing that "like any strong medicine, however, a pill can be misused," and that "a rights plan can be deployed inappropriately to benefit incumbent managers and directors"); Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988) (disfavoring poison pills "designed for the primary purpose of interfering with the effectiveness of a stockholder vote").

31 Transcript of Oral Argument on Plaintiff's Motion for Expedited Proceedings and Rulings of the Court at 5, PS Fund 1, LLC v. Allergan, Inc., No. 9760-CB (Del. Ch. dismissed June 28, 2014).

32 *Id.* at 55.

33 *Id.* at 58.

34 *Id*. at 56. In this case, the additional facts included a preexisting bylaw that permitted shareholders to call a special meeting only if requested by 25% of the investor polity. *See id.* at 5–7. The court was unwilling to preemptively bless a customary pill when combined with a peculiar bylaw.

35 Phil Milford & Drew Armstrong, *Allergan Poison Pill Won't Be Triggered by Pershing Call*, BLOOMBERG (June 27, 2014, 5:27 PM), https://www.bloomberg.com/news/articles/2014-06-27/allergan-settles-pershing-square-suit-over-poison-pill [https://perma.cc/NFF5-X66V].

36 ISS and Glass Lewis both recommend voting against firms with poison pills of longer than a one-year duration. They both urge case-by-case consideration of firms with shorter term poison pills. *See* SIDLEY AUSTIN LLP, SIDLEY UPDATE: ISS AND GLASS LEWIS POLICY UPDATES FOR THE 2017 PROXY SEASON (2016), https://www.sidley.com/~/media/update-pdfs/2016/11/iss-and-glass-lewis-policy-updates-for-the-2017-proxy-season.pdf [https://perma.cc/2XNX-YM3G].

In summary, managers often wish to halt would-be acquirers, yet defensive tactics are constrained by both law and investor expectations. In light of this unmet demand for defensive capacity, it will later prove unsurprising if managers find other springs at which to slake their thirst.

B. Bidding Wars

It is not only managers who sometimes want to stop an unwanted bidder. Because competitive auctions channel value to the seller,[37] it would be far better for a would-be acquirer to be the *only* would-be acquirer.

Consider the raucous bidding war depicted in the book and film *Barbarians at the Gate*.[38] RJR Nabisco's market capitalization stood at about $12.5 billion before one of Wall Street's biggest firms offered to buy it out. Other bidders soon followed. This tug-of-war drove the purchase price to $25 billion and saddled the "victor" with a crushing debt obligation—the ultimate winner's curse.[39] How much nicer it would have been if the first bidder had been able to disable the second bidder at the start. Perhaps the deal could have been consummated quietly and quickly before egos were enflamed and wallets opened.

Bidders already expend considerable energy to reduce competition in a potential acquisition,[40] but they are subject to a number of legal constraints. The Williams Act imposes myriad protections for target company shareholders, which make it easier for competitor bidders to come into the fold. For example, acquirers must disclose their presence and intentions within ten days of acquiring 5% of the target company.[41] Tender offerors must disclose their conflicts of interest.[42] They must hold offers

---

37 *See* Kenneth R. French & Robert E. McCormick, *Sealed Bids, Sunk Costs, and the Process of Competition*, 57 J. BUS. 417, 423–24 (1984).

38 *See* BRYAN BURROUGH AND & JOHN HELYAR, BARBARIANS AT THE GATE: THE FALL OF RJR NABISCO (1990); *Barbarians at the Gate* (HBO 1993).

39 *See generally* Richard H. Thaler, *Anomalies: The Winner's Curse*, 2 J. ECON. PERSP. 191 (1988) (describing the general phenomenon of auction winners bidding too much).

40 Bidders keep their acquisition plans secret, and they may condition their bids upon promises by the target not to seek other bids, not to cooperate with other bidders, or simply to decide quickly enough that other bids are unlikely. These deal-protection efforts have spurred considerable academic debate. *See generally* Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers: A Reply and Extension*, 35 STAN. L. REV. 23 (1982); Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); Ronald J. Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense*, 35 STAN. L. REV. 51 (1982).

41 *See* 15 U.S.C. § 78m(d) (2012) (requiring 5% owners to comply with SEC filing requirements); 17 C.F.R. § 240.13d-1 (2017) (requiring filing from 5% owners); *id.* § 240.13d-101 (stipulating content of filing).

42 Tender Offers, Securities Act Release No. 6,158, Exchange Act Release No. 16,384, 44 Fed. Reg. 70,326 (Dec. 6, 1979) (describing the requirements of Item 3(b) on Schedule 14D-9).

open for at least twenty business days,[43] accept tendered shares on a pro rata basis,[44] and otherwise abjure discriminatory tender offers.[45] State antitakeover laws impose similar requirements and restrictions.[46]

These legal restrictions impair bidders' abilities to bid without competition. Given the potential costs entailed by bidding wars, bidders are likely to think of every possible way to avoid serious competition. We shall see later that insider trading law can play a role in thwarting competing bidders.

C. Wolf Packs

It is not just longtime antagonists, such as intransigent managers and competitor bidders, who may wish to block the trading of another. Some would-be cooperators could use trading restrictions to buttress their coordination efforts. One context where this dynamic is true is among coordinated activist investors, often called "wolf packs," in which cooperation is valued but unstable.

Activist investors take a stake in a target company in order to exert influence on management, with an eye to increasing share prices. A wolf pack is "a loose network of activist investors that act in a parallel fashion but deliberately" try to avoid triggering certain filing obligations.[47]

Activists work together to disperse the risks and challenges which would concentrate on a single activist acting alone. If a dozen like-minded hedge funds each take a 4% stake in a company, their collective influence will be irresistible, but no individual fund needs to accept all the economic risks of a controlling stake.

Working together also helps each firm stay below the threshold for ownership-triggered legal effects. Poison pills, or rights offerings, and similar defensive tactics typically activate or become available against owners of 10% of a company's stock.[48] A stake of 10% of a target company's stock will designate the investor an "insider" for the purposes of

43 17 C.F.R. § 240.14e-1(a).

44 *Id.* § 240.14d-8. Non-pro rata acceptance might be deemed coercive, insofar as early tenderers might receive better treatment than later tenderers.

45 *Id.* §§ 240.13e-4, 240.14d-10; Amendments to Tender Offer Rules: All-Holders and Best-Price, Exchange Act Release No. 23,421, 51 Fed. Reg. 25,873 (July 17, 1986).

46 *See generally* Michal Barzuza, *The State of State Antitakeover Law*, 95 VA. L. REV. 1973 (2009) (surveying characteristics of state antitakeover laws).

47 John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 562 (2016). The filing obligations are those owed by "groups" under § 13(d)(3) of the Exchange Act of 1934. *See infra* notes 49–52 and accompanying text.

48 *See, e.g.*, Third Point LLC v. Ruprecht, C.A. No. 9469-VCP, 2014 WL 1922029, at *26 (Del. Ch. May 2, 2014) (declining to enjoin a pill with a 10% threshold for active acquirers).

Section 16 of the Securities Exchange Act of 1934.[49] Section 16 insiders must disgorge any "short-swing" profits, which include gains made from selling stock purchased within the last six months.[50] Even lower, at 5%, the Williams Act requires large shareholders to report their position.[51]

Splitting up the activist campaign among several funds lets many hover below a given ownership threshold and potentially avoid the associated consequences. This "divide and conquer" solution is the central benefit of wolf packs, which Coffee and Palia identify as "a leading cause of increased hedge fund activism" in recent days.[52]

Though wolf packs solve economic and legal problems for activists, such arrangements present their own challenges. If the hedge funds coordinate too closely, they can be deemed a "group" for the purposes of federal securities laws,[53] which would undermine many of the benefits that led to the use of a wolf pack.[54] Avoiding this problem requires funds to maintain a large degree of independence. This independence leads to instability: members of the wolf pack will work together as long as it is in their individual best interests, but they may not support the group goal if it becomes more advantageous to defect from it.

Indeed, activists may opportunistically abandon their joint effort.[55] Although the disclosure of activist involvement usually raises stock prices,[56] the success of a campaign is never assured, and failed campaigns may result in a lower stock price.[57] The result can be a sort of prisoner's dilemma, with some funds tempted to sell soon after announcement so as to

---

49 *See* Securities Exchange Act of 1934 § 16(a), 15 U.S.C. § 78p(a) (2012).

50 *See id.* § 78p(b); *see also* Ellen Taylor, *Teaching an Old Law New Tricks: Rethinking Section 16*, 39 ARIZ. L. REV. 1315, 1323–24 (1997) (arguing that Section 16(b) is overinclusive).

51 15 U.S.C. § 78m(d). The public filing of one's position has a number of negative consequences. It alerts all other investors to your plans, so it may be hard to acquire any more shares at a reasonable price. It also notifies management, which may initiate defensive tactics such as implementing a poison pill if they have not already.

52 Coffee & Palia, *supra* note 47, at 550.

53 15 U.S.C. § 78m(d)(3) ("When two or more persons act as a . . . group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a 'person' for the purposes of this subsection.").

54 *See* Coffee, & Palia, *supra* note 47, at 562–64 (explaining the tactical benefits that turn on not being a "group").

55 *See id.* at 567 ("[S]ome members may drop out well before the proxy contest is begun or comes to a vote. Most do not appear to hold for the long run.").

56 *See* Brav et al., *supra* note 9, at 1730.

57 Leslie Picker, *Billionaire Investor Nelson Peltz Sells Stake in PepsiCo*, N.Y. TIMES (May 13, 2016), https://nyti.ms/24QZ8ya [https://perma.cc/C3VJ-8EFL] ("The news of [the activist's] exit contributed to a slight decline in Pepsi's stock price, which slipped 1.8 percent on Friday, to $104.18.").

lock in their gains so far.[58] The more funds that take this approach, the less likely the activist campaign is to succeed, as once-allied voters run for the door. This can become a self-fulfilling cycle as funds fear being the last one out the door. A viable and collectively rational campaign can collapse under the weight of individual defection.

Defection can occur even before the campaign is actually begun.[59] A fund may feign interest in the activist campaign in order to encourage its formation but spend the accumulation period selling shares rather than buying them. Consider an example of such a betrayal, perpetrated by one of Japan's first activist investors, Yoshiaki Murakami.[60]

A former Ministry of Economy, Trade, and Industry official, Murakami made his name by launching Japan's first postwar tender offer.[61] Then in 2003, he set his sights on Nippon Broadcasting System (NBS), buying up 18% of the company's shares and applying increasing public pressure for a change in management. As the months went on, Murakami sought an ally in his campaign. He found one in Takafumi Horie, another larger-than-life figure.[62]

Murakami and Horie met to discuss a coordinated assault on NBS's defenses. If Horie could acquire 33% of the NBS stock, they would jointly

---

58 *See* Coffee & Palia, *supra* note 47, at 593 (describing the potential for "relatively riskless profit" if a group member defects early).

59 Another form of early defection is to simply steal the idea. A well-known activist's indication that a company is ripe for influence can serve as an important signal to other hedge funds. Those most critical of activists tend to suggest that activists have a knack for picking underperforming companies, for whom reversion to the mean may be imminent. *See* Martijn Cremers et al., Hedge Fund Activism and Long-Term Firm Value 6 (Nov. 19, 2015) (unpublished manuscript), https://ssrn.com/abstract=2693231 [https://perma.cc/J2VN-H8KG] ("[H]edge funds seem to primarily target relatively undervalued firms."). For a twist on this, consider the facts of the RJR Nabisco bidding war. *See supra* text accompanying notes 40–41. There, the management group met with KKR to discuss a tender offer but then withdrew to work with American Express. We can style KKR as a competing group, or we could conceive of the managers themselves as a competing group, withdrawing from and competing with the group they themselves founded with KKR. Regardless, the saga left numerous feelings hurt because its participants *felt* that they had been victims of defection at various stages.

60 For more information about these events, see generally Stephen Givens, *Looking Through the Wrong End of the Telescope: The Japanese Judicial Response to Steel Partners, Murakami, and Horie*, 88 WASH. U. L. REV. 1571 (2011).

61 *See* ENRICO COLCERA, THE MARKET FOR CORPORATE CONTROL IN JAPAN 110 (2007). Interestingly, METI was the government agency that, at the time of the Murakami's violation, was helping to draft authorized poison pills for the first time under Japanese law. CORP. VALUE STUDY GRP., CORPORATE VALUE REPORT (2006), http://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/houkoku06_eng.pdf [https://perma.cc/BB2J-LAHM].

62 Although Horie would later be jailed for securities fraud, in 2005 he was a big-spending internet tycoon and a serial acquirer of stodgy but hitherto respectable companies. *See* Justin McCurry, *Japanese Internet Tycoon Guilty of Securities Fraud*, GUARDIAN (Mar. 16, 2007, 10:06 AM), https://www.theguardian.com/business/2007/mar/16/japan.internationalnews [https://perma.cc/SAR5-37HT].

control the company—provided that Murakami retained his block. Would he do so? "I can't promise anything, but trust me."[63] This hedged response foreshadowed Murakami's later faithlessness but was enough for Horie to indicate that he was "definitely interested" and would seek appropriate financing for his buying spree.[64]

Horie spent the next three months buying NBS shares—35%, in total—before he announced his triumphant achievement.[65] However, Murakami had not followed through on his end. Instead of holding his shares and assuring the coalition a controlling stake, Murakami had betrayed his partner by discretely *selling* his shares. In fact, Horie had basically bought up Murakami's shares. The activist campaign would therefore fail, and Horie would be left holding the bag,[66] enabling Murakami to discreetly liquidate a vast position that might have otherwise been difficult to liquidate.

In light of these events, the future Hories of the world may be more skeptical about putatively coordinated efforts, just as the future Murakamis must work hard to build trust. Each would be pleased to discover some credible commitment device for blocking unauthorized trades. We shall see that insider trading law can serve to make tacit cooperation credible.

*   *   *

The examples above give ample evidence that the power to veto the trades of another would carry substantial value. But can it be accomplished? Most traders would not voluntarily submit themselves to the veto of a competitor or antagonist. Those who might accept such a yoke will not necessarily find the law supportive of the arrangement. Yet there is a body of law that constrains trading: the securities laws concerning insider trading. It is to that body of law that we now turn.

[63] *See* Givens, *supra* note 60, at 1596 (quoting Tōkyō Chihō Saibansho [Tōkyō Dist. Ct.] July 19, 2007 (Japan) (unpublished), https://www.westlawjapan.com/case_law/pdf/WLJP_10-01-2008_04_22.pdf [https://perma.cc/ZJJ9-SJ52]).

[64] *See id.*

[65] *See id.* at 1578.

[66] The campaign's failure had other causes. It is also the first one in which a poison pill was permitted by Japanese courts—two months before publication of the government's official report urging their permissibility. *See id.* at 1579.

II. THE LAW PREVENTING INSIDER TRADING

Dozens of traders each year are investigated for trading on the basis of proscribed information,[67] resulting in dozens of civil enforcement actions.[68] Since 2009, more than eighty traders have been criminally convicted by federal prosecutors in Manhattan alone.[69]

While the United States certainly regulates informed trading, you might not know it just by reading primary legal texts such as codified criminal law. No statute or rule defines "insider trading."[70] Until thirty years ago, the words *insider trading* appeared in no statute[71] and was not a government enforcement priority.[72] It has been said that there simply was no legal or moral proscription of informed trading until the SEC conjured one in the early 1960s.[73]

Regardless, a federal common law of insider trading has rapidly developed in recent decades,[74] interpreting and extending Rule 10b-5 and

---

67 *See* Nate Raymond, *FBI Says Conducting 30 Undisclosed Insider Trading Probes*, REUTERS (July 5, 2016, 2:30 PM), http://www.reuters.com/article/us-usa-insidertrading-idUSKCN0ZL2G4 [https://perma.cc/EC5S-ACDY] (stating that the FBI has more than fifty ongoing insider trading investigations in New York City alone).

68 *See* U.S. SEC, SELECT SEC AND MARKET DATA: FISCAL 2014, at 3 (2014), https://www.sec.gov/about/secstats2014.pdf [https://perma.cc/DAY3-8N6Y] (reporting fifty-two civil and administrative insider trading actions in 2014). *See generally* Urska Velikonja, *Reporting Agency Performance: Behind the SEC's Enforcement Statistics*, 101 CORNELL L. REV. 901, 927–28 (2016) (discussing the quality and provenance of SEC statistics).

69 Raymond, *supra* note 67.

70 Several efforts to define the act were introduced in recent years, but none received substantial support. *E.g.*, Stop Illegal Insider Trading Act, S. 702, 114th Cong. (2015); Ban Insider Trading Act of 2015, H.R. 1173, 114th Cong. (2015); Insider Trading Prohibition Act, H.R. 1625, 114th Cong. (2015).

71 *See* Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (codified in scattered sections of 15 U.S.C.). The only prior statutory provision addressing something like insider trading actually targeted conduct bearing no resemblance to the practices we now debate: Section 16(b) of the Securities Exchange Act of 1934 penalizes rapid trading by certain officers and directors of public companies, regardless of whether they have any special information. 15 U.S.C. § 78p(b) (2012).

72 *See* Stephen J. Crimmins, *Insider Trading: Where Is the Line?*, 2013 COLUM. BUS. L. REV. 330, 349 ("From the SEC's founding in 1934 to Chairman Cary's groundbreaking 1961 decision in *Cady, Roberts*—a span of twenty-seven years—the SEC brought no insider trading cases at all. Over the subsequent twenty years, insider trading continued to be a relatively low prosecution priority in terms of the number of cases at the agency . . . .").

73 *See* HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET 1 (1966) ("Prior to the year 1910 no one had ever publicly questioned the morality of corporate officers, directors, and employees trading in the shares of corporations."). *But see* Michael A. Perino, The Lost History of Insider Trading 51 (unpublished manuscript) (on file with the Northwestern University Law Review) (arguing that insider trading in turn-of-the-century stock markets was not universally accepted and that its propriety was challenged at some publicly traded companies).

74 *See In re* Cady, Roberts & Co., Exchange Act Release No. 34-6668, 40 S.E.C. 907, 1961 WL 60638 (Nov. 8, 1961) (adjudicating for the first time a claim for trading with an unfair informational advantage).

Section 10(b) of the Securities Exchange Act of 1934,[75] and it this federal common law that most discussions of insider trading concern.[76] Sprouting for the most part from a fraud statute, sometimes enriched by state fiduciary law, American insider trading law is deeply a product of its terroir.

A. Fraud Theories

Two types of informed trading are prohibited on the theory that they amount to fraud.[77]

---

[75] Section 10(b) of the Securities Exchange Act (as amended) provides (in pertinent part):

> It shall be unlawful . . .
>
> . . . .
>
> [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (2012). Pursuant to the grant of authority contained in Section 10(b), the SEC promulgated Rule 10b-5, which provides:

> It shall be unlawful . . .
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) 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
>
> (c) 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 (2017). *See generally* Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN L. REV. 385 (1990).

[76] Some theory or another is necessary because the operative rule for prosecuting most insider trading is Rule 10b-5, an antifraud rule. *See* Chiarella v. United States, 445 U.S. 222, 234–35 (1980) ("Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud. When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak."). At common law, it is not fraud to remain silent about one's knowledge unless one is under an affirmative duty to speak. *Id.* at 227–28 (stating that such an affirmative duty has been traditionally imposed on corporate insiders). The typical securities trader is silent when executing a trade through a broker or anonymous stock exchange, so there can be no fraud unless the trader is under a duty to speak.

The two insider trading theories (classical and misappropriation), discussed *infra*, are accounts of why a duty to speak might arise in connection with a given securities transaction. These theories are independently sufficient grounds for liability, covering slightly different facts. *See* Steginsky v. Xcelera Inc., 741 F.3d 365, 371 (2d Cir. 2014) ("[W]e hold that the fiduciary-like duty against insider trading under section 10(b) is imposed and defined by federal common law . . . ."); *see also* A.C. Pritchard, *Justice Lewis F. Powell, Jr., and the Counterrevolution in the Federal Securities Laws*, 52 DUKE L.J. 841, 930 (2003) ("Powell saw Rule 10b-5's jurisprudence as a species of 'federal common law.'").

While most litigation and enforcement, and most of this Article, are focused on Rule 10b-5, insider trading can also be pursued under federal mail and wire fraud statutes. *See generally* William K.S. Wang, *Application of the Federal Mail and Wire Fraud Statutes to Criminal Liability for Stock Market Insider Trading and Tipping*, 70 U. MIAMI L. REV. 220 (2015).

[77] *Cf.* Zachary J. Gubler, *A Unified Theory of Insider Trading Law*, 105 GEO L.J. 1225, 1254–55 (2017) (explaining that courts may not inquire into one theory if the other theory better fits the facts).

The *Classical Theory* bars insider trading as an abuse of some special relationship that may exist between two traders, which would entitle one to full disclosure by the other before consummating a trade.[78] Most crucially, the Supreme Court has held that "a relationship of trust and confidence [exists] between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation."[79] Hence, certain officers and directors commit a fraud by engaging in insider trading because they remain silent while transacting with individuals (existing and would-be shareholders) to whom they owe candor as a result of the principal–agent relationship that gave rise to the information in the first place.[80]

The *Misappropriation Theory* "holds that a person commits fraud 'in connection with' a securities transaction, and thereby violates § 10(b) and Rule 10b-5, when he misappropriates confidential information for

---

This suggests that these theories are not completely independent bases for liability. One theory may succeed or fail in part because of the success or failure of another theory.

[78] *See e.g.*, *Chiarella*, 445 U.S. at 228 (noting that a duty to disclose arises when the parties to the trade have a fiduciary relationship or other "relation of trust and confidence" (quoting RESTATEMENT (SECOND) OF TORTS § 551(2)(a) (1976))). The status of such a duty prior to *Chiarella* is contested. Some state courts had found such a duty as a matter of corporate law. *See, e.g.*, Strong v. Repide, 213 U.S. 419, 431 (1909) (surveying various state supreme court cases related to a director's duty to disclose). And some federal courts had found such a duty as a matter of the law of fraud. *See, e.g.*, Myzel v. Fields, 386 F.2d 718, 733 (8th Cir. 1967); Royal Air Props., Inc. v. Smith, 312 F.2d 210, 212 (9th Cir. 1962); Speed v. Transamerica Corp., 99 F. Supp. 808, 829 (D. Del. 1951); Kardon v. Nat'l Gypsum Co., 73 F. Supp. 798, 800 (E.D. Pa. 1947). However, such outcomes were not universal, and generally operated only when the transaction was face-to-face or otherwise personal. *See* Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition*, 52 WASH. & LEE L. REV. 1189, 1220 (1995) (noting that while some courts rejected any fiduciary duty for corporate officers and directors, most courts trended toward a special-circumstances rule or a fiduciary rule). Courts have sometimes accepted that impersonal insider trading is a breach of the duty of loyalty for the purposes of state corporate law. *See, e.g.*, Brophy v. Cities Serv. Co., 70 A.2d 5, 7–8 (Del. Ch. 1949); *accord* Kahn v. Kolberg Kravis Roberts & Co., L.P., 23 A.3d 831, 838 (Del. 2011); *In re* Primedia, Inc. Shareholders Litig., 67 A.3d 455, 479–80 (Del. Ch. 2013).

[79] *Chiarella*, 445 U.S. at 228. For further discussion of the classical theory, see WANG & STEINBERG, INSIDER TRADING: LIABILITY AND COMPLIANCE §§ 5.02–03 (3d ed. 2013).

[80] One's status as a government official may give rise to similar duties. It appears that members of Congress and their staff have done extremely well in the stock market. Alan J. Ziobrowski et al., *Abnormal Returns from the Common Stock Investments of Members of the U.S. House of Representatives*, 13 BUS. & POL. 1 (2011) (documenting significant abnormal returns for stock market trades of members of Congress). An outcry followed news reports that the laws did not bar insider trading by members of Congress. The result was the 2012 STOCK Act, which prohibited many kinds of insider trading by Congressmen and their staffs. STOCK Act, Pub. L. No. 112-105, 126 Stat. 291 (2012) (codified in scattered sections of 5 U.S.C., 15 U.S.C.). Other governmental (and pseudogovernmental) actors have been subject to explicit restrictions for a longer time. *E.g.*, 7 U.S.C. § 13(c) (2012) (barring insider trading by members of the CFTC and their staff). *But see* Donna M. Nagy, *Insider Trading, Congressional Officials, and Duties of Entrustment*, 91 B.U. L. REV. 1105, 1111 (2011) (arguing that governmental insider trading was always illegal under Rule 10b-5, at least to whatever degree nongovernmental insider trading was illegal).

securities trading purposes, in breach of a duty owed to the source of the information."[81] The Supreme Court recognized the misappropriation theory in *O'Hagan*, in which a lawyer bought shares in a company because he knew that the company would soon be acquired (by one of the law firm's clients).[82] Under the classical theory, O'Hagan would not have been barred from trading; he was no fiduciary of the shareholders of the target company. However, he must have misrepresented his intentions, feigning loyalty, in order to gain his firm's trust in order to get this information. In Justice Ginsburg's words, "a fiduciary's undisclosed, self-serving use of a principal's information to purchase and sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information."[83]

Both fraud-based theories of insider trading cast a pall over trading by certain insiders as well as those whom they tip. A trader cannot escape liability simply because she *herself* is not an executive at the issuer company (though her information source is) and she did not *personally* misappropriate the information (if her source misappropriated it). Rather, the law allows for tippee liability on a derivative basis. If the tippee knows or should know that the tip was acquired or shared in violation of a duty, then the tippee can be liable for insider trading.[84] This is most evident when the source of information gets a personal benefit, often pecuniary, from informing the tippee.[85] It is not essential that the tippee have anything to do with the misappropriation so long as she is on notice of it.[86]

---

[81] United States v. O'Hagan, 521 U.S. 642, 652 (1997). For discussion of the misappropriation theory, see WANG & STEINBERG, *supra* note 79, § 5.04.

[82] *O'Hagan*, 521 U.S. at 648.

[83] *Id.* at 652. The SEC has promulgated a list of relationships that can establish a duty of trust and confidence. 17 C.F.R. § 240.10b5-2 (2017). Importantly, a duty is present if "the person communicating the material nonpublic information and the person to whom it is communicated have a history, pattern, or practice of sharing confidences." *Id*. § 240.10b5–2(b)(2). For example, one trader was sanctioned for trading on a secret he learned at an Alcoholics Anonymous meeting. SEC v. McGee, 895 F. Supp. 2d 669, 682 (E.D. Pa. 2012), *aff'd*, United States v. McGee, 763 F.3d 304 (3d Cir. 2014).

[84] When the source breaches a duty in acquiring or sharing the information, the tippee can be a "participa[nt] after the fact." WANG & STEINBERG, *supra* note 79, § 5.03[1]. When the tipper does not violate the law in acquiring the information or in tipping it, the tippee may be a primary violator by breaching her duty of trust and confidence to the source. *See* Dirks v. SEC, 463 U.S. 646, 660 (1983) ("[A] tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material non-public information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.").

[85] *See Dirks*, 463 U.S. at 663. The recent *Salman* decision affirmed *Dirks* in almost all respects. In particular, *Salman* did not require a pecuniary benefit to the tipper. Instead, a chain of tippees can be implicated if the tipper simply sought to confer a gift on a "trading relative or friend." Salman v. United States, 137 S. Ct. 420, 427–28 (2016) (quoting *Dirks*, 463 U.S. at 664). The decision seems to have done little to change insider trading law, other than to undo part of what the earlier *Newman* case had

It is a fraud to trade "on the basis" of proscribed information, but what is "on the basis"?[87] Is trading barred only if the trader *used* the information, somehow changing her conduct in light of the information? Or is a trader culpable even if she would have made the same trade regardless, her only offense being that she traded while knowing a secret? In other words, need there be a causal connection between the trade and the trader's knowledge of proscribed information?

This question has come to be known as the "causation" standard, and it has occasioned substantial debate. Several circuits embraced a prodefendant "use" standard, in which traders could lawfully go about their business, even if they happened to obtain proscribed information, so long as it did not actually cause them to trade any differently.[88] Other circuits adopted a mere "knowledge" standard.[89] On this standard, it does not matter

done to bolster the protection of the personal benefit test. *See* United States v. Martoma, 869 F.3d 58, 67 (2d. Cir. 2017) (eliminating *Newman*'s requirement that the tipper has a "meaningfully close personal relationship" with the tippee friend or relative (quoting United States v. Newman, 773 F.3d 438, 452 (2d Cir. 2014))).

Still, by cleaving to *Dirks*, *Salman* may worry critics about the boundaries of the gift-based prohibition. These boundaries may appear vague—how close a friend is a "friend"?—or expansive. *Cf. Newman*, 773 F.3d at 452 ("[The personal benefit standard] does not suggest that the Government may prove the receipt of a personal benefit by the mere fact of a friendship, particularly of a casual or social nature. If that were true, and the Government was allowed to meet its burden by proving that two individuals were alumni of the same school or attended the same church, the personal benefit requirement would be a nullity."). On the personal benefit test in the misappropriation context, see generally Merritt B. Fox & George Tepe, *Insider Trading: Personal Benefit Has No Place in Misappropriation Tipping Cases*, CLS BLUE SKY BLOG (July 25, 2017), http://clsbluesky.law.columbia.edu/2017/07/25/insider-trading-personal-benefit-has-no-place-in-misappropriation-tipping-cases [https://perma.cc/QRE8-9DFP].

86 SEC v. Obus, 693 F.3d 276, 288 (2d Cir. 2012) ("[T]ippee liability can be established if a tippee knew or had reason to know that confidential information was initially obtained and transmitted improperly (and thus through deception), and if the tippee intentionally or recklessly traded while in knowing possession of that information.").

87 For discussion of this issue, see generally WANG & STEINBERG, *supra* note 79, § 4.04.5. Rule 14e-3 is actually written to cover those "in possession" of proscribed information, *see* 17 CFR § 240.14e-3(a) (2017), which accords with the "possession" standard discussed *infra*.

88 *E.g.*, SEC v. Adler, 137 F.3d 1325, 1337 (11th Cir. 1998) ("We believe that the use test best comports with precedent and Congressional intent, and that mere knowing possession . . . is not a *per se* violation."); United States v. Smith, 155 F.3d 1051, 1067 (9th Cir. 1998) ("[W]e believe that the weight of authority supports a 'use' requirement."). *But see* Johnson v. Aljian, 394 F. Supp. 2d 1184, 1198–99 (C.D. Cal. 2004) (adopting the lower "possession" standard in civil cases, distinguishing *Smith* as a precedent for criminal matters).

Adler actually adopted an intermediate position, in which use is required but presumed based on knowing possession—and the burden is on the defendant to rebut a presumption of use "by adducing evidence that there was no causal connection between the information and the trade." *Adler*, 137 F.3d at 1337.

89 The modern "knowledge" or "possession" standard has its genesis in the SEC's investigation into Sterling Drug, Inc. There, two directors sold shares after learning that news of the company's recent improvements in sales and income should be taken with a grain of salt. Report of Investigation in

whether traders had prior, independent, and lawful reasons to execute a trade; once they obtain proscribed information bearing on the trade, they must disclose the information or abstain from trading.

The SEC's answer, acquiesced to by both courts[90] and Congress,[91] is that traders break the law if they trade while they are "aware" of proscribed information.[92] This standard is much closer to the noncausal "knowing possession" standard than the "use" standard. And even those courts which had endorsed a "use" standard in theory tended to apply it as though it were a knowledge standard.[93] Thus, American insider trading law generally

---

the Matter of Sterling Drug, Inc., Exchange Act Release No. 14,675, 14 SEC Docket 824, 826, 1978 WL 198166 (Apr. 18, 1978). The directors claimed that they had ample reason to sell shares apart from what they learned in that meeting, and so they did not trade because of the information. *Id.* at 827. The Commission deemed their motives irrelevant, however:

> Rule 10b-5 . . . does not require a showing that an insider sold his securities for the purpose of taking advantage of material non-public information. Purchasers of securities in the public market should be able to rely upon information available to the public at the time of the transaction. If an insider sells his securities while in possession of material adverse non-public information, such an insider is taking advantage of his position to the detriment of the public.

Id. The next major step came fifteen years later in the Second Circuit's *Teicher* decision, which seemingly endorsed a possession approach, albeit in dicta. United States v. Teicher, 987 F.2d 112, 120–21 (2d Cir. 1993) (discussing the superiority of a "knowing possession" standard compared to a "causal connection" standard). The defendants had argued that "the district court's jury charge erroneously instructed the jury that the defendants could be found guilty of securities fraud based upon the mere possession of fraudulently obtained material nonpublic information without regard to whether this information was the actual cause of the sale or purchase of securities." *Id.* at 119. The court was skeptical of this argument but avoided ruling on the issue. *Id.* at 121.

[90] *See, e.g.*, United States v. Rajaratnam, 719 F.3d 139, 158–59 (2d Cir. 2013) (discussing the elevation of *Teicher*'s "knowing possession" standard to the "law of the Circuit" following the promulgation of Rule 10b5-1). *But see* SEC v. Lipson, 278 F.3d 656, 660–61 (7th Cir. 2002) ("[I]f Lipson would have sold the shares in the same amounts and on the same dates that he did sell them even if he had not possessed any inside information, then he would be home free, because then the existence of a causal connection between his inside information and the challenged sales would be negated.").

[91] *See, e.g.*, 15 U.S.C. § 78u-1(a)(1) (2012) (imposing civil fines for trading "while in possession of" material nonpublic information.); *id.* § 78t-1(a) (providing for a private right of action against defendants who traded "while in possession of" material nonpublic information).

[92] 17 C.F.R. § 240.10b5-1(b) (2017) ("[A] purchase or sale of a security of an issuer is 'on the basis of' material nonpublic information about that security or issuer if the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale.").

[93] This is because these courts typically reject the defendant's alternative explanations for the trade. *E.g.*, SEC v. Mayhew, 916 F. Supp. 123, 131 (D. Conn. 1995) ("Defendant's attempted justification of why he purchased on those particular dates . . . is simply unpersuasive."). A second reason that the shoreline remains near *Teicher*, despite decisions urging a "use" standard, is that the SEC has not acquiesced in those results. Instead, it promulgated Rule 10b5-1, which adopts an *awareness* standard, i.e., a "knowing possession" standard. § 240.10b5-1(b). While there may be debate in theory about whether we have a "use" or "possession" standard, there is no debate in practice for individuals who would rather not be the subject of a ruinous government investigation (even one in which they will ultimately prevail).

operates to bar certain species of informed trading, regardless of whether that information caused the trade.

B. *Ad Hoc Theories*

Apart from the two fraud-based theories of insider trading, several other types of informed trading are prohibited through ad hoc provisions meant to fill perceived gaps in the forgoing approaches. The most important of these rules regulates trading in advance of tender offers. A tender offer is a public invitation to sell or tender shares to an acquirer,[94] often in connection with an attempt to take over a company without the approval of the target company's board. SEC Rule 14e-3 prohibits trading while in possession of material nonpublic information about a pending tender offer, without regard to whether there is a relationship of trust or confidence and without the challenge of defining "on the basis of."[95]

[94] *See* Wellman v. Dickinson*,* 475 F. Supp. 783, 823–24 (S.D.N.Y. 1979) (reciting the SEC's definition of tender offer as including "(1) active and widespread solicitation of public shareholders for the shares of an issuer; (2) solicitation made for a substantial percentage of the issuer's stock; (3) offer to purchase made at a premium over the prevailing market price; (4) terms of the offer are firm rather than negotiable; (5) offer contingent on the tender of a fixed number of shares, often subject to a fixed maximum number to be purchased; (6) offer open only a limited period of time; (7) offeree subjected to pressure to sell his stock . . . [(8)] public announcements of a purchasing program concerning the target company precede or accompany rapid accumulation of large amounts of the target company's securities") Note that Rule 14e-3 does not in fact define *tender offer*.

[95] § 240.14e-3. The bidder itself may, of course, buy shares while knowing about their own plans, subject to the other disclosure requirements of the Williams Act. The SEC considered and rejected a fuller prohibition that would have prohibited even the bidder from buying prior to its own tender offer. Tender Offers, Securities Act Release No. 6,022, Exchange Act Release No. 15,548, Investment Company Act Release No. 10,575, 44 Fed. Reg. 9,956, 9,976–78, 9,987–88 (proposed Feb. 15, 1979) (proposed Rule 14e–2); Tender Offers, 44 Fed. Reg. 70,326, 70,338, 70,348 (proposed Dec. 6, 1979) (proposed Rule 14e–2). The rule is only triggered if a bidder has taken a substantial step toward commencing a tender offer, though the trader need not know who the bidder is nor whether that bidder has in fact taken a substantial step. *See* 3C HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW § 19:30 (Supp. Dec. 2017). Furthermore, the defendant need not know that the information is nonpublic or that the source was a bidder or a bidder's associate, so long as she has reason to know. *Id.*; *see also* SEC v. Ginsburg, 362 F.3d. 1292, 1304 (11th Cir. 2004) ("Rule 14e-3, by its terms, does not require that the offender know or have reason to know that the information relates to a tender offer, so long as the information in fact does relate to a tender offer and the offender knows or has reason to know the information is nonpublic and was acquired by a person with the required status."). Likewise, Rule 14e-3 is triggered only if the informed trader knows that their information comes from the bidder; the target company; or an officer, director, partner, or employee of the bidder or target. § 240.14e-3(a); s*ee also id.* § 240.14e-3(b)(2) (establishing a defense for legal entities that implement a compliance program intended to prevent agents from acquiring and trading on tender offer information). For further discussion of Rule 14e-3, see generally WANG & STEINBERG, *supra* note 79, §§ 9.01–04.

C. Permitted Trading

Notwithstanding fraud-based theories, ad hoc prohibitions on some trading, and an aggressive causation standard, the fact remains that American insider trading law permits most forms of informed trading. As in all of federal securities law, an advantage is only problematic if the acquired information is material,[96] meaning that there is "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having altered the 'total mix' of information made available."[97] Likewise, there is no violation in trading on the basis of public information, even if your counterparty does not know or has not fully appreciated the information.[98]

More importantly, American law does not even prohibit much trading on the basis of material, nonpublic information. We do not have a parity of information approach to insider trading.[99] That sort of broad prohibition was advanced by the SEC in *Cady, Roberts & Co.* and accepted by the Second Circuit Court of Appeals in *Texas Gulf Sulphur*, but the Supreme Court in *Chiaralla* rejected the notion that it is generally illegal to take advantage of an undisclosed informational advantage.[100] Instead, trading is restricted only if it falls within the scope of one of the forgoing "theories" of insider trading or ad hoc prohibitions.[101] Those who neither steal information nor abuse their trusted role to get information may trade with near impunity.[102] Thus, "only some persons, under some circumstances,

---

[96] *See* Basic Inc. v. Levinson*,* 485 U.S. 224, 231–32 (1988).

[97] TSC Indus., Inc. v. Northway, Inc. 426 U.S. 438, 449 (1976).

[98] United States v. Whitman, 904 F. Supp. 2d 363, 367 (S.D.N.Y. 2012), *aff'd* 555 F. App'x 98 (2d Cir. 2014) (stating that whether information is nonpublic "is largely a factual issue, turning on such factors as written company policies, employee training, measures the employer has taken to guard the information's secrecy, the extent to which the information is known outside the employer's place of business, and the ways in which other employees may access and use the information").

[99] Chiarella v. United States, 445 U.S. 222, 233 (1980) ("[N]either the Congress nor the Commission ever adopted a parity-of-information rule.").

[100] *Compare In re* Cady, Roberts & Co., Exchange Act Release No. 34-6668, 1961 WL 60638 (Nov. 8, 1961) (discussing the "inherent unfairness" when the parties to a trade do not have the same information), *and* SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968) (en banc) (stating that the rule "is based in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information"), *with Chiarella,* 445 U.S. at 233 (rejecting a broad duty to disclose in favor of the rule that such duty "arises from a specific relationship between two parties").

[101] *Cf.* Gubler, *supra* note 77, at 1240–54 (criticizing the classical theory as permissive of too much insider trading).

[102] For example, a famous football coach was acquitted for trading in advance of a merger, which he discovered while eavesdropping on company executives attending a game. SEC v. Switzer, 590 F. Supp. 756, 761–62 (W.D. Okla. 1984).

will be barred from trading while in possession of material nonpublic information."[103]

While some—most notably the SEC—seem displeased that informed trading is often unconstrained,[104] others defend a presumption in favor of lawful trading.[105] Informed trading improves price accuracy and gives traders a reason to do research in the first place.[106]

Perhaps most importantly for our purposes, American insider trading law does not impose liability for much accidental or intentional tainting of others with inside information. Innocent traders need not fear discovering something that would ruin their trading options, nor do they need fear that a competitor or adversary will salt the earth with injurious tips. All a trader need do is refrain from misappropriating information, avoid positions of trust, and stay far from the merger team, and then she can retain all of her flexibility. We seem to have in our power the ability to avoid wrongdoing—and preserve our trading freedoms—by just acting decently and carefully.[107]

Or so the theory has been. The next Part shows how uneasy the safe harbor really is. In fact, traders can and do become burdened with trading prohibitions without any affirmative and culpable efforts to acquire proscribed information, and the risk is far greater if an adversary seeks to establish this state of affairs. Tainting with inside information is eminently possible.

III. THE LAW PERMITTING INSIDER TAINTING

It is plain why managers and bidders might wish to disable the trades of another person.[108] Yet it is still natural to doubt that insider trading law

---

103 Dirks v. SEC, 463 U.S. 646, 657 (1983).

104 *See, e.g.*, Selective Disclosure and Insider Trading, Securities Act Release No. 7,881, Exchange Act Release No. 43,154, Investment Company Act Release No. 24,599, 65 Fed. Reg. 51,716 (Aug. 24, 2000) [hereinafter Regulation FD Final Rule] (defending the equal access ideal in promulgating Regulation FD); *see also* Thomas Lee Hazen, *Identifying the Duty Prohibiting Outsider Trading on Material Nonpublic Information*, 61 HASTINGS L.J. 881, 913 (2010) (arguing in favor of an equal access rule).

105 *See, e.g.*, Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 885 (1983). For a discussion of the arguments for and against regulating insider trading, see WANG & STEINBERG, *supra* note 79, §§ 2.01–04.

106 *See* Kevin S. Haeberle & M. Todd Henderson, *Information-Dissemination Law: The Regulation of How Market-Moving Information Is Revealed*, 101 CORNELL L. REV. 1373, 1382 (2016) (discussing the impact of hypothetical legal reforms on market prices).

107 *See* United States v. Chestman, 947 F.2d 551, 567 (2d Cir. 1991) ("[A] fiduciary duty cannot be imposed unilaterally by entrusting a person with confidential information.").

108 *See supra* Part I.

could matter to any such stratagem. We have seen that American law often allows traders to take full advantage of superior information.[109]

Likewise, it is natural to think that insider tainting would be self-deterring because each instance of insider tainting would expose the tippers (i.e., the actor who seeks to taint another) to serious legal risks themselves.

Yet insider tainting is indeed viable and credible. Section A shows that there are many ways for a tipper to *impose* insider trading risks onto an unwilling victim. Some methods actually make it illegal for the tippee to trade. Other methods may not quite succeed in making the trade illegal, but they still cast a pall over it. It is feasible for the tipper to deliver the tip in such a way that the victim must fear legal risks. Even brave traders must take into account the risk of prosecutor, plaintiff, or court error.

Next, Section B shows that such tipping is not self-deterring. There are a number of relatively safe ways for tippers to perpetrate their tainting plans. For example, securities fraud liability generally attaches only in the presence of a trade; yet successful tainting blocks the victim's trade, thus protecting the tipper. Because a number of techniques exist for safely tainting, bluffs become credible as another safe strategy.

Section C discusses tainting in the context of the three scenarios (takeover defense, competitive bidding, and wolf packs) from Part I.

A. Tainting Is Viable

Insider tainting is viable because it is possible to impose serious legal risks to an individual's subsequent trades, even without her complicity or consent. The following subsections explain how this is possible under the various insider trading theories.

1. Preliminary Remarks: Risk

Insider tainting can deter trades even in cases where the odds of enforcement and conviction are less than 100%. That is because of the high costs of defending against a potential suit and the fierce penalties looming even in cases where punishment is unlikely.

An insider trading conviction can entail serious monetary penalties[110] or jail time.[111] Even if a defendant is ultimately vindicated, the mere accusation of wrongdoing can ruin a career or destroy a business enterprise.

---

[109] *See supra* Part II.

[110] *See* 15 U.S.C. § 78u-1(a)(1) (2012) (authorizing SEC to seek civil penalties when a person violates the Exchange Act "by purchasing or selling a security . . . while in possession of material, nonpublic information"); *id.* § 78u-1(a)(2) (authorizing penalties of up to "three times the profit gained or loss avoided as a result of such unlawful purchase, sale, or communication"). For a discussion of the civil money penalties that the SEC may seek against insider trading defendants, see generally WANG & STEINBERG, *supra* note 79, § 7.03.4.

For example, federal investigators effectively destroyed the $2 billion Diamond Partners hedge fund merely by publicizing the fact that an investigation had been initiated. Investors fled the fund rapidly in the wake of the investigation.[112] Years later, the FBI paid $6 million to the firm and its managers in an uncommon recognition of the degree to which the fund prevailed against the government in the subsequent insider trading trials.[113] While the $6 million was surely appreciated, the principals and employees of Diamondback were not remotely compensated for their losses, underscoring the importance of avoiding controversy.[114]

In light of the costs and risks entailed by any investigation, tainting can work even in cases where the probability of conviction is actually quite low. Indeed, even a very low-level risk of liability may be enough to disable a trader if her employer has a robust compliance program.[115] Compliance officers may adopt categorical restrictions on trading, even when risks are minute.[116]

---

[111] *See* § 78ff(a) (providing for not more than $5 million in fines, twenty years' imprisonment, or both for any willful violation of the Exchange Act or any rule thereunder). For a discussion of the criminal penalties against insider trading, see generally WANG & STEINBERG, *supra* note 79, § 7.02.

[112] The fund announced its closure during the insider trading trial of its former employee, Todd Newman. *See* Chad Bray, *Diamondback Is Shutting Down*, WALL ST. J. (Dec. 6, 2012), http://www.wsj.com/articles/SB10001424127887324001104578163043667373604 [https://perma.cc/T7LJ-BN8Y].

[113] *See* Matthew Goldstein, *U.S. to Return $6 Million to Diamondback Capital in Insider Trading Case*, N.Y. TIMES (June 3, 2016), http://www.nytimes.com/2016/06/04/business/dealbook/us-to-return-6-million-to-diamondback-capital-in-insider-trading-case.html [https://perma.cc/6VJN-AZRN]. Diamondback was the home to Todd Newman, whose acquittal in the Second Circuit, United States v. Newman, 773 F.3d 438 (2d Cir. 2014), set in motion the Supreme Court's recent *Salman* decision. *See* Salman v. United States, 137 S. Ct. 420, 428 (2016) (abrogating *Newman*, at least in part).

[114] If compensated under the traditional "two and twenty" rule, the manager of a $2 billion fund would have been entitled to $40 million per year, plus 20% of the fund's gains above some benchmark. *See* Victor Fleischer, *Two and Twenty: Taxing Partnership Profits in Private Equity Funds*, 83 N.Y.U. L. REV. 1, 3 (2008).

[115] *Cf.* Brief of Defendant-Appellant Todd Newman at *8, *44, United States v. Newman, 773 F.3d 438 (2d Cir. 2014) (No. 13-1837-cr(L)), 2013 WL 4497029 (acknowledging that the compliance department was privy to many allegedly tipping emails). Tippers can fortify their tainting schemes by looping compliance departments, which may be more risk averse than individual traders, into the tip. The strategic invocation of compliance personnel is characteristic of the phenomenon of "offensive compliance." *See* Miriam Baer, *Offensive Compliance*, PRAWFSBLAWG (Feb. 21, 2012, 12:36 PM), http://prawfsblawg.blogs.com/prawfsblawg/2012/02/offensive-compliance.html [https://perma.cc/HYJ6-87CC].

[116] An overprotective approach may result from the compliance officers' failure to understand the nuances of the factual and legal context, a rational effort to build workable rules (that are simply not right in every case), or the desire to assert their importance and protect their own reputation (which may depend on a spotless compliance record). On the compliance industry and its incentives, see generally William A. Birdthistle & M. Todd Henderson, *Becoming a Fifth Branch*, 99 CORNELL L. REV. 1, 44–49 (2013).

2. *Preliminary Remarks: Disclosure*

American law never prohibits trading on public information, so involuntary tippees may regain their right to trade if they publicly disclose the tainting information.[117] This option limits the danger from tainting.

However, self-protective disclosure carries legal risks, too. If there is any argument that the tippee had assumed a duty of confidentiality, their disclosure exposes the tippee to liability for violating by disclosure. Moreover, if the information turns out to be false, or if the disclosing tippee does not publicize it with perfect accuracy, the tippee might herself be accused of making an actionable misstatement.[118]

Even if the law allowed the tippee to disclose, doing so will still leave her worse off than if she had never been tainted.[119] More interestingly, the choice to disclose rather than abstain reveals information about the disclosing tippee: to opt for disclosure, the trader must think that there is a trading opportunity with respect to this stock apart from the one disclosed. Otherwise, why would she disclose rather than abstain? If she discloses the tainting information, she also hints at her remaining undisclosed information.

For example, a would-be acquirer might be tainted with a peek at quarterly earnings. If she discloses those earnings to the world, it will signal that she wishes to buy the company and had that wish apart from the now-disclosed earnings. This will lead other traders to draw inferences or engage in additional research. Does the trader know that one of the company's drugs has been approved or a lawsuit settled?

Careful observers (e.g., competitors, arbitragers) will read the tea leaves. They may not know exactly what motivates the tainted trader to disclose, but they will sometimes be able to make inferences. If Mark Cuban discloses that he was given information about an upcoming stock offering, it will be easy to infer that he has independent reasons to sell his stock.

---

[117] The most expansive formulation of American insider trading law is the "disclose or abstain" rule. Chiarella v. United States, 445 U.S. 222, 227 (1980). The trader could disclose in a recognized public forum, such as a newspaper like the *Wall Street Journal*, or through some regulatory filing. For example, the SEC requires anyone making a tender offer to file a Schedule TO containing numerous disclosures. *See* 17 C.F.R. § 240.14d-3(a)(2) (2017) (requiring tender offerors to file Schedule TO); *id.* § 240.14d-100 (Schedule TO). One such disclosure could involve any unintended tips received.

[118] *See* § 240.10b-5 ("It shall be unlawful . . . [t]o make any untrue statement of a material fact . . . in connection with the purchase or sale of any security.").

[119] Disclosing the proscribed information is likely to cause the market price to move. If the information is consistent with the victim's reason to trade, then the disclosure makes the victim's subsequent sale or purchase occur at a less optimal price. The disclosure to the trader therefore discourages her to same degree that a public disclosure by the tipper would have discouraged her.

Even if it is difficult to determine from the context what direction the tainted party's own prior trading interest is, other traders will react to the signal that there is an informed trader about to act. Some traders may engage in further research about the security, knowing now that there is some useful information to be discovered. Market makers may simply become cautious, widening bid–ask spreads. Regardless, the tainting party will have frustrated the victim's trading efforts even if the latter opts for disclosure because prophylactic disclosure still signals interest and implies information.

3. *Techniques: Rule 14e-3*

At least in the tender offer context, Rule 14e-3 proves a potent vector for insider tainting. Rule 14e-3 prohibits trading while in possession of undisclosed information about a tender offer.[120] Unlike the fraud-based insider trading theories, 14e-3 does not require any special relationship between the trader and either the source or the counterparty; it is enough to trade while knowing the proscribed information.[121] It is for this reason that 14e-3 has been variously called a "strict liability"[122] offense or vindication of "equal access" principles.[123]

---

120 *See* § 240.14e-3.

121 SEC v. Mayhew, 121 F.3d 44, 49 (2d Cir. 1997) ("[R]ule 14e-3 . . . imposes liability . . . without regard to whether the trader owes a fiduciary duty to respect the confidentiality of the information."); SEC v. Anticevic, No. 05 CV 6991(KMW), 2010 WL 2077196, at *5 (S.D.N.Y. May 14, 2010) ("Rule 14e-3 imposes an obligation 'to disclose or abstain' from trading or tipping regardless of whether the individual (1) owes a fiduciary duty to respect the confidentiality of the information; (2) has knowledge that the material, non-public information in his or her possession relates to a tender offer; and/or (3) actually used the information." (citations omitted)); SEC v. Sekhri, No. 98 Civ. 2320(RPP), 2002 WL 31100823 (S.D.N.Y. July 22, 2002) (same, citing *Mayhew*).

The wide scope of Rule 14e-3 is no coincidence. The SEC promulgated this rule to respond to the perceived injustice of its loss in *Chiarella*. *See generally* 18 DONALD LANGEVOORT, INSIDER TRADING REGULATION, ENFORCEMENT, AND PREVENTION § 7:1 (Supp. Apr. 2017); Karen A. Tallman, Note, *Private Causes of Action Under SEC Rule 14e-3*, 51 GEO. WASH. L. REV. 290, 295–96 (1983) (discussing whether Rule 14e-3 is consistent with Congress's purpose in enacting the Williams Act).

122 *See, e.g.*, John P. Anderson, *Anticipating a Sea Change for Insider Trading Law: From Trading Plan Crisis to Rational Reform*, 2015 UTAH L. REV. 339, 369 n.208; Joanna B. Apolinsky, *Insider Trading as Misfeasance: The Yielding of the Fiduciary Requirement*, 59 U. KAN. L. REV. 493, 535 (2011); Maria Babajanian, *Rewarded for Being Remote: How* United States v. Newman *Improperly Narrows Liability for Tippees*, 46 STETSON L. REV. 199, 218 (2016); Carol B. Swanson, *Insider Trading Madness: Rule 10b5-1 and the Death of Scienter*, 52 U. KAN. L. REV. 147, 179 (2003).

123 *See, e.g.*, Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition*, 52 WASH. & LEE L. REV. 1189, 1198 (1995) (asserting that Rule 14e-3 represents an effort to "revive the [*Texas Gulf Sulphur*] equal access to information rule"); Thomas W. Joo, *The Worst Test of Truth: The "Marketplace of Ideas" as Faulty Metaphor*, 89 TUL. L. REV. 383, 430 (2014) (stating, in the context of Rule 14e-3, that the SEC "views equalization . . . as an important aspect of market health"); Steve Thel, *Statutory Findings and Insider Trading Regulation*, 50 VAND. L. REV. 1091, 1101 (1997) (describing the promulgation of Rule 14e-3 as "adoption of a principle of equal access to information"). Rule 14e-3 is also said to support a parity-of-information regime. *See, e.g.*,

Rule 14e-3 does contain some protective limitations: The Rule is only violated if the information came from certain sources (e.g., the bidder) and is used after someone takes a "substantial step" toward a nonpublic tender offer.

Still, it is significant what limits are *not imposed*. The trader need not know *who* the bidder is[124] or *whether* that bidder has in fact taken a substantial step.[125] Furthermore, the defendant need not know *whether* the information is nonpublic or *whether* the source was a bidder or their associate, so long as she has reason to know.[126]

In theory, all a tipper needs to do to taint a trader is to state that a tender offer is pending with respect to the security in question. If this statement is true, it would then be unlawful for the victim to trade. Even if it were false, prudent traders would become more cautious, given the penalties involved. They might not trade even if they are not *sure* that a tender offer is forthcoming or they were never told who the bidder might be. They would rationally pause if they think it is possible that a court will later determine that a tender offer is merely likely, that a court would think one was pending, or that a prosecutor or plaintiff might think one was pending. Therefore, the potential for Rule 14e-3 to deter trading is not limited to the tender offer context—it applies in any context where a tender offer is plausible.

4. *Techniques: Fraud-Based Theories*

The fraud-based theories (classical and misappropriation) likewise permit insider tainting. This may be surprising because these theories require a fraudulent breach of a duty and innocent recipients of information do not take any such fraudulent actions. Even the risk of wrongful enforcement based on ambiguous facts would seem to be low because traders can protect themselves by avoiding situations where they assume a confidence or appear to confer a benefit on any information source. When

Roberta S. Karmel, *Outsider Trading on Confidential Information—A Breach in Search of a Duty*, 20 CARDOZO L. REV. 83, 96 (1998); Joel Seligman, *The Reformulation of Federal Securities Law Concerning Nonpublic Information*, 73 GEO. L.J. 1083, 1135 (1985) ("The only significant difference between [R]ule 14e-3 and the parity of information approach concerns the scope of application.").

124 *See* United States v. O'Hagan, 139 F.3d 641, 648 n.3 (8th Cir. 1998) (describing the fact that the defendant did not know the identity of the bidder as "of little significance").

125 *See id.* at 650 ("The rule does not require the defendant to have knowledge of these acts."); BLOOMENTHAL & WOLFF, *supra* note 95, § 19:30.

126 *See* SEC v. Ginsburg, 362 F.3d. 1292, 1304 (11th Cir. 2004) ("Rule 14e-3, by its terms, does not require that the offender know or have reason to know that the information relates to a tender offer, so long as the information in fact does relate to a tender offer and the offender knows or has reason to know the information is nonpublic and was acquired by a person with the required status."); BLOOMENTHAL & WOLFF, *supra* note 95, § 19:30.

someone asks for a confidence or a quid pro quo, the trader can emphatically decline.

Yet that is not quite right as a statement of the fraud-based theories. Actually, liability hinges on what the tippee knows about the information's provenance, rather than what the tippee actually did. The tippee need not breach a duty of trust and confidence; insider trading liability follows if *someone* breached a duty and the tippee is aware of this breach.[127]

A tipper can therefore taint a victim by delivering information *as well* as a story explaining why it is proscribed. For example, a tipper could deliver material information and also declare, "My brother bribed an executive to get that information." If this is statement is true, then it is illegal for the tippee to trade.[128] If it is not true, then the law does not actually bar trading, but a reasonable trader may be unsure whether it is true or whether a plaintiff or prosecutor will believe that it was true. Either way, the information's origin story casts a pall over the trader's plans.

The forgoing example concerned a statement about the information having been misappropriated, but it is also possible to cloud information under the classical theory. Recall that the classical theory bars trading when the source breached a duty by disclosing the information in order to obtain a personal benefit such as improved reputation, reciprocal favors, or the simple joy of helping "a trading friend or relative."[129] To implicate this theory, a tipper could say, "By the way, I gave this information to you because I expect reciprocal favors, and also because I genuinely want to benefit you, my friend."[130] Such a comment establishes that the secret was

[127] *See* SEC v. Obus, 693 F.3d 276, 288 (2d Cir. 2012) ("[T]ippee liability can be established if a tippee knew or had reason to know that confidential information was initially obtained and transmitted improperly (and thus through deception), and if the tippee intentionally or recklessly traded while in knowing possession of that information."); a*ccord* United States v. Parigian, 824 F.3d 5, 11 (1st Cir. 2016) (citing *Obus* for the same).

[128] When the source breaches a duty in acquiring or sharing the information, the tippee can be a "Participant[] After the Fact." WANG & STEINBERG, *supra* note 79, § 5.03[1].

[129] Salman v. United States, 137 S. Ct. 420, 427–28 (2016). The latter is akin to trading and then sharing the cash proceeds. *See id.*

[130] It is true that the tippee or the court may believe that this postscript is a pretext. It is certainly false that a tipper intends to benefit a tippee if her principal goal is actually to frustrate the tippee's trading plans. Nor may a malicious tipper always expect loyalty from the tippee. *See* Langevoort, *supra* note 3, at 446 ("[T]rickery can hardly lead to a reasonable expectation of fidelity."). Note, however, that cooperative tipping in the wolf-pack context may conceivably involve tipping *both* to hinder and to help the tippee, whose tainting is what permits them to join the potentially profitable acquisition coalition. *See supra* Section I.C.

Moreover, other classical theory postscripts may *actually succeed* in establishing liability. Directors breach their duty of loyalty when they take unreasonable steps to entrench themselves. *See, e.g.*, AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 114 (Del. Ch. 1986) (finding that a defensive step taken to resist an any-and-all cash tender offer was not reasonable in relation to the given in breach of the tipper's duty, and knowledge of that breach taints the tippee.

Notice that both of these examples involve the tainting backstory being given after the information, a technique we can call "postscripting." I have structured the examples this way in order to emphasize how hard it is for the trader to protect herself from tainting. Any time one learns information, the source may soon after disclose its problematic source. Only if a trader breaks off all contact with the world can she avoid hearing information along with its potentially problematic postscript.

It may be argued that at least some forms of postscripts cannot establish liability precisely because they come too late. A statement that the tipper trusts and expects confidence from the tippee arguably creates obligations only going forward. Leon Cooperman, a billionaire hedge fund manager accused of insider trading, staked his defense on precisely this objection to postscripting liability. The SEC charged Cooperman, and his funds, with buying shares in Atlas Pipeline Partners on the basis of information disclosed to him by Atlas executives on three phone calls—information he was expected to keep confidential.[131] Cooperman argued that an expectation of confidentiality, if any existed, emerged only *after* the tip was given.[132]

While plausible, there are three problems with Cooperman's position.

First, Cooperman's argument would only prevent postscripting relating to the tippee's duty of confidentiality. Other forms of postscripting, such as declaring the information to be the product of misappropriation, would remain effective.

Second, it is not clear as a general matter that a statement (or omission of a vital truthful statement) about trust must precede disclosure. While it

threat, and thus a breach of the directors' duty of loyalty); *see also supra* Section I.A. It would therefore violate the duty of loyalty for a director to share information as part of an unreasonable entrenchment effort. When a manager shares information in order to stop a takeover that endangers her job, the manager arguably defrauds her principal by using the corporation's secrets to obtain a personal benefit. Therefore, the following postscript plausibly taints the tippee: "I told you that information in the hopes that it will disable your trading plans, and thereby save my job." Candid antitakeover tainting plausibly succeeds in tainting.

131 *See* Complaint ¶ 34, SEC v. Cooperman, 243 F. Supp. 3d 597 (E.D. Pa. 2017) (No. 2:16-cv-05043-JS), 2016 WL 5239782 (stating that the Atlas Pipeline executive who shared confidential information with Cooperman "believed Cooperman had an obligation not to use this information to trade APL securities. Indeed, during one of these conversations . . . Cooperman explicitly agreed that he could not and would not use the confidential information").

132 *See* Memorandum of Law in Support of Defendants' Motion to Dismiss at 14, *Cooperman*, 243 F. Supp. 3d 597 (No. 2:16-cv-05403-JS), 2016 WL 9113200 ("[I]nformation can be misappropriated only if the source of the information provides it to the corporate outsider *after* the outsider has agreed to keep the information confidential.").

might seem that fraud is only fraud if it *induces* some form of reliance (like disclosure of information), the Supreme Court recently rejected this proposition in another complex investment setting.[133]

Third, as an evidentiary matter, defendants will not always be secure in the proof that they ended the conversation or disclaimed confidentiality prior to the time liability attached. Will the SEC or a jury believe that the trader deleted an email after the first paragraph signaled that the subsequent information is proscribed? Traders may wisely fear that their trades will be scrutinized in light of what they *might* have read or heard or agreed to. This risk is even greater if other witnesses have their own version of the events and timing.[134]

Despite promising a vigorous defense, Cooperman settled the case. He paid $4.9 million, agreed to have an independent compliance monitor look after his fund until 2022, and promised not to publicly deny wrongdoing (although he was not forced to admit wrongdoing either).[135] More importantly, Cooperman's fund had shrunk from about $9.4 billion under management to just $3.5 billion.[136] Cooperman estimated his losses from

[133] *See* Husky Int'l Elecs., Inc. v. Ritz, 136 S. Ct. 1581, 1590 (2016) (holding that one can commit "actual fraud" for the purposes of the bankruptcy code even when a defendant made no statements and owed no duty of candor, and the victim in no way relied on any deception; rather, intentional efforts to hinder creditors could be a fraud even if the debts were accumulated with perfect honesty (quoting 11 U.S.C. § 523(a)(2)(A) (2012))).

[134] Recall that in Mark Cuban's case, the tipping CEO stated in his deposition that Cuban had agreed to confidentiality. *See supra* text accompanying note 2.

[135] *See* Joint Motion to Enter Final Judgment Pursuant to Consent, Exhibit A, Consent of Defendant Leon G. Cooperman ¶¶ 2, 4, *Cooperman*, 243 F. Supp. 3d 597 (No. 2:16-cv-05043). He thus paid over $3 million more than the alleged gains from insider trading, *see id.* ¶ 2 (trading gains alleged to be $1.76 million), and Cooperman promised not to collect insurance or indemnification for his personal share of the sum, *see id.* ¶ 3.

[136] *Compare* Simone Foxman & Erik Schatzker, *Cooperman Says Omega's Assets Fell to $4 Billion Amid Case*, BLOOMBERG (Oct. 11, 2016, 10:53 AM), https://www.bloomberg.com/news/articles/2016-10-11/cooperman-says-omega-s-assets-dropped-to-4-billion-amid-case [https://perma.cc/WC32-KY2L] (stating that Omega had $9.4 billion in assets under management at the time when Omega first disclosed SEC subpoenas), *with* Bob Van Voris & Matt Robinson, *Cooperman Agrees to Lighter Penalty in Deal With Trump's SEC*, BLOOMBERG (published May 18, 2017, 3:49 PM; updated May 18, 2017, 6:36 PM), https://www.bloomberg.com/news/articles/2017-05-18/cooperman-omega-agree-to-settle-sec-insider-trading-lawsuit [https://perma.cc/BG37-Y9GX] (stating that the firm has $3.5 billion in assets under management). More conservative estimates would time the drop from the beginning of the SEC's actual lawsuit. In that case, the decline would only be from $5.4 billion. Van Voris & Robinson, *supra*. Of course, some of this decline may have been a result of forces unrelated to the SEC. *See* Rob Copeland & Timothy W. Martin, *Hedge Fund Star: We Are 'Under Assault,'* WALL ST. J. (May 12, 2016), https://www.wsj.com/articles/hedge-fund-star-we-are-under-assault-1463071444 [https://perma.cc/A9ST-7KPT] (noting massive outflows from the entire hedge fund sector).

the investigation would exceed $100 million due to managing a smaller corpus,[137] a figure that jives with typical management fees.[138]

Cooperman's settlement signifies that enforcement is costly even if a trader has a strong legal argument. It also denies the public a full airing of his theory. Had he pursued his claim, we might have had an answer to the question of whether post hoc demands for confidentiality can or cannot taint a trader. As it stands, the lesson is that traders face costly risks under the fraud theories for even postscript tainting, and that means that the arsenal for would-be tainters is quite substantial.

B. *Tainting Is Credible*

The law of insider trading creates risks for tippers too. They can be charged for perpetrating or abetting insider trading.[139] Moreover, specific rules prohibit tipping even if no trading occurs.[140] Finally, even if the law

---

[137] *See* Berkeley Lovelace Jr., *Leon Cooperman: Our Assets Under Management Shrank by More than Half to $3.4 Billion After SEC Charges*, CNBC (published Jan 5, 2017 12:01 PM; updated Jan. 5, 2017, 12:54 PM), http://www.cnbc.com/2017/01/05/leon-cooperman-assets-under-management-shrank-by-more-than-half.html [https://perma.cc/4TY4-YKCE].

[138] Fund managers customarily also charge a 2% annual fee as well as a performance fee based on fund returns. A 2% fee on $5.9 billion (the difference between the high and low) is $118 million. *See supra* note 114.

[139] *See* WANG & STEINBERG, *supra* note 79, §5.03.1 (noting that a trading tippee's liability is derivative of a tipper's Rule 10b-5 violation).

[140] Regulation FD prohibits companies from selectively granting early peeks at company secrets to select shareholders and market professionals. *See* 17 C.F.R. § 243.100(a) (2017) ("Whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information . . . to [certain] person[s] . . . the issuer shall make public disclosure of that information . . . ."). The relevant persons are securities market professionals and shareholders who are likely to trade on the information. *See id.* § 243.100(b)(1). Disclosures can be cured by filing an 8-K or a similarly public dissemination. *See id.* § 243.101(e).

Violations of Regulation FD can result in civil and administrative enforcement actions but not private civil or public criminal actions. *See* Regulation FD Final Rule, *supra* note 104. There has been some debate about whether Regulation FD is supposed to contribute to the insider trading jurisprudence. *Compare* Michael D. Guttentag, *Selective Disclosure and Insider Trading*, 69 FLA. L. REV. 519 (2017) (arguing that Regulation FD *should* contribute to insider trading jurisprudence, and that language to the contrary is better read as disclaiming private civil actions), *with* Pritchard, *supra* note 76, at 870 (arguing that violations of Regulation FD are not fraudulent and so do not support an insider trading theory). The source of this disagreement is § 243.102. It provides: "No failure to make a public disclosure required solely by [Regulation FD] shall be deemed to be a violation of Rule 10b-5 under the Securities Exchange Act." § 243.102 (citation omitted); *see also* Selective Disclosure and Insider Trading, Securities Act Release No. 7,787, Exchange Act Release No. 42,259, Investment Company Release Act No. 24,209, 64 Fed. Reg. 72,590, 72,594 (proposed Dec. 28, 1999) (codified at 17 C.F.R. §§ 243.100–243.103 (2017)) [hereinafter Regulation FD Proposed Rule] ("The approach we propose does not . . . revisit the insider trading issues addressed in *Dirks*.").

Regulation FD marked a change in American disclosure practices. In his majority opinion in *Dirks*, Justice Powell specifically rejected a parity-of-information theory on the ground that issuers sometimes needed to seed valuable information in order to curry favor from analysts—a legitimate corporate were no obstacle, many tippers would balk at their tainting strategy out of fear that the tippee would be emboldened by the tip; a tainting plan is foolish if your victim will be delighted to trade after receiving the tip.

If these risks were sufficiently great, then the strategic tipping plans discussed *infra* would be irrational for most potential tippers and there would be no insider tainting to diagnose or prosecute. Moreover, bluffs of tainting would not be credible.

However, there are ample places where the law provides cover to tippers. Sometimes, the cover is a safe harbor—conduct that is strictly legal.[141] Other times, the cover is incomplete, either activated only by contingent facts or dependent upon evidentiary practicalities for assurance. These latter protections do far less to encourage insider tainting. However, rational tippees will not assume that all tippers are rational. They will give some credence to the possibility that a desperate or optimistic tipper may act even without full protection.

1. *Obscured Tips*

Tippers can protect themselves by hiding their identities or tipping information that is, in the end, not actually proscribed.

Anonymous tips do some work in protecting the tipper. A tipper can deliver tips though an anonymous email, letter, phone call, or even human surrogate. These tips allow information to be sent with substantially reduced liability for the tipper and so render credible the threat that some other tips might be true.[142] Tippees may take anonymous information less

---

purpose. *See* Dirks v. SEC, 463 U.S. 646, 658–59 (1983) (describing how analysts ask corporate officers for information in order to judge a security's market worth); *see also* Regulation FD Final Rule, *supra* note 104, at 51,716 n.7 ("[I]n light of the 'personal benefit' test set forth in the Supreme Court's decision in *Dirks* . . . many have viewed issuer selective disclosures to analysts as protected from insider trading liability." (citation omitted)). The legitimacy of this practice was undermined in the wake of the collapse of the dot-com bubble. In part, it seemed unfair that analysts and their patrons got better information than everyone else. In part, there was a concern that analysts were thereby corrupted by the tips; they were unwilling to criticize companies, lest their access to timely information dry up. *See* Regulation FD Proposed Rule, *supra*, at 72,592; *see also* Gretchen Morgenson, *How Did So Many Get It So Wrong?*, N.Y. TIMES (Dec. 31, 2000), http://www.nytimes.com/2000/12/31/business/how-did-so-many-get-it-so-wrong.html [https://perma.cc/YX6N-4Q7L] (describing concern over analyst corruption). This latter concern drove home one of the many ironies baked into information regulation. Practices thought to improve information dissemination—giving true information to individuals whose reputations depend on sharing it—leads to inferior information, as those individuals compromised other aspects of their message.

[141] Tippers must be cautious even when the law is on their side, for the very reasons discussed *supra* Section III.A, concerning ambiguous facts. But they can be more confident than tippees that they will prevail because, as the perpetrator of the scheme, they can take steps to preserve evidence establishing the legality of their tip.

[142] There remain meaningful risks in these cases. Law enforcement officials have powerful forensic tools and may be able uncover the source of information. *See* Peter J. Henning, *More Use of Wiretaps Is*

seriously than attributed information, but prudent tippees may still change their plans in light of such tips.

Safer, and more effective, is for a tipper to share false information. If information turns out to be incorrect, there is no breach in a tipper's disclosure.[143] A tipper can almost risklessly send false tips to the tippee in order to complicate their trading options.

The potential for false tips does much to protect tippers, but such tips do not render insider tainting credible by themselves. False tips probably create no trading liability for the tippee.[144] If all tainting is based on false tips masquerading as true, the entire enterprise will not be credible.[145] However, false tips can make for credible bluffs if an appreciable portion of them are real or carry serious risks of liability for the tippee. Fortunately for tainting perpetrators, the law allows many avenues for lawful, and therefore credible, tipping. We will therefore proceed to examine various channels for credible tainting.

2. *Faithful Tipping*

The law generally tolerates "faithful" tippers (i.e., those who tip for a corporate purpose). The court in *Dirks* held that the law is only broken if "the insider personally will benefit, directly or indirectly, from his disclosure . . . . *i.e.*, whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a

Likely to Come in Trading Cases, N.Y. TIMES (June 24, 2013), https://dealbook.nytimes.com/2013/06/24/more-use-of-wiretaps-is-likely-to-come-in-trading-cases [https://perma.cc/9DRW-NNMX] (describing investigative tools).

143 Of course, the dissemination of lies is often illegal under our securities laws. *See* Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 304–05 (1985) (permitting the recipient of a false tip to sue the tipper, despite the in pari delicto defense); *see also* SEC v. Pirate Inv'r LLC, 580 F.3d 233, 254 (4th Cir. 2009) (holding liable the seller of false tips). Securities fraud is only actionable in private suits when relied upon to buy or sell. If the tippee disbelieves the tip, she does not rely. If she believes the tip and relies, it will be by abstaining from trading. But nontraders have no standing under Rule 10b-5. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 751–52 (1975) (noting that the court was "unable to locate a single decided case from any court . . . which would support the right of [nonbuyers or sellers of a security] to bring a private suit under Rule 10b-5"). When a trader actually trades because of the tip, she will have little desire to make this confession in order to incriminate a tipper.

144 *See* Matthew D. Menghini, Note, *The Availability of the* In Pari Delicto *Defense in Tippee–Tipper Rule 10b-5 Actions After* Dirks v. SEC, 62 WASH. U. L.Q. 519, 540–42 (1984) (discussing a tippee's liability for trades on false tips). *See generally* WANG & STEINBERG, *supra*, note 79, § 4.01 & nn.14–16 (discussing the scope of Rule 10b-5 and various defenses available to the defendant). However, if the tippee is *unsure* about the truth of the false tip, she *can* be convicted of an *attempt* to violate Rule 10b-5 or the federal mail and wire fraud acts. *See* WANG & STEINBERG, *supra* note 79, §§ 4.01 & nn.14–16, 5.02[8][f] & nn.467–69, 5.02[8][g] & n.480, 11.01 & n.5.

145 Recipients of information that they know to be false may still be deterred from trading if the recipients are unsure whether regulators will readily accept that the information was false.

reputational benefit that will translate into future earnings."[146] Tippers who do not obtain such a personal benefit can tip without violating the law. The *Dirks* personal benefit limitation was intended to protect selective disclosures made to help the issuer. The example considered in *Dirks* was disclosure to stock analysts.[147]

Although not rooted in Rule 10b-5's classical theory, Rule 14e-3 liability for trading on tender offers provides tippers with a good faith exception. Tippers are not liable for disclosures to those involved in planning, financing, preparing, or executing a tender offer,[148] nor are they liable for any disclosures pursuant to law.[149]

The law used to tolerate a great deal more faithful tipping than it now does.[150] Indeed, the very conduct at issue in *Dirks* is now proscribed by Regulation FD.[151] However, Regulation FD only disallows selective disclosure to certain market professionals and to shareholders who the tipper reasonably foresees will trade.[152] It would seem that tips to would-be *buyers* of stock are *not* disallowed. Thus, tipping is not barred under Regulation FD to head off bidders and acquirers. Likewise, if the tipper believes the shareholder will not trade—say, because of the risk of insider trading liability—then Regulation FD would not seem to be triggered because they do not foresee trading. Furthermore, Regulation FD applies only to reporting companies, leaving many companies unaffected.[153] Finally, Regulation FD violations do not give rise to private rights of

[146] Dirks v. SEC, 463 U.S. 646, 662–63 (1983). This personal-benefit test was affirmed with little modification in the Supreme Court's *Salman* decision. *Salman* reaffirmed that a tipper may violate the law if he "makes a gift of confidential information to a trading relative or friend." Salman v. United States, 137 S. Ct. 420, 427 (2016) (emphases omitted) (quoting *Dirks*, 463 U.S. at 664); *see also supra* note 85 and accompanying text. *Salman* thus retained the notion that, absent a qualifying personal benefit of that sort, there is no violation.

[147] *See Dirks*, 463 U.S. at 658 ("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 . . . ."). The *Dirks* court also noted that the SEC recognized the importance of analysts to the health of the securities markets. *See id.*

[148] *See* 17 C.F.R. § 240.14e-3(d)(1)(ii) (2017).

[149] *See id.* § 240.14e-3(d)(1)(iii) (exempting from liability any disclosures made "pursuant to a requirement of any statute or rule or regulation promulgated thereunder").

[150] *See* Guttentag, *supra* note 140, at 524–25 (discussing how the adoption of Regulation FD and the rise of the misappropriation theory have narrowed the scope of faithful tipping).

[151] *See id.* For discussion of Regulation FD, see generally WANG & STEINBERG, *supra* note 79, § 5.02[3][c][iii].

[152] It is also worth noting that Regulation FD only covers individuals speaking for a corporate issuer. *See supra* note 141.

[153] *See* 17 C.F.R. § 243.101(b) (defining "issuer" to include only reporting companies).

action.[154] Thus, even those who actually violate it in their strategic tainting face a risk only if government enforcers take interest.

3. *Successful Tainting*

In most cases, tipping is illegal only if the tippee will trade. This is because Section 10(b), the statute under which most insider trading is pursued, regulates only conduct "in connection with the purchase or sale of any security."[155] Accordingly, there can be no liability for conduct which does not result in an actual securities transaction, even if the conduct's chief evil was in discouraging a planned transaction.[156] Therefore, *successful* tainting fully avoids most tipper liability under our securities laws.[157]

It may appear imprudent for the tipper to take actions that are only safe if they achieve their desired effect, but the strategy is less risky than it may appear. A core finding in game theory indicates that the second to last mover in a game can often make costly ultimatums to the last mover.[158] In

[154] *See* Regulation FD Final Rule, *supra* note 104, at 51,718; *see also* 17 C.F.R. § 243.102 (providing that Regulation FD violations are not Rule 10b-5 violations).

[155] 15 U.S.C. § 78j(b) (2012). Other provisions contain similar limitations. *See, e.g.*, *id.* § 77q(a) (prohibiting fraud "in the offer or sale of any securities"). Even more expansively, Rule 14e-3's good faith exception is available even if there is a trade, so long as the tipper does not have reason to think that the tippee will trade. *See* 17 C.F.R. § 240.14e-3(d); *see also supra* notes 151–55 and accompanying text. When tainting law-abiding citizens, tippers may be justifiably confident that no trade will occur. It is therefore possible that a tipper could escape liability under Rule 14e-3 even if a trade actually occurs.

[156] *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 754–55 (1975) (declining to allow private damage actions under Rule 10b-5 by plaintiffs who were neither purchasers nor sellers of securities).

[157] For further discussion of this issue, see WANG & STEINBERG, *supra* note 79, § 5.02.8(f). An interesting related question is whether mail or wire fraud convictions could be secured, even in the absence of a trade. *See* Wang, *supra* note 76, at 254 & n.124, 255 nn.127–28, 257 n.133 (comparing the scope of Rule 10b-5 to that of the mail and wire fraud statutes).

[158] *See* THOMAS SCHELLING, THE STRATEGY OF CONFLICT 83 (3d prtg. 1966) ("[W]hat one player *can* do to avert mutual damage affects what another player *will* do to avert it . . . ."). Other features of the game suggest that the tipper can control the outcomes. The risk to the tipper is often smaller than the risk to the tippee. For example, Rule 14e-3 allows a good faith defense to tippers, but there is no good faith defense for the tippee. *See* 17 C.F.R. § 240.14e-3(d)(1). Even if a court might not ultimately accept that the tipper acted in good faith, the availability of the defense gives tippers more leverage against investigators and prosecutors. Even where the law is not *more favorable* to tippers, the fact that it is less developed than tippee liability may deter some prosecutors. *Cf.* Guttentag, *supra* note 140, at 523–24 ("[N]o obvious common law precedent suggests how to determine when the selective disclosure of material nonpublic information constitutes a deceptive practice."). These differences in elements matter because tippees can be liable even when the tipper is not. *See, e.g.*, United States v. Evans, 486 F.3d 315, 323 (7th Cir. 2007) (noting that a tippee may be convicted in "the rare case where the tipper is acquitted and yet the relationship between the tipper and the tippee is such that the tippee may yet be prosecuted for acting upon the tipper's breach"). In a game that imposes risks only if two parties both violate the law, the party with lesser potential punishment may sometimes take liberties knowing that the other party faces even higher incentives to prevent a bad outcome.

parallel, so long as the tippee is concerned *enough* to abstain, she protects her tipper.

The tippee has the last clear chance to avoid liability for both herself and the tipper. The tipper takes a risk by sharing information, but the tippee must decide unilaterally whether to expose *herself* to legal risks by trading. If the tippee opts not to trade, she protects both herself and the tipper. Importantly, the tippee might abstain for many reasons. She might be normatively concerned about fairness or the authoritative status of the law, she may fear government investigation, or she may worry about how insider trading would affect her status within a company.

C. Tainting in Context

To show how insider trading law may be deployed as a sword, this Section returns to the three contexts described in Part I in which an individual would like to disable the trades of another.

1. Tainting by Managers

Managers have recently discovered the power of insider trading law to disrupt involuntary changes in ownership. In one recent example, a target company used insider trading law as part of its arsenal of antitakeover devices in order to resist both a hostile tender offer and an activist campaign. The colorful characters involved, the terrific sums of money, and the novel uses of legal stratagem made the affair national news.[159] Though there has been no suggestion of strategic tainting, the facts are illustrative of the power of insider tainting to disrupt takeover attempts.

In 2014, Pershing Square and Valeant bought shares of Allergan, the pharmaceutical company that makes Botox.[160] Pershing Square is a well-known activist investment fund, which buys shares with the goal of exerting influence over management, often in order to increase dividend payments. Valeant is a competitor to Allergan, interested in acquiring Allergan for strategic purposes but also to fund dividend payments by slashing R&D.[161]

---

159 *See, e.g.*, Antoine Gara, *Bill Ackman's Insider Trading Lawsuit May Cost Pershing Square Investors $75 Million*, FORBES (Mar. 29, 2017, 6:25 PM), https://www.forbes.com/sites/antoinegara/2017/03/29/bill-ackmans-insider-trading-lawsuit-may-cost-pershing-square-investors-75-million/#4cf8d506849a [https://perma.cc/YZ6P-Y4BX].

160 To be slightly more accurate, the shares were acquired by PS Fund 1, a subsidiary of Pershing Square formed as an acquisition vehicle. PS Fund 1 was 97% owned by Pershing Square and 3% owned by Valeant. *See* Complaint for Violations of Securities Laws ¶¶ 7, 10, 59, Allergan, Inc. v. Valeant Pharm. Int'l, Inc., No. 8:14-CV-01214 (C.D. Cal. dismissed Apr. 9, 2015), 2014 WL 10726137. PS Fund 1 acquired 9.7% of Allergan's stock between February 25, 2014, and April 21, 2014. *Id.* ¶ 66.The facts in this section are generally drawn from the various court opinions.

161 Valeant had been rebuffed in a 2012 friendly takeover offer. *Id.* ¶ 48.

Pershing Square and Valeant were mutually aware of one another's plans. Supposedly, Valeant first approached Pershing Square in pursuit of financing for an attempted takeover of Allergan. Valeant would also stand to gain if Pershing Square acquired a large stake of shares with the intention of voting alongside Valeant in their control efforts. It would allow Valeant to exercise outsize influence without as large a capital outlay and without immediately filing the Williams Act disclosures triggered by large investments.[162] Pershing Square, for its part, would also appreciate an ally in its attempt to shake up Allergan—and early knowledge of Valeant's tender offer would lock in almost assured gains for stock acquired at pre-tender offer prices. On the day the tender offer was announced, Allergan's share price spiked some 30%, generating perhaps a billion dollars in profit for Pershing Square.[163]

Allergan's board disliked both the activist and the hostile acquirer and sought to use insider trading law as a defensive weapon. Allergan sued, arguing that the acquirers' coordinated campaign violated Rule 14e-3's ban on insider trading in the lead-up to a tender offer.[164] Specifically, they alleged that Pershing Square violated the rule by buying shares while aware of Valeant's tender offer plans and Valeant violated the rule by informing Pershing Square of those plans. The presiding court agreed that the facts "raised serious questions as to whether Defendants' conduct . . . . violated Rule 14e-3" and granted a partial injunction.[165] Allergan pursued these arguments in court[166] and on the floor of Congress.[167] Former shareholders followed on with their own suit,[168] netting a $290 million settlement.[169]

---

[162] The Williams Act seeks to limit covert acquisitions by requiring large acquirers to disclose their presence and intentions. *See supra* notes 41–45 and accompanying text.

[163] *See* Jad Chamseddine, *Allergan's Pyott Questions Valeant, Pershing*, CQ ROLL CALL (July 31, 2015), 2015 WL 4591605 ("Pershing walked away with almost $950 million in profit after the stock price was driven up by more than 80 percent during the seven-month standoff.").

[164] *See* Complaint for Violations of Securities Laws, *supra* note 160, ¶ 19.

[165] Order Granting in Part Motion for Preliminary Injunction at 29, *Allergan*, No. 8:14-CV-01214.

[166] Allergan later dropped this lawsuit. *See* Joint Stipulation of Voluntary Dismissal, *Allergan*, No. 8:14-CV-01214.

[167] *See Impact of the U.S. Tax Code on the Market for Corporate Control and Jobs: Hearing Before the Permanent Subcomm. on Investigations, S. Comm. on Homeland Sec. & Gov'tl Affairs*, 114th Cong. (2015) (testimony of David E.I. Pyott, former Chair & CEO of Allergan) (alleging that Allergan was the victim of insider trading and urging investigation); *Oversight of the SEC's Division of Corporation Finance, Hearing Before the Subcomm. on Capital Mkts. & Gov't Sponsored Entities, H. Comm. on Fin. Serv.*, 113th Cong. (2014) (testimony of Keith F. Higgins, Dir., Division of Corp. Fin., SEC) (questioning by Rep. Edward R. Royce related to the Valeant matter).

[168] *See* Complaint for Violations of the Federal Securities Laws, Basile v. Valeant Pharm. Int'l, Inc., No. 8:14-CV-2004 (C.D. Cal. filed Dec. 16, 2014), 2014 WL 7176420; *see also* Order Denying Motion to Dismiss, *Basile,* No. 8:14-CV-2004, 2015 WL 7352005.

These insider trading allegations were part of the reason that Allergan was able to undermine the Valeant–Pershing Square bid. Ultimately, the Allergan board approved a sale to another firm, Actavis, for $70.5 billion,[170] considerably more than the $59 billion offered by Valeant.[171] So Allergan's use of insider trading law as a defensive tactic may have benefited the shareholders. Then again, the deal consummated more than a year later, exposing the shareholders to substantial risk. And, as with all defensive tactics, there is no assurance that the board is even trying to maximize sale price rather than protect themselves.

After Allergan's example, the strategic use of insider trading law to disrupt activist campaigns is now presented as a standard practice.[172]

Allergan did not seed Pershing Square with secrets in order to block their efforts, and so this is not in itself a case of insider tainting. However, the drama could have unfolded in a very similar way had Allergan in fact been the source of the tainting information. Allergan could have communicated to Pershing Square that a tender offer would soon be launched by Actavis. That communication would have triggered Rule 14e-3, rendering subsequent purchases by Pershing Square illegal.

The scope of Rule 14e-3 is potent. It does not require that the disclosure be in breach of a duty or misappropriated, so Pershing Square cannot avoid this risk simply by disclaiming any confidentiality.[173] If the issuer (or bidder) tells you about a pending offer, you cannot trade, period. The consequences of tender offer information are thus much harder to escape (which makes it a much more potent tool for manager insider tainting) than run-of-the-mill material, nonpublic information.[174]

---

169 Anthony Noto, *Judge Approves Settlement Between Allergan Shareholders and Ackman*, N.Y. BUS. J. (Jan. 17, 2018,) https://www.bizjournals.com/newyork/news/2018/01/17/judge-approves-settlement-between-allergan-and.html [https://perma.cc/6PGS-6XM2].

170 *See Actavis Completes Allergan Acquisition*, PR NEWSWIRE (Mar. 17, 2015), https://www.prnewswire.com/news-releases/actavis-completes-allergan-acquisition-300051633.html [https://perma.cc/Z4E2-P8P5].

171 *See* Stuart Pfeifer, *Valeant Says It's Willing to Raise Offer for Allergan to $200 a Share*, L.A. TIMES (Oct. 27, 2014, 5:10 PM), http://www.latimes.com/business/la-fi-valeant-allergan-20141028-story.html [https://perma.cc/9SCB-363E].

172 *See, e.g.*, 3 RANDY RINICELLA ET AL., SUCCESSFUL PARTNERING BETWEEN INSIDE AND OUTSIDE COUNSEL § 46B:33 (Supp. May 2017) ("Insider trading rules may provide another litigation avenue [in responding to activist campaigns]."); *see also* ARTHUR FLEISCHER, JR. ET AL., TAKEOVER DEFENSE: MERGERS AND ACQUISITIONS § 1.03 n.43 (8th ed. 2018) (discussing the Allergan matter).

173 *See supra* Section III.A.2.

174 Recall again Mark Cuban's run-in with the SEC, described *supra* text accompanying notes 1–10. Conceivably, the CEO of Mamma.com sought to taint Mark Cuban with inside information so that Cuban could not sell his shares. The SEC's case depended on testimony that Cuban had agreed to keep the conversation confidential. The case failed in part because Cuban denied the promise of confidentiality and the jury believed him. *See* Bondi, *supra* note 8. A similar case in the UK held

The only way that Pershing Square could avoid this risk is to cease communications with Allergan, but that is a highly unrealistic means of self-preservation. Activist investors like Pershing Square make their living by engaging in dialogue with management, applying pressure and seeking to introduce changes to corporate policy.

2. Tainting by Bidders

Apart from the takeover context, insider tainting is also viable in the competitive bidding context. That strategic application was central to a recent decision by the Japanese regulators overseeing the world's second largest pool of securities trading.[175] The Financial Services Agency of Japan appointed a Working Group on Insider Trading Regulations to reflect on several problems with the law that had become evident in the first decade of the twenty-first century. One of those problems was insider tainting.

The minutes from the Working Group include several different Working Group members expressing concern about intentional tainting.[176] The FSA official in charge reported that that "law firms often inform FSA that these problems of intentional tainting actually happen" and that this problem of intentional tainting "has practically been pointed out for a long time."[177] Yasuhisa Abe, a director of the Japan Business Federation, stated that "this matter has long been pointed out, and [the Federation] has demanded the improvement."[178] The December 24, 2012, final report acknowledged this problem in the tender offer context:

> Under insider trading regulation pertaining to TOB [Tender Offer Bid] Insiders, a recipient of unpublished Tender Offer Facts, in principle, cannot purchase shares of the offeree company until the offeror publishes the Tender Offer Facts. It has been pointed out that therefore, for instance, if a person, who has decided to buy out a listed company, discloses unpublished Tender

together because disclaiming confidentiality is ineffective even outside of the tender offer context. *See* Peter J. Henning, *Einhorn Case Highlights Britain's Broader Definition of Insider Trading*, N.Y. TIMES: DEALBOOK (Jan. 31, 2012, 3:24 PM), http://dealbook.nytimes.com/2012/01/31/einhorn-case-highlights-britains-broader-definition-of-insider-trading [https://perma.cc/B5KN-FXM2] (comparing the Einhorn and Cuban cases).

175 After U.S.-based exchanges, Japan is home to the world's second largest securities trading market. *See Top 10 Stock Exchanges in the World,* WORLD STOCK EXCHANGES, http://www.world-stock-exchanges.net/top10.html [https://perma.cc/BMU3-YF8V].

176 E-mail from Kevin Goldstein, Assoc., Weil Gotshal & Manges LLP, to Andrew Verstein, Assoc. Professor of Law, Wake Forest Univ. Sch. of Law (Oct. 19, 2015, 7:46 PM) (on file with author) (forwarding correspondence from Yoshinori Tatsuno, Assoc., Mori Hamada & Matsumoto, concerning Fin. Servs. Agency (Japan), *Ministerial Conference "Working Group on Insider Trading Regulations" (Part 5) Minutes* (Nov. 27, 2012), http://www.fsa.go.jp/singi/singi_kinyu/insider_h24/gijiroku/20121127.html [https://perma.cc/834K-YNXG]).

177 *Id.*

178 *Id.* However, no specific incidents were discussed.

Offer Facts to other potential acquirers, this would prevent them from increasing their stake.[179]

As a result of this widely perceived problem, the Working Group urged a change in the law, at least in regards to tender offers, to allow trading after an appropriate period of time passes:

> From the perspective of promoting fair competition with respect to mergers and acquisitions and facilitating an orderly securities trading, it would be appropriate for the recipients of unpublished Tender Offer Facts [to] be allowed to purchase shares of the offeree company where investor confidence in the securities markets would not be harmed.[180]

Those recommendations subsequently became law.[181] Legal commentators concurred that the main focus of this law was to address intentional tainting of bidding competitors.[182]

Although written without specific reference to "tainting," the focus of the new safe harbor has not eluded its audience. One major international law firm summarized the provision with explicit reference to tainting.

> In consideration of the fact that a Tender Offeror could intentionally "taint" competitors through the disclosure of its intention to engage in a tender offer bid, the Working Group recommended that limitations be enacted on those parties that became aware of non-public information of a tender offer bid if such transaction would not impede fairness and undermine sound operation of the securities market.[183]

---

179 FIN. SERVS. AGENCY OF JAPAN, THE REVIEW OF INSIDER TRADING REGULATION FOLLOWING RECENT VIOLATIONS AND OTHER DEVELOPMENTS 11–12 (2012), http://www.fsa.go.jp/en/refer/councils/singie_kinyu/20121225/02.pdf [https://perma.cc/7GL9-NWFN].

180 *Id.* at 12.

181 *See* Financial Instruments and Exchange Act [FIEA], Law No. 25 of 1948, art. 167, *translated in Laws, Guidelines, etc.*, FIN. SERVS. AGENCY, http://www.fsa.go.jp/common/law/fie01.pdf [https://perma.cc/KX5S-8U3G] (Japan). The Diet passed the amendment on June 19, 2013. *See* ATSUSHI YAMASHITA ET AL., LEGAL INSIGHT: AMENDMENTS TO JAPANESE INSIDER TRADING REGULATIONS WHICH BROADEN THE SCOPE OF APPLICATION TO TIPPERS AND TENDER OFFER BIDS 1 (2013), http://www.klgates.com/files/Publication/a25ec1bd-267d-484b-a12d-4c0c201095e7/Presentation/PublicationAttachment/de028501-617b-4266-a7fe-7353128aeaf2/Alert%20-%20Amendments%20to%20Japanese%20Insider%20Trading%20(FINAL)_July%202013.pdf [https://perma.cc/99LC-5E4T]. The provisions became effective on April 1, 2014. *See* FIN. SERVS. & TRANSACTIONS GRP., ANDERSON MŌRI & TOMOTSUNE, AMENDMENTS TO THE REGULATION ON INSIDER TRADING (2014), https://www.amt-law.com/pdf/bulletins2_pdf/140327.pdf [https://perma.cc/RZ7G-V9G9].

182 *E.g.*, WORKING GROUP RECOMMENDATIONS WITH RESPECT TO THE INSIDER TRADING REGULATIONS OF JAPAN 2 (2013), http://www.whitecase.com/alerts-03142013-1/#.VCxQzSldWRM [https://perma.cc/DZQ2-TN3B].

183 *Id.*

The Working Group did not quantify the extent of tainting, nor did it cite specific instances nor attempt an international comparison. So it provides only suggestive evidence that insider tainting occurs. Still, this expert body's conviction that a new safe harbor to combat insider tainting was necessary, and the regulators' decision to adjust the law in concurrence, help to dispel any concern that insider tainting might be too speculative. Although Japanese insider trading law differs in some respects from American law, the comparison is still instructive because both bodies of law are similar enough to suffer from similar pathologies.[184]

3. Tainting by Wolves

The forgoing discussion has implicitly addressed manager and competitor tainting, but insider tainting can also be used to coordinate cooperation.[185] By constraining unilateral trading options, insider tainting can reduce defection from cooperatively rational joint bidding strategies.

Consider again Murakami, the swashbuckling Japanese investor who betrayed his activist ally, Takafumi Horie. Because Murakami sold his shares (to Horie, it would be discovered) while he was aware of Horie's planned tender offer, Murakami violated Japan's equivalent to 14e-3.[186] He was charged in 2006 and soon convicted of insider trading. His fund was fined ¥1.149 billion, worth about 10 million USD.[187] Murakami was personally sentenced to two years of hard labor. The lesson is clear: once you start down a road that ends in a tender offer, you must walk all the way together or else end up in trouble.

What may not be clear is why loyalty could have (presumably) protected Murakami from liability. After all, even if he bought shares as planned, Murakami would still have been buying while in possession of tender offer information. Absent an exemption, he would still be guilty of unlawful insider trading.[188] Given this expansiveness, how do rules like 14e-3 allow *any* coordination rather than outlaw it?

184 Japanese insider trading law is generally more restrictive of insiders and more tolerant of tippees. This suggests that some forms of tainting will be easier than others in Japan than in America, but that it will not be systematically out of line with U.S. experience.

185 Although cooperative from an ex ante perspective, cooperative tainting remains a strategic use of insider trading law and one that may be strenuously resisted by its ex post victim whose preferred plans are curtailed.

186 *See* FIEA (Japan), art. 167(5).

187 *See* Givens, *supra* note 60, at 1594–99.

188 Specifically, it would seem that Murakami would be guilty of warehousing, which is tipping off allied purchasers to help stack the stockholder roles with sympathetic investors. *See* Chiarella v. United States, 445 U.S. 222, 234 (1980) (noting that the SEC promulgated Rule 14e-3 to prevent warehousing); LANGEVOORT, *supra* note 121, § 7:4 ("[T]he practice of 'warehousing'—which occurs when the bidder tips other persons about the bid and encourages them to purchase target company shares in an effort to

The answer emerges from Rule 14e-3's exemptions. Despite its reach, Rule 14e-3 is not unlimited. *Some* people get to trade while they are aware of the tender offer. At a minimum, the tender offeror *herself* must be permitted to trade.[189] Rule 14e-3 recognizes an exemption for offerors, and courts have interpreted the offeror exemption to cover both offering persons *and* co-offering persons.[190] And the contours of this judicially created exception are almost perfectly suited to tamp down on wolf pack defections.[191]

Insider trading law creates a narrow path of safety through a perilous realm and thus channels investors to remain on the path. To see the exemption's power as a commitment device, look to who precisely gets the co-offering person exemption. The *Valeant* court crafted a "fact-specific, case-by-case inquiry"[192] by melding together an eight-factor test used by the SEC in a closely related context alongside four additional factors appropriate for this particular legal context.[193]

---

get them into friendly hands—is unlawful under [Rule 14e-3]."). A court evaluating the Pershing Square–Valeant bid for Allergan actually granted a partial injunction against Pershing Square voting any shares, on the theory that there were "serious questions" about whether Pershing Square was entitled an offering person's exemption or instead was simply warehousing shares for the real offering person, Valeant. *See* Order Granting in Part Motion for Preliminary Injunction, *supra* note 165, at 16–20.

189 The SEC actually wished to ban trading by the bidder herself but relented on this point. *Compare* Tender Offers, Securities Act Release No. 6,022, Exchange Act Release No. 15,548, Investment Company Act Release No. 10,575, 44 Fed. Reg. 9,956, 9,978 (proposed Feb. 15, 1979) ("Under [proposed Rule 14e-2], the purchase of subject company securities by a bidder which has determined to make a tender offer but has not publicly announced its intention to do so would be proscribed . . . ."), *with* Tender Offers, Securities Act Release No. 6,158, Exchange Act Release No. 16,384, 44 Fed. Reg. 70,326, 70,338 (proposed Dec. 6, 1979) (noting that, in response to commentators' objections, "the Commission has determined not to adopt the proposal at this time," although the SEC "continues to be concerned by purchases by bidders after the determination to make a tender offer has been made").

190 *E.g.*, Order Granting in Part Motion for Preliminary Injunction, *supra* note 165, at *14 ("[T]he Court concludes from its review of the relevant statutory and regulatory text that the term 'offering person' can include multiple persons.").

191 Coffee and Palia would actually push the law more fully in that direction. They propose

> a bright-line rule: a hedge fund or other investor should not be deemed a "co-offering person" (and thus exempt from insider trading rules), unless it joins fully in making the tender offer and has joint and several liability for its payment. This would preclude most hedge funds from making a modest contribution to the strategic bidder in return for advance knowledge of the bid—a tactic that is hard to distinguish from paying a bribe for a tip.

Coffee & Palia, *supra* note 47, at 600. Under Coffee and Palia's "full commitment" standard, even minor defections from the wolf pack plan would expose the defector to criminal sanctions.

192 Order Granting in Part Motion for Preliminary Injunction, *supra* note 165, at 17.

193 *See id.* at 12, 20. Factors one through eight were drawn from the SEC's test for who must be disclosed as a "bidder" for purposes of Regulation 14D. *See id.* (quoting from *Excerpt from Current Issues and Rulemaking Projects Outline*, U.S. SEC (published Nov. 14, 2000; updated Feb. 8, 2007), https://www.sec.gov/divisions/corpfin/guidance/ci111400ex_tor.htm [https://perma.cc/969L-QQYS]). Factors nine through ten are among those added as additional factors to narrow the application of this

These ten factors are relevant to determining whether a person is a co-offering person:

(1) The person's "role in initiating, structuring, and negotiating the tender offer";
(2) Whether the person is "acting together with the named bidder";
(3) The person's "control [over] the terms of the offer";
(4) Whether person is "providing financing for the tender offer, or playing a primary role in obtaining financing";
(5) Their "control [over] the named bidder";
(6) Whether "the person form[ed] the nominal bidder, or cause[d] it to be formed";
(7) Whether "the person beneficially own[s] the securities purchased by the named bidder in the tender offer or the assets of the target company";
(8) The "extent to which the other party benefits from the transaction";
(9) Their "control over the surviving entity";
(10) Their "identity with the named bidder."[194]

Notice that most of these factors hinge on extended cooperation with the other members of the activist group, and all of them may be proven in part through the testimony of the other members of the activist group. By tying the exemption to the cooperation and testimony of the activist group, courts have fashioned a test that encourages members of the group to hang together.

Consider the forms of defection discussed previously. An investor who promises to buy shares with the group but instead sells them will not be invited to control the subsequent tender offer or control its terms, and she can be excluded from any joint venture acquisition vehicle. Lacking shares at the time of the tender offer, she will not benefit from its effects. With these elements missing, the investor will likely not be considered a

test to fewer persons. *See id.* at 19–20. The court accepted the plaintiff's argument that the Regulation 14D bidder inquiry is meant to be cast widely to facilitate disclosure, whereas the Rule 14e-3 exception for co-offering persons ought to be narrow to prevent too much informed trading. *Id.* (justifying the narrower test as "consistent with Rule 14-3's purpose of limiting the universe of persons permitted to trade on inside information only to the person making the tender offer"). The other additional factors suggested by the plaintiff largely overlapped with those already enumerated by the SEC.

[194] *Id.* at 17, 20.

co-offering person and any bids in advance of the offer will violate Rule 14e-3.[195]

When Allergan accused Pershing Square of illegally trading with knowledge of Valeant's tender offer, Pershing Square indeed argued that it should escape liability as a co-offering person.[196] The court found that there were "serious questions" about whether Pershing Square was indeed a co-issuing person because it lacked control over the offer price and did not retain any interest in the surviving entity.[197] If Pershing Square wanted to join in the tender offer gains, it could only do it by keeping a robust control and economic stake. Thus, even if investors see grounds for self-enrichment, the threat of insider trading liability gives them a reason to resolve their differences and pursue their common project.

In addition to these objective indicia, evidentiary factors are also important. If the difference between warehousing and co-offering seems vague, that only bolsters the power of tainting to support commitment. The testimony of the putative co-offering person or persons could prove helpful in distinguishing pernicious warehousing from virtuous co-offering. One gets less useful testimony from those who bear grudges. For both evidentiary and legal reasons, one's co-offering partner has a partial veto over one's trading options.

*   *   *

Insider tainting is viable and credible. It can be used by managers to covertly block takeovers, stifling the market for corporate control. Insider tainting lets managers circumvent antitakeover jurisprudence. The result is that corporate assets may remain under the control of ineffective managers, and shareholders lose out on potentially lucrative buyouts.

Shareholders likewise lose when acquirers face no competition. Insider tainting lets bidders knock out their competition and potentially buy a company for a song. They effectively circumvent federal laws meant to render the tender offer process fair, competitive, and noncoercive.

Likewise, the use of tainting by wolf packs allows these activist groups to work in concert while circumventing the Williams Act's regulation of concerted activism. We can be agnostic about whether the rise of wolf packs is good or bad and yet still be skeptical of this element of

[195] An investor who sets off on her own activist campaign might still benefit from the primary group's tender offer but no more than any other shareholder. Regardless, it is hard to imagine a co-offeror exemption applying to a competitor.

[196] *See* Order Granting in Part Motion for Preliminary Injunction, *supra* note 165, at 20.

[197] *Id.* at 22.

their arsenal. If the law would impose disclosure and other obligations on hedge funds coordinated through contract, it is a peculiar arbitrage to suspend those obligations when the coordinating law is instead insider trading law.

Whether or not insider tainting is always bad is an interesting question.[198] For now, we proceed on the assumption that insider tainting is generally a problematic phenomenon. If that is so, it is worth asking how we can prevent it and what it signifies about U.S. insider trading laws in general. It is to those questions that the final Part looks.

IV. CONSIDERING INSIDER TAINTING

We have seen that insider tainting is viable and credible. If we wish to control it, we must reduce its credibility, reduce its viability, or both. That is, we must either catch and punish those who engage in insider tainting or we must protect those who are victimized by insider tainting, or both.

There are indeed some steps we might consider in both of those veins. However, both tasks are more difficult than they may appear. Section A discusses possible modifications to the securities enforcement regime, highlighting both what might help and what is fraught with difficulty.

This discussion of solutions sets the stage for reflection on the deeper significance of insider tainting. It is a very strange thing that insider trading law can be misused in this way and that this misuse is difficult to prevent. Ultimately, insider tainting is a window into the telos and praxis of information regulation. Section B undertakes these discussions.

A. Enforcement

Can insider tainting be controlled through appropriate exercise of the government's prosecutorial and enforcement powers? Subsection 1 describes the potential for preventing tainting through aggressive policing of its perpetrators. Subsection 2 explores the role of lenience for tainting's victims.

1. Punishing Perpetrators

It is difficult to prosecute tainters because much tainting is arguably legal under U.S. securities laws.[199] For example, successful tainting cannot be prosecuted under Rule 10b-5 because that rule requires a purchase or

[198] For instance, if state and federal M&A law ever leads to inefficient results, then using insider tainting to circumvent the law could lead to more efficient results. If that occurs often, and if the circumvented law cannot be changed to accommodate these cases, then insider tainting could even be overall efficient.

[199] *See supra* Section III.B.

sale, and successful tainting results in no purchase or sale. Congress could create an ad hoc offense targeting tainting, regardless of whether there is a purchase or sale.[200] The ad hoc prohibition here could be akin to Regulation FD but cover a wider variety of defendants and apply in a wider variety of cases. Regulation FD itself could likewise be adjusted to more completely prohibit tainting conduct. Finally, prosecutors and the SEC could simply resolve to catch perpetrators of insider tainting.

Securities law interventions could be supported by corporate law. Managers who disclose corporate secrets for inappropriate purposes violate the duty of loyalty,[201] and states have long offered their own insider trading restrictions based on fiduciary theories.[202] When tippers undermine corporate interests in order to protect their jobs, they should be liable under state corporate law.[203]

The more interesting question concerns manager tainting efforts that are plausibly beneficial to the corporation. Like all takeover defenses, they might be useful in blocking a foolhardy or myopic acquirer or in buying time to drum up other bids. One might think that some uses of insider

---

[200] Congress did as much in prohibiting spoofing, which entails the placing of trading orders with the intent to cancel them prior to execution. *See* 7 U.S.C. § 6c(a)(5)(C) (2012). Effective spoofing may therefore involve no purchase or sale. *See generally* John I. Sanders, Comment, *Spoofing: A Proposal for Normalizing Divergent Securities and Commodities Futures Regimes*, 51 WAKE FOREST L. REV. 517, 518–19 (2016).

[201] *See* Penn Mart Realty Co. v. Becker, 298 A.2d 349, 351 (Del. Ch. 1972) ("Fraud and self-dealing are not the only ways in which corporate directors may breach their fiduciary duty; they may also breach that duty by being grossly negligent or by wasting corporate assets.").

[202] S*ee, e.g.*, Brophy v. Cities Serv. Co., 70 A.2d 5, 8 (Del. Ch. 1949) (allowing a complaint that alleged that a corporate insider violated his duty of loyalty by trading in the company's securities on the basis of nonpublic information); *see also In re* Primedia, Inc. Shareholders Litig., 67 A.3d 455 (Del. Ch. 2013) (declining to dismiss a class action complaint to block a merger on the grounds that the Primedia directors did not get any value for a pending *Brophy* claim). For discussion of cases both allowing and rejecting state law claims by the issuer against insider trading defendants, see WANG & STEINBERG, *supra* note 79, § 15.03[2].

[203] One core rationale for insider trading regulation is the limitation of agency problems. *See* James D. Cox, *Insider Trading and Contracting: A Critical Response to the "Chicago School,"* 1986 DUKE L.J. 628, 643, 648 (arguing that insider trading might distract executives, or lead to manipulation and leaks); *see also* Frank H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 SUP. CT. REV. 309, 332 (arguing that insider trading may lead to excess volatility); Saul Levmore, *Securities and Secrets: Insider Trading and the Law of Contracts*, 68 VA. L. REV. 117, 149 (1982) ("[T]he temptation of profit might actually encourage an insider to act against the corporation's interest."). *But see* Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 874–76 (1983) (arguing that risk-averse managers need such incentives and their team dynamics limit how far things can go without a leak); Jesse M. Fried, *Insider Signaling and Insider Trading with Repurchase Tender Offers*, 67 U. CHI. L. REV. 421, 425 n.18 (2000) ("The prospect of insider trading profits can . . . encourage insiders to invest in projects that are difficult for outsiders to assess, whether these projects are otherwise desirable or not, in order to increase the information asymmetry between themselves and public shareholders . . . ."). It is ironic that insider tainting has the potential to aggravate agency problems, insofar as it acts as an antitakeover strategy.

tainting are reasonable and proportionate. However, insider tainting is not disclosed to shareholders, who therefore cannot evaluate its appropriateness. It is no great reach to argue that state corporate law should incorporate a per se ban on insider tainting.[204]

Bidders do not owe fiduciary duties to the target company shareholders, so state corporate law is not a useful channel by which to restrain them. However, when bidders use insider tainting to deter or discipline other acquirers, this tactical choice is almost certainly appropriate for disclosure under the Williams Act. Anyone buying 5% or more of a stock must timely file with the SEC a detailed disclosure, including discussion of their intentions.[205] It should not be controversial for the SEC and courts to deem Schedule 13D filings incomplete if they omit discussion of recourse to insider tainting. Similar disclosures are required, and should cover tainting, for the execution of a tender offer.

Yet legal restrictions—whether state or federal, corporate or securities—face information problems. Courts cannot discipline perpetrators without information about their efforts, and perpetrators will go to great lengths to conceal their conduct.

Further surveillance and evidentiary problems arise from the fact that victims of insider tainting will be reluctant to come forward. The victims of insider tainting will often be sophisticated traders and investors whose research practices may well push the boundaries of the law. To report tainting to the SEC, victims would necessarily admit to possessing material, nonpublic information and invite careful consideration of their practices. Victims' reluctance to expose themselves to scrutiny by reporting a crime replicates in a white-collar context a phenomenon familiar to scholars of street crime and immigration law: in order to actually enforce the law in marginalized communities, law enforcement officials must assure victims that they are safe to report and cooperate.[206]

---

204 The fact that some of the simplest and most important fixes are obtained from corporate law underscores the importance of transsubstantive analyses. *See generally* James J. Park, *Reassessing the Distinction Between Corporate and Securities Law*, 64 UCLA L. REV. 116 (2017) (rejecting some distinctions between securities and corporate law, but embracing others).

205 *See supra* note 41 and accompanying text.

206 *See* NIK THEODORE, INSECURE COMMUNITIES: LATINO PERCEPTIONS OF POLICE INVOLVEMENT IN IMMIGRATION ENFORCEMENT 1 (2013), http://www.policylink.org/sites/default/files/INSECURE_COMMUNITIES_REPORT_FINAL.PDF [https://perma.cc/9DBX-JHE4] (stating that 44% of Latinos and 70% of undocumented immigrants report that they are less likely to contact law enforcement authorities if they are victims of crime); Lou Furman & Alison R McCrary, *Building Trust in Law Enforcement: Community-Police Mediation in New Orleans*, 63 LA. B.J. 192, 194 (2015) (noting that civilians who attended a community–police mediation program designed to build trust reported an increased likelihood to report incidents to the police); Tracey L. Meares, *The Path Forward: Improving the Dynamics of Community–Police Relationships to Achieve Effective Law*

This leads naturally to the question of how to assure the victims of insider tainting that they will not be punished for what they report or the attention that it brings to them. We turn to that question now.

2. *Protecting Victims*

Prosecutors can attempt to allay the fears of the victims of insider tainting (that they might be prosecuted if they report their involvement with the tipper) by trying not to prosecute victims of insider tainting. But this policy will give little comfort to some tainted individuals; an individual prosecutor may not believe the victim that the tipping was unwanted. Even if all regulators exercised appropriate restraint, private plaintiffs would not. Insider trading gives rise to private actions under Rule 10b-5.[207] Entrepreneurial plaintiffs' lawyers are unlikely to restrain themselves if given the chance to pursue disgorgement.

We could institutionalize lenience toward victims of tainting in order to make lenience credible and predictable.[208] Japan did as much, adopting a safe harbor for victims of tainting in the tender offer context.[209] The amended law gives tainted traders two ways to overcome the taint. First, they may disclose both the content of the tip as well as how they came to learn it.

Enforcement Policies, 117 COLUM. L. REV. 1355, 1359–60 (2017) (explaining low cooperation in terms of perceptions that police are not procedurally fair). *But see* Adam B. Cox & Thomas J. Miles, *Legitimacy and Cooperation: Will Immigrants Cooperate with Local Police Who Enforce Federal Immigration Law?* 48–49 (Coase-Sandor Inst. for Law & Econ., Working Paper No. 734 (2d Series), 2015), http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=2438&context=law_and_economics [https://perma.cc/9H2U-JJUS] (questioning the assumption that deputizing police to enforce immigration laws via the Secured Communities program undermined immigrant communities' trust in law enforcement).

207 For discussion of Rule 10b-5 private actions against insider trading defendants, see generally WANG & STEINBERG, *supra* note 79, §§ 6.01–13.

208 We could expand this exemption to cover private suits as well.

209 Japan has a law similar to SEC Rule 14e-3, which prohibits trading while in possession of information about a pending tender offer. *See* Financial Instruments and Exchange Act [FIEA], Law No. 25 of 1948, art. 167, *translated in Laws, Guidelines, etc.*, FIN. SERVS. AGENCY, http://www.fsa.go.jp/common/law/fie01.pdf [https://perma.cc/KX5S-8U3G] (Japan). The law provided that "[u]nder insider trading regulation . . . a recipient of unpublished Tender Offer Facts, in principle, cannot purchase shares of the offeree company until the offeror publishes the Tender Offer Facts." WORKING GROUP RECOMMENDATIONS WITH RESPECT TO THE INSIDER TRADING REGULATIONS OF JAPAN, *supra* note 182, at 11. The enacted statute used the phrase "Fact Concerning Launch of a Tender Offer" in lieu of the Working Group's "Tender Offer Facts." *See* FIEA (Japan), art. 167(2) (defining "Facts Concerning Launch of a Tender Offer"). A Working Group appointed by the Japanese securities regulator was concerned that these restrictions would inhibit the takeover market. In June of 2013, the law was amended in a variety of ways to implement the proposals put forth by the Working Group. Among them were provisions added to address the possibility of insider tainting. The amended law gives tainted traders two ways to overcome the taint. *See supra* note 181 and accompanying text.

Second, and more interestingly, they may wait six months.[210] After that period, the trader may begin to trade again—though it seems that the tainted trader remains barred from making her own tender offers.[211] The notion is that after six months, any inside information is likely to have lost its value. Consistent with the Japanese approach of listing certain types of information as per se material, we might say that this safe harbor deems certain stale information as per se immaterial.

The SEC could adopt such a safe harbor as a partial solution. A trader who received any information—tender offer or otherwise—would be eligible to trade again after an appropriate period of time.

Yet such an approach is both under- and overinclusive. It is overinclusive in that it would supply a defense to traders who were not tainted. Dyed-in-the-wool insider traders would calibrate their conduct and litigation defenses to match any available safe harbor, fabricating earlier-in-time origin stories for any information obtained.

It is underinclusive in that many victims of tainting will find a long delay interminable. Many reasons to buy or sell—an urgent need for liquidity, a sense that the stock is temporarily mispriced, the realization by many firms at the same time that acquiring a given supplier will give the acquirer a strategic edge—must be acted upon soon or not at all. This is particularly true in the case of competitive bidding. A target company is likely to be off the market six months after the auction would have begun.

Another form of systematic protection for victims would be to alter the knowledge or causation standard now used in insider trading law.[212] Recall that one reason that tainting is possible is that victims cannot simply set aside the information tipped. Once tipped, they are aware of the proscribed information, that is, they are in knowing possession. Under the SEC's "awareness" standard, the proscribed information need not actually cause any change in trading conduct; so information "set aside" is still sufficient to create liability. Under a "use" standard, traders would not be liable for trading upon receipt of a tip if—as many victims will—they had ample reason to trade and would have done so anyway. Given the amount of debate surrounding this standard, it is natural to ask whether insider tainting offers a reason to reconsider the law's causation standard.[213]

---

210 *See* FIEA (Japan), art. 167(5)(viii)–(ix).

211 *See id.*

212 *See supra* Section II.A.

213 Some of the arguments for a "use" standard include: (1) It gives proper attention to the importance of scienter, whereas a "possession" standard allows conviction of a defendant with no fraudulent or deceptive intent. *See* United States v. Smith, 155 F.3d 1051, 1067–68 (9th Cir. 1998) (discussing the benefit of a scienter requirement under a "use" standard); s*ee also* SEC v. Adler,

The most reasonable conclusion may not be a wholesale change of the causation standard but a targeted change for tainted traders. Where there are credible allegations of insider tainting, the facts will often support some inference that the defendant was going to trade anyway, and this could be an effective affirmative defense.[214]

The main rationales in favor of a "possession" standard include easing the practical burden imposed by a "use" standard,[215] references to statutory text,[216] conformity with prior decisions,[217] and consistency with the classical theory of insider trading.[218] Most interestingly, Professor Fried argues that a

---

137 F.3d 1325, 1338 (11th Cir. 1998) (stating that "we do not believe that the SEC's knowing possession test would always and inevitably be limited to situations involving fraud"). For scholars raising similar criticisms, see, for example, Stuart Sinai, *A Challenge to the Validity of Rule 10b5-1*, 30 SEC. REG. L.J. 261, 264–67, 271, 282 (2002); Swanson, *supra* note 122, at 196–99, 204 (criticizing the lack of scienter and suggesting that the SEC may have exceeded its authority in promulgating such a rule); Kevin E. Warner, *Rethinking Trades "on the Basis of" Inside Information: Some Interpretations of SEC Rule 10b5-1*, 83 B.U. L. REV. 281, 305–14 (2003) (arguing that courts should read a scienter requirement into Rule 10b-5). (2) By relieving prosecutors of the question of whether the trade was motivated in part by proscribed information—whether or not the defendant is allowed an affirmative defense—an awareness standard shifts significant burdens of proof onto the defendant, which is unacceptable in a criminal action and undesirable in a civil action. *See Smith*, 155 F.3d at 1069 (noting that because the case is a criminal prosecution, the court is "therefore not at liberty . . . to establish an evidentiary presumption that gives rise to an inference of use").

214 Under *Adler*, such an affirmative defense is already possible. *See Adler*, 137 F.3d at 1337 (noting that trading while in possession of information gives rise to a "strong inference" that such information was used, but that the defendant can "rebut the inference by adducing evidence that there was no causal connection between the information and the trade"). Likewise, Rule 10b5-1(c) recognizes its own affirmative defense. *See* 17 C.F.R. § 240.10b5-1(c) (2017). However, the formalities for that rule make it unworkable in a variety of tainting contexts. It operates if the trader has already entered into a binding contract to trade, instructed someone to execute their trade, or adopted a written trading plan. *See id.* § 240.10b5-1(c)(A). The plan must specify the terms of a series of transactions to come and allow the trader no discretion to vary it. *See id.* § 240.10b5-1(c)(B). Such an affirmative defense is fine for executives who wish to buy or sell corporate stock at regular intervals, but it is plainly too restrictive for any of the M&A contexts described in this article.

215 *See* United States v. Teicher, 987 F.2d 112, 120–21 (2d Cir. 1993) (discussing the simplicity of the "knowing possession" standard).

216 *E.g.*, 15 U.S.C. §§ 78u-1, 78t-1 (2012) (both referring to "any person" who violates or has violated "any provision of this chapter or the rules or regulation thereunder by purchasing or selling a security while in possession of material, nonpublic information"). *Compare* LANGEVOORT, *supra* note 121, § 3.13 (arguing that this language is "an endorsement of the broader ["possession"] test for insider trading liability"), *with* WANG & STEINBERG, *supra* note 79, § 4.04[5] (arguing that "[c]hoice of the phrase 'while in possession of' could be either an endorsement of the broader standard or a refusal to choose between the two standards").

217 *See Teicher*, 987 F.2d at 120–21 (noting that the "possession" standard is consistent with the "disclose or abstain" rule (quoting Chiarella v. United States, 445 U.S. 222, 227 (1980))); *see also In re* Cady, Roberts & Co., Exchange Act Release No. 34-6668, 1961 WL 60638 (Nov. 8, 1961) (establishing the "disclose or abstain" rule).

218 *See* Donna M. Nagy, *The "Possession vs. Use" Debate in the Context of Securities Trading by Traditional Insiders: Why Silence Can Never Be Golden*, 67 U. CIN. L. REV. 1129, 1135 (1999) (justifying the "possession" standard on the grounds of fairness).

"possession" standard is a logical fit with a regime that allows insiders to profitably abstain and cannot prevent them from doing so.[219] Insiders are indeed hemmed in by a "possession" standard, blocked from trades they would otherwise make, but their losses from these trades approximately offset the relative gains they make from "insider abstentions."[220] That is, insiders can lawfully cancel trades in light of material, nonpublic information, averting losses. If we accept that insider abstentions are inevitable, but we do not want insiders to make above-market returns based on their knowledge, then a possession rule makes sense.

While accepting Professor Fried's claims in general, we can say with confidence that it applies with less strength in the context of, and therefore in the shadow of, insider tainting. Fried's point is that insiders already get a perk by virtue of their role—by learning about information adverse to their current trading plans, insiders can always abstain from trading and avoid the loss befalling the less informed masses. Our law does not seek to stop this behavior, nor could it easily do so. But the tax imposed by way of a "knowing possession" standard precisely offsets this perk. Traders who intended to trade will be unable to do so because of confirmatory but proscribed information. Fried shows that the expected value of abstention opportunities gained should approximately match the expected cost of trading opportunities lost because news is just as likely to contradict one's trading plans as to bolster them.[221]

Such an outcome is not assured when strategic actors disseminate information to suit their own plans. A mogul in the business of buying operating companies for her conglomerate is *not* going to receive a representative sample of information, some reinforcing her buying plans and some reinforcing her plans to abstain from buying certain stocks. Strategic tippers will only bother to give information intended to frustrate likely plans to buy or sell. Hostile buyers will be tipped of other pending tender offers relating to the target company, for example, not about other companies they never planned to buy. Unlike the executives in Fried's framework, law-abiding victims of tainting will be systematically disadvantaged by the information they receive.

While recognizing a different causation standard for tainting than the rest of insider trading might appear ad hoc and complex, it is not unimaginable that the different economics of insider tainting warrant a subtly different rule. Professor Donna Nagy has argued that the standard—

[219] *See* Jesse M. Fried, *Insider Abstention*, 113 YALE L.J. 455, 489 (2003).

[220] *Id.*

[221] *See id.*

possession or use—should turn on the sort of insider trading. Professor Nagy argues that classical insiders, such as the directors of firms, owe broad disclosure duties and may not trade without disclosing all the material information that the shareholders might want to know; thus they are subject to a "knowing possession" standard.[222] Various other actors, such as tippees, do not stand in a fiduciary relationship with their trading partners and so are subject to less stringent disclosure duties.[223] For them, the appropriate standard really is the use rule. Insofar as this insider tainting arises in all insider trading contexts *except* classical theory trading by classical corporate insiders, it fits nicely with Professor Nagy's analysis. That is, the typical individuals inhibited by insider tainting are outsiders to the firm, such as would-be investors. These individuals do not owe fiduciary duties to other traders that would justify a "possession" standard. Thus, abusive information tainting can be reduced in a way that is consistent with the underlying logic of the main theories of insider trading.

There is a case to be made for a "use" standard in this context, but it comes with obvious risks. Intransigent insider traders will gin up stories about intentional tainting in order to avoid liability. It is an open question whether it is worth the effort and cost of vetting those claims to deal with this problem. And even victims of tainting may be making the best of it by trading even more aggressively in light of their new information. Any safe harbor would have to prevent (or risk) licensing such post-taint insider trading.

The causation (use or possession) standard is not the only substantive component of insider trading law that bears on the viability of tainting. Another way to protect victims of tainting is to make the law turn on facts that are objectively demonstrable at the time of the tip. If tippees can be sure that they will not be liable for trading and if they know that it will be a simple matter to vindicate themselves before prosecutors or compliance departments, then they can safely ignore the tainting tip. The benefits of bright-line assurance provide some support for a strong personal benefit test and some reason to oppose an expansive equal access rule.

The Supreme Court in *Dirks* held that individuals are generally free to share information and to trade on the information they receive. However, trading may be proscribed when certain "objective criteria" are met, such as when "the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will

222 *See* Nagy, *supra* note 218, at 1135.

223 *See id.*

translate into future earnings."[224] The Second Circuit's *Newman* decision, later overruled,[225] seized upon the language of "pecuniary gain" to heighten the personal benefit test. During the brief life of *Newman*, conviction required "a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature. In other words . . . a *quid pro quo*."[226]

The personal benefit requirement of *Dirks* and, briefly, *Newman* is usually understood as a carve-out to protect discrete classes of useful conduct. Executives may sometimes help their employers by sharing information with analysts. Analysts improve market efficiency by cobbling together information. A personal benefit requirement separates these useful activities from the corrupt and inefficient sale of secrets by insiders.

Insider tainting allows us to view the personal benefit standard in a new light. Rather than just protecting certain classes of tippers and tippees (executives interfacing with analysists), the personal benefit test helps protect all traders against tainting. That is because a trader can know at the time of the tip whether she has conferred a personal benefit onto the tipper. When there is no suggestion of a personal benefit to the tipper, the tippee can trade with confidence.

This confidence is even greater if courts require objective indicia of pecuniary quid pro quo to satisfy the personal benefit test. A tippee will know immediately whether she has given cash to the tipper. In most tainting cases, the tippee will not have paid for the tip. This fact will not only protect her at trial but will also give her immediate assurance of safety, demonstrable enough to calm prosecutors and compliance departments.

This is not a perfect safe harbor. The personal benefit test may not apply in all classical theory cases or any misappropriation cases. And after *Salman*, the personal benefit test has been widened again to allow more than objective and pecuniary benefits. Still, the personal benefit test is a prodefendant rule that helps protect against tainting more than other prodefendant rules. For example, a heightened burden of proof on materiality (requiring prosecutors to establish by clear and convincing evidence that the tip was material) would help defendants win cases, but it

[224] Dirks v. SEC, 463 U.S. 646, 663 (1983).

[225] United States v. Newman, 773 F.3d 438 (2d Cir. 2014), *overruled by* Salman v. United States, 137 S. Ct. 420, 428 (2016) (overruling the requirement of pecuniary gain), United States v. Martoma, 869 F.3d 58, 67 (2d Cir. 2017) (overruling the requirement of "meaningfully close personal relationship"); *see also supra* note 85.

[226] *Newman*, 773 F.3d at 452.

would not give them ex ante certainty of victory, nor would it make it easy for them to quickly convince prosecutors and compliance departments to leave them alone. This difference in the timing and demonstrability of assurance, and the resultant protection against tainting, provides some vindication of a strong personal benefit test.

Tainting also points out an additional cost of a more restrictive insider trading rules. In the context of tender offers, American law mostly prohibits trading while in possession of material nonpublic information, regardless of how one learned the information. For many, this parity of access presumption is the ideal and would be appropriately expanded to prohibit informed trading in all assets. Whatever the merits or demerits of such a regime, insider tainting adds another argument against its adoption. In an equal access regime, knowledge alone is always disabling, and so tainting is much easier to achieve. The tipping party need not add a postscript about the provenance of the information, nor can the information recipient protect themselves by avoiding a personal or pecuniary relationship with the source.

Although tainting is possible because of peculiar features of our system (e.g., harsh punishment for lawbreakers a "use" standard for causation), it is also tempered by other features of our law (e.g., restrictions that turn on duty and may require a showing of a personal benefit, rather than an equal access rule). Whether these features are ultimately justified cannot be settled here, but it is worth noticing that there is at least a kind of symmetry and fit with regards to the threat of insider tainting.

B. Learning from Tainting

This Section broadens the view, asking what insider tainting might teach about the law of insider trading generally and, even more broadly, the regulation of information in markets.

1. Competing Impulses in American Insider Trading Law

If insider trading is possible, and if it is hard to constrain, it serves to highlight the competing natures of U.S. insider trading law. On the one hand, the law is prodefendant. Rule 10b-5 applies only to purchases and sales. Our law generally allows insider trading in most assets, and it blocks insider trading in securities only when we can implicate the trader with some kind of fraud and, usually, breach of a duty.[227] This tolerant attitude differs from the approach of other jurisdictions, which have long barred

[227] *See supra* Section II.A.

trading in *any* financial asset while possessing essentially *any* informational advantage.[228]

This prodefendant strain of insider trading law may reflect American solicitude toward white-collar criminals, our commitment to robust capital markets, suspicion of lawyer-driven private litigation, or the path dependency of our common law rulemaking. It also may reflect a legacy of toleration of insider trading. Informed trading only became the market's most notorious offense beginning in the early 1960s,[229] and it was only thirty years ago that the words "insider trading" appeared in a statute for the first time.[230]

Yet while the substance of our law has often favored defendants, American insider trading law remains a fearsome creature in terms of its penalties and potential for enforcement. Dozens of traders each year are investigated for trading on the basis of proscribed information,[231] resulting in a multitude of civil enforcement actions.[232] Since 2009, more than eighty traders have been criminally convicted by federal prosecutors in Manhattan alone.[233] The law authorizes double-digit prison terms and multimillion dollar fines.[234] The litigation process is expensive and can impose interim harms on a defendant's reputation and business. In addition, the harshness of penalties and the indirect impact of an enforcement action impose a chilling aura over conduct anywhere near the line of legality.

---

[228] European law is not strictly more expansive. The European Union's Market Abuse directive instructs member states to prohibit "insider dealing," which occurs "where a person possesses inside information and uses that information by acquiring or disposing of, for its own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates." Council Regulation 596/2014, art. 8, ¶ 1, 2014 O.J. (L 173) (EU). It therefore adopts a "use" standard for causation. *See* Hui Huang, *The Insider Trading "Possession Versus Use" Debate: An International Analysis*, 34 SEC. REG. L.J. (2006) (comparing the relevant standards under UK, Australian, and Canadian law).

[229] *See* MANNE, *supra* note 73, at 2 (stating that insider trading did not evoke public condemnation in the early twentieth century); *see also* Crimmins, *supra* note 72, at 349 ("From the SEC's founding in 1934 to Chairman Cary's groundbreaking 1961 decision in *Cady, Roberts*—a span of twenty-seven years—the SEC brought no insider trading cases at all. Over the subsequent twenty years, insider trading continued to be a relatively low prosecution priority in terms of the number of cases at the agency . . . ."). *But see* Perino, *supra* note 73, at 51 (challenging the view that insider trading was an accepted practice in the early twentieth century).

[230] *See supra* note 71.

[231] *See supra* note 67.

[232] *See supra* note 68.

[233] *See supra* note 69.

[234] *See, e.g.*, 15 U.S.C. § 78ff(a) (2012) (providing for not more than $5 million in fines, 20 years imprisonment, or both for any willful violation of the Exchange Act or any rule thereunder). *See generally* WANG & STEINBERG, *supra* note 79, § 7.02[1].

And it is often unclear where the line is. No statute or rule defines "insider trading,"[235] leaving defendants without the sort of notice normally expected for potentially criminal acts.[236] In most cases where the SEC has offered guidance, it has done so in ways disadvantageous to defendants. For example, it has instituted an awareness standard for the causal inquiry of whether a trade was "on the basis of" material nonpublic information.[237] Most other jurisdictions have rejected this approach.[238] Likewise, the SEC has defined tender offer insider trading in such a way that traders need not even know all the elements of their alleged offense.[239]

Although critics have decried both American harshness and American lenience, the equilibrium may have proven stable because it struck a palatable balance: much is permitted, but violators are in hot water.

Yet it is this combination of hot and cold that makes insider tainting possible. Strategic actors can position themselves in the law's protective eddies after leading their targets down the law's most dangerous channels. Numerous accommodations protect those who tip for tainting purposes: the requirement of a purchase or sale protects successful tainting efforts, the personal benefit requirement allows much loyal tipping, etc. With so many safe harbors, actual and bluffing tainting efforts are credible. Yet they are also meaningful to the victim. Insider trading law is harsh and expansive, covering even those lacking in bad intent. Without any sort of good faith defense, prudent tippees may wisely abstain from planned trades. The features that make the law so effective against genuinely bad actors also make it a dangerous threat to innocent tippees.

United States securities laws have developed in fits and spurts, emerging from sporadic congressional action and the accretion of federal court decisions (and the shadow of them). While it appears defensibly workable much of the time,[240] increasingly sophisticated market participants are likely to continue to test its boundaries and kinks. At some point, we may decide that the time has come for the hard work of agreeing upon a unified, clear statutory scheme for this domain.

---

[235] *See supra* note 70.

[236] *See* John P. Anderson, *Solving the Paradox of Insider Trading Compliance*, 88 TEMP. L. REV. 273, 282–85 (2016) (discussing the ambiguity of when information becomes public).

[237] *See supra* Section II.A.

[238] *See supra* note 228.

[239] *See supra* note 133 and accompanying text.

[240] *See, e.g.*, Peter J. Henning, *What's So Bad About Insider Trader Law?*, 70 BUS. LAW. 751 (2015) (generally defending the status quo).

2. *The Nature of Information*

Arguably the most important development in economics in recent decades has been a heightened focus on information.[241] Three pioneers of information economics, a field focused on strategic action under conditions of imperfect information, were crowned with the Nobel Prize in 2001.[242]

Much of the literature, particularly as it comes to inform the law, presumes that additional information is a good thing, both for the recipient and for society in general. Scholars have praised the use of information disclosures to protect consumers.[243] Our federal securities regulation regime is principally a regime of mandatory disclosure of information to the public. We hope and expect that, as a result of these disclosures and other market dynamics, securities markets will be largely efficient, with prices reflecting all publicly available information.[244]

And, of course, information plays a central role in shaping the regulation of informed trading—in both securities markets and ordinary contract markets. We wish to encourage individuals to develop knowledge about assets and to contribute that knowledge to the public good.[245] Allowing trading profits is one way to encourage research and dissemination.[246] On the other hand, informed traders increase trading costs and lower liquidity for all other traders, widening spreads and potentially

---

[241] *See* Ben S. Bernanke, Chairman of Bd. of Governors of the Fed. Reserve Sys., Speech at the Conference Co-Sponsored by the Center for Economic Policy Studies and the Bendheim Center for Finance (Sept. 24, 2010), 2010 WL 3726649, at *5 ("[O]ne of the most important developments in economics over recent decades has been the flowering of information economics . . . ."). Myriad law and economics papers apply game theoretic models of information asymmetry to predict behavior and propose improved law in light of incentives. *See, e.g.*, Andrew F. Daughety & Jennifer F. Reinganum, *Revelation and Suppression of Private Information in Settlement-Bargaining Models*, 81 U. CHI. L. REV. 83 (2014).

[242] *See The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 2001*, NOBELPRIZE.ORG (2001), http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/2001 [https://perma.cc/4AZV-4XEC] (describing the Nobel Prize in economics awarded to George Akerlof, Michael Spence, and Joseph Stiglitz "for their analyses of markets with asymmetric information" (emphasis omitted)).

[243] *See, e.g.*, Cass R. Sunstein, *Informing America: Risk, Disclosure, and the First Amendment*, 20 FLA. ST. U. L. REV. 653, 655–58 (1993) (arguing for informational remedies on the grounds of liberty, economics, and democracy). *But see* OMRI BEN-SHAHAR & CARL E. SCHNEIDER, MORE THAN YOU WANTED TO KNOW: THE FAILURE OF MANDATED DISCLOSURE 7–13 (2014) (criticizing the mandated-disclosure regime on a variety of grounds).

[244] *See* Basic Inc. v. Levinson, 485 U.S. 224, 246–47 (1988) (justifying the adoption of the fraud-on-the-market presumption on the grounds that the market price of a security reflects all publicly available information).

[245] *See* Jack Hirshleifer, *The Private and Social Value of Information and the Reward to Inventive Activity*, 61 AM. ECON. REV. 561, 573 (1971) (stating that public information, but not private information, has social value).

[246] *See id.* ("Speculative profits . . . provide the knowledgeable individual with an incentive to disseminate (publicize) his private information.").

lowering the informativeness of prices.[247] Both our securities law of insider trading and our contract doctrine of mistake are attempts to balance these two competing information paradigms.

Anthony Kronman's seminal paper provides the simplest formula for how the law should balance the right to informed trading against the obligation of disclosure.[248] He argued that the law should allow trading based on information that was deliberately acquired (in order to encourage such acquisition) but bar trading based on information that was casually acquired, either by chance or as an inevitable consequence of their career.[249] This theory helps explain, for example, why diligent analysts are permitted to trade on the secrets they discover but corporate executives are not permitted to take their company's juicy secrets home for evening time trading. It also helps validate the sentiment—not actually reflected in U.S. law—that "a businessman who acquires a valuable piece of information when he accidentally overhears a conversation on a bus" should not be able to trade on that information.[250] The businessman presumably does not need any trade-based incentive to ride the bus to work. A law against trading based on bus-acquired secrets would prevent windfalls without discouraging productive research. After all, "it would certainly be strange if he stopped riding buses altogether," and so a disclosure rule appears compatible with continued inadvertent learning.[251]

Kronman's approach has been very influential,[252] though subsequent scholars have criticized Kronman's formulation[253] and problematized the distinction between deliberately and casually acquired information by

---

[247] *See* Merritt B. Fox et al., *The Regulation of Informed Trading and Its Regulation*, J. CORP. L. (forthcoming 2018).

[248] *See* Kronman, *supra* note 18, at 16–17.

[249] *See id*.

[250] *Id.* at 13.

[251] *Id.* at 14.

[252] *See, e.g.*, United States v. Dial, 757 F.2d 163, 168 (7th Cir. 1985) (citing Kronman in analyzing informed trades by a broker).

[253] *E.g.*, WANG & STEINBERG, *supra* note 79, § 2.02[2] & nn.30–32 (criticizing Kronman—among other reasons—for presuming that unilateral mistakes are socially wasteful, and stating that his standard is difficult to apply). Responding to these criticisms (and sometimes to their own), subsequent scholars have provided more complex versions of Kronman's core insight. *See, e.g.*, Melvin A. Eisenberg, *Disclosure in Contract Law*, 91 CALIF. L. REV. 1645, 1648, 1687 (2003) (developing a "multi-stranded rule" to govern disclosure in contract law); Steven Shavell, *Acquisition and Disclosure of Information Prior to Sale*, 25 RAND J. ECON. 20, 21 (1994) ("[I]f information is not socially valuable . . . a disclosure obligation is socially desirable because it will reduce . . . the incentive to acquire information.").

pointing out the ability of traders to deliberately put themselves into a position to acquire information.[254]

The possibility of insider tainting goes further in problematizing the deliberate–casual distinction by highlighting an underlying linkage between these two paths for obtaining information: casually acquired information is just information that was not deliberately avoided. We can think of it as deliberately acquired information with a negative coefficient.

To return to Kronman's example of the bus-riding businessman, a rule barring trades while in possession of material, nonpublic information might indeed lead some individuals to avoid the bus, at least on the days when those individuals are about to execute a major trade. And individuals who could not avoid the bus might well invest less in research, knowing that they might lose the right to use it, due to background noise on their commute.

Kronman presumably doubts that buses traffic in enough secrets for either effect to matter, but insider tainting upsets that assumption. Within the set of casually acquired information is information that *others* endeavored to deliver. If there is an incentive to taint certain traders, tippers may well seek out their bus route (or email address or cell phone number) in order to frustrate their trading plans. This fact gives potential victims a reason to invest in protective efforts, meaning that the possibility of strategic tainting will affect investor behavior.

The possibility of insider tainting does indeed alter incentives for potential victims. Just as individuals can deliberately situate themselves to casually acquire information, they can deliberately situate themselves to avoid casual acquisition. Tainting parties are most likely to wish to taint traders with independent reasons to trade, typically with the victim's own private information justifying the trade. Insider tainting will therefore tend to occur where individuals have invested in information, and it will act to reduce the value of that information ex post. From an ex ante perspective, potential victims will invest less in information development if they know that the law may later force them to sit on the sidelines.

And as a trader's preferred moment of execution occurs, the trader gains an incentive to plug her ears. She may opt to avoid taking calls or emails, at least from anonymous sources, lest a preplanned trade become invalid by virtue of new, casually acquired information. Yet these self-

[254] *See, e.g.*, Easterbrook, *supra* note 203, at 330 (noting that investors' skill, wealth, and human capital differences result in different abilities to use the information they discover); Kimberly D. Krawiec, *Fairness, Efficiency, and Insider Trading: Deconstructing the Coin of the Realm in the Information Age*, 95 NW. U. L. REV. 443, 478 (2001) (pointing out that individuals might opt to become an executive in order to acquire information).

protective efforts further limit the flow of information. An activist hedge fund might instruct its employees not to take calls or open email from employees of the issuer firm. This would help to protect the firm from tainting, but it would limit the research and engagement that makes activist investment useful to begin with. Tuning out market information before a trade is hardly the optimal behavior for the market's best informed traders.

In the presence of insider trading law, casually acquired information can harm diligently informed traders. This effect is not random. It grows as the trader spends more resources on research because of the strategic element of insider tainting. In light of insider tainting, insider trading law acts as a tax on diligently acquired information. This complicates the trade-offs involved in the regulation of information in markets, rendering our trade-offs far more dynamic than previously assumed.

Of course, strategic tainting is just a special case of the more general phenomenon that regulating information can affect its production and distribution.[255] Strategic tainting means that traders may fear getting a toxic flow of information, which tends predictably to harm their trading plans. But accidental information discovery, say under Rule 14e-3, still affects information in surprising ways. The more information one has accumulated already, the more one will lose if a later discovery disables one's trades. So any proscribed information regime acts as a friction on continued information acquisition, decreasing the marginal return to greater research. The magnitude of these dynamics, and how they interact with other features of the information and trading environment, are worthy of further study.

[255] *See, e.g.*, M. Todd Henderson et al., *Offensive Disclosure: How Voluntary Disclosure Can* Increase *Returns from Insider Trading*, 103 GEO. L.J. 1275, 1300 (2015) (providing data to support the hypothesis that "voluntary disclosure may shield informed trades from legal scrutiny"). Of course, securities law is not the only area to confront strategic information sharing. Patent scholars have also identified cases where it pays to share information because it can disrupt competitors' patenting efforts. *See* Scott Baker & Claudio Mezzetti, *Disclosure as a Strategy in the Patent Race*, 48 J.L. & ECON. 173, 177 (2005) ("Disclosure in essence extends the race."); *cf.* Jennifer Nou & Edward H. Stiglitz, *Strategic Rulemaking Disclosure*, 89 S. CAL. L. REV. 733, 751–55 (2016) (describing strategic disclosure by agencies). *See generally* Gideon Parchomovsky, *Publish or Perish*, 98 MICH. L. REV. 926 (2000). And, akin to the hedge fund coordination strategies discussed above, scholars have described how strategic disclosure can be used to hold cartels together. *See generally* Scott Baker et al., *Intellectual Property Disclosure as "Threat"* 1–2 (Univ. of Leicester, Dep't of Econ., Working Paper No. 07/08, 2007), https://www.le.ac.uk/economics/research/RePEc/lec/leecon/dp07-8.pdf [https://perma.cc/3ZLS-TAEB] ("We show how disclosure threats can effectively enforce explicit and tacit agreements between firms.").

CONCLUSION

Many would-be traders are grateful to receive material, nonpublic information; many tippers share information to help the tippee or to earn their gratitude. If there were no laws banning insider trading, almost all tipping would involve mutually consensual transfers. Indeed, our insider trading laws are predicated on the notion that enthusiastic tipping dyads would ignore the public interest.

Nevertheless, insider trading law may sometimes lead to *more* tipping precisely because of the way that the law is structured. Rather than simply removing informational advantages, American insider trading law pushes informed traders to abstain altogether. That may leave the recipients worse off than they started. Thus, informational disclosure becomes a method for constructing legal barriers to the tippee's action.

Tainting with inside information is a viable strategy because of the many ways that tippers can elude responsibility for their disclosures and because tippees are unable to protect themselves from tainting. They cannot simply abstain from fraud or refuse to pay bribes for tips. Insider trading law is invoked if the tippee is told the magic words that someone else breached a duty to get this tip to them. And having heard those words, the trader cannot just disregard the information because they will remain aware of it. Tainting casts a cloud even in the many cases where a clear-sighted judge would actually acquit the trader based on the facts simply because the facts and law are not always clear. Traders may fear that prosecutors, plaintiffs, or judges may see things differently than they are.

There are a number of fact patterns in which tippers may find insider tainting attractive. Executives working at an issuer company might use tainting as a strategy for deterring undesirable acquirers—whether for the company's benefit or for their own. Competing traders or investors might use tainting to temporarily eliminate their competitors in an acquisition or at a trading desk. Cooperative traders might likewise use insider trading law to buttress their planned collective investment strategy.

Insider tainting serves as a useful vehicle to think about how much our insider trading regime costs and how it works. It is not just that insider trading law is vague or punishes selfish but not obviously destructive conduct; it also serves as a weapon for strategic actors to wield against one another.

The threat of tainting reveals an unexpected implication of our scheme of information regulation: it can constrain innocent trading and tax the creation of useful information. There is a strong link between deliberately acquired and deliberately avoided information. Insider trading law does not just discourage casual or corrupt information gathering; it sometimes encourages deliberate information avoidance. Surprisingly, the law's injunction to *do no evil* seemingly entails a subsidiary injunction: *hear no evil*.