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Insider Trading and the Law Professors

*Henry G. Manne**

I. Introduction

When *Insider Trading and the Stock Market*[1] appeared in November, 1966, I was fully prepared for a goodly amount of disagreement. I was not prepared however for the emotional, almost hostile response my book received from some members of the academic community.[2] This is not to say that all the reviews by law professors were unsympathetic and emotional in tone. Indced the majority of them were not, and while critical reviews outnumbered favorable ones, most were in some degree mixed, and the tone was generally scholarly, impersonal, and in many cases constructive.[3] But the response to my book in the academic community outside of law schools has been more gratifying personally. Unfortunately this response cannot be objectively measured in terms of the number of pro and con book reviews, but with a number of economists of high academic standing my book is taken as an original contribution to the analysis of an important but heretofore almost unexamined area.[4]

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1. H. Manne, Insider Trading and The Stock Market (1966) [hereinafter cited as ITSM].

2. *See* Hetherington, *Insider Trading and the Logic of the Law*, 1967 Wis. L. Rev. 720; Schotland, *Unsafe at Any Price: A Reply to Manne, Insider Trading and the Stock Market*, 53 Va. L. Rev. 1425 (1967). For other reviews by law professors, sce Baum, Book Review, 1967 Duke L.J. 456; Jennings, Book Review, 55 Calif. L. Rev. 1229 (1967); Kripke, Book Review, 42 N.Y.U.L. Rev. 212 (1967); Marsh, Book Review, 66 Mich. L. Rev. 1317 (1968); Painter, Book Review, 35 Geo. Wash. L. Rev. 146 (1966). For reviews in law journals by nonlaw professors, see Garrett, Book Review, 43 Notre Dame Law. 465 (1968); Poser, Book Review, 53 Va. L. Rev. 753 (1967); Sommer, Book Review, 54 A.B.A.J. 692 (1968); Tunks, Book Review, 10 S. Tex. L.J. 179 (1968); Vogt, Book Review, 16 Buffalo L. Rev. 520 (1967); Weston, Book Review, 35 Geo. Wash. L. Rev. 140 (1966); Wright, Book Review, 21 Sw. L.J. 405 (1967). *See also* Cary, Cases and Materials on Corporations 714-15 (4th ed. 1969). The present article will also consider Mendelson, *The Economics of Insider Trading Reconsidered*, 117 U. Pa. L. Rev. 470 (1969) (an article review of my book by a professor of finance).

3. I would mention specifically Professors Baum, Cary, Hetherington, and Painter for doing me the courtesy, not always displayed by others, of carefully reading and trying to undcrstand my book and for appreciating the spirit in which it was offered.

4. *See, e.g.*, Demsetz, *Perfect Competition, Regulation, and the Stock Market*, in Economic Policy and the Regulation of Corporate Securities 1 (H. Manne ed. 1969); Benston, *The Effectiveness and the Effects of the SEC's Accounting Disclosure Requirements*, *id.* at 23; Williamson, *Corporate Control and the Theory of the Firm*, *id.* at 281.

Some disparity of reaction between economists and lawyers is not too surprising. The book was written largely as an exegesis into economics, although the subject was of primary interest to lawyers. I claim only amateur expertise in economics, but no more than that is needed to let one conclude that the reviews of my book by certain law professors displayed an abysmal ignorance of the principles of market economics, principles which are of utmost importance if the complex subject of stock market information is to be understood and appropriately treated in the law. Many reviewers assumed the matter to be one simply of political doctrine or one to be resolved solely as an ethical or normative matter. But this is not the case. The debatable aspects of insider trading are capable of resolution through tools of economic analysis. The "discovery" of ethical and moral issues and a recurrent insistence on this approach strike me more as an outgrowth of frustration than of cogent analysis.

Another aspect of my critics' work is far more disturbing than their lack of sophistication about economic concepts. Many professors teaching securities law today have worked within the Securities and Exchange Commission. With these, and with others perhaps trained in the same point of view, there regularly appears a firm and unwaivering conviction that what the SEC says is right. The desirability of securities regulation is assumed almost as a matter of faith. For 35 years hardly a law professor in the United States wrote a piece really critical of the SEC, nor had anyone ever carefully analyzed the fundamental economic premises on which the Commission operates.[5] That is what I attempted to do, and what was uncovered was a fierce loyalty to a Government agency and its totally unexamined "philosophy."

This is unseemly behavior for academics. If they have a single great responsibility beyond teaching it is to be loyal, competent, and objective critics of the establishment. Political partisanship is more destructive of honest academic endeavor than is anything else. This

5. There were naturally hundreds of lawyer-like pieces praising the cases or splitting legislative hairs with great skill and intelligence, even though the general tone of the great mass of legal literature in this field has been of the "how-to-do-it" variety. *See* ABA SECTION OF CORPORATION, BANKING AND BUSINESS LAW, SELECTED ARTICLES ON FEDERAL SECURITIES LAW (1968). The first truly critical analysis was Stigler, *Public Regulation of the Securities Markets*, 37 J. BUS. 117 (1964). This piece, by an eminent economist, critical of the SEC, REPORT OF THE SPECIAL STUDY OF SECURITIES MARKETS, H.R. DOC. No. 95, 88th Cong., 1st Sess. (1963), occasioned cries of anguish from a somewhat coddled bureaucracy not used to criticism. Subsequent to the special study and the debate spawned thereby, only "law reform" type materials have been significant. *See* Cohen, *"Truth in Securities" Revisited*, 79 HARV. L. REV. 1340 (1966). For an indication that future reform is in the hands of the old guard, see Loss, *The American Law Institute's Federal Securities Code Project*, 25 BUS. LAW. 27 (1969).

problem, of course, goes much deeper than the narrow specialty of SEC regulation. It is at the base of much of the ambiguity surrounding the position of a law school as part of a university.[6] Forty years of legal realism and neo-realism have not been sufficient to make law professors as comfortable with other academians as they are with other lawyers.

With that introduction, or spleen-venting, as the case may be, I should like to turn to what I consider the major errors in my critics' reviews. I have selected only what I consider the more important and basic of these ideas. In the course of these various discussions, I shall also offer some new arguments which did not appear in my book, and I will discuss evidence which has appeared since my book, all of which seems strongly to substantiate my thesis. If I were writing the book now for the first time, I should certainly emphasize different points than I did initially. But the basic thesis has weathered the storm of complaint with considerably more vigor and utility than I anticipated for such a complex and fundamental new model of our securities markets.

II. Morals, Morals, Morals

Morals, someone onee said, are a private luxury. Carried into the arena of serious debate on public policy, moral arguments are frequently either sham or a refuge for the intellectually bankrupt. Just because the phrase "insider trading" raises a spector of dishonesty, fraud, exploitation, and greed is not sufficient basis for assuming that the fact must be so or that the practice must, ipso facto, be outlawed. Yet one of the leading academic figures in the field of securities regulation stated to me personally, "We didn't need any book on insider trading. I know it's wrong, and that's all there is to it." As far as I know, however, no one has adduced actual evidence that this person is God.

For some writers the moral argument seemed to be substantiated simply by changing the terminology. To this group, insider trading must be outlawed because the information is the "property" of the shareholders.[7] These victims of acute formalism establish themselves one rung below the divinity of the last paragraph. They are content

6. *Cf.* Goldstein, *The Unfulfilled Promise of Legal Education*, in LAW IN A CHANGING AMERICA 157 (G. Hazard ed. 1968).

7. Professor Jennings, for instance, clearly illustrates this fallacy when he states that inside information is not the property of the insiders, "but fairly belongs to all of the shareholders." Jennings, *supra* note 2, at 1234.

merely to conclude that they are law givers. For them the ukase that the information does not belong to the insider but rather is the property of the shareholders seems to satisfy all demands of logic.[8]

One is certainly tempted to suggest that by now intelligent lawyers would realize the emptiness of that position. They should recognize that the concept of property is no more nor less than the rights and obligations recognized by law[9] and that the statement above neither proves nor disproves a thing. But the statement was not only vacuous; as a legal matter, it was also erroneous. As I stated numerous times in my book, the question at issue was how the law should develop after the date of writing.[10] At that time the *Texas Gulf Sulphur* case[11] had not been decided in the district court, and it just could not be said with the serene confidence evinced in a number of reviews, that the information "belonged" to the shareholders. And why the *shareholders*? How about an insider selling to an outsider when the insider has knowledge of an earnings decline? Is that knowledge to be considered the "property" of the outsider? The argument is not worthy of serious attention, and first year law students should always be taught to be on guard against this fallacy.

To demonstrate just how artificial the morality and the property arguments are, one need only consider other situations in which information is used in a transaction to the benefit of the person who has it. For instance a large corporation plans to establish an extensive production facility in a new location. Typically, with all the secrecy of the CIA planning an assassination, the company will send its agents out to purchase land as discreetly as possible. The case law is clear that unless the seller has been deceived, as for instance by being told that there is no undisclosed principal,[12] the transaction is a perfectly valid one.[13] And I do not know of any commentator who has ever classified this as immoral conduct.

So notice the irony: TGS officials buying stock with knowledge of a new ore vein have somehow done something immoral, but the company itself buying surrounding land, *utilizing precisely the same*

8. It should be clear, moreover, that the lawyers making this argument were not merely offering it as a statement of law but, perhaps more important, as a reason why insider trading should not be allowed. The circularity of this approach should be readily apparent.

9. *See* Reich, *The New Property*, 73 YALE L.J. 733, 739 (1964).

10. ITSM, *supra* note 1, at 33-46.

11. SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262 (S.D.N.Y. 1966), *rev'd*, 401 F.2d 833 (2d Cir. 1968).

12. RESTATEMENT (SECOND) OF AGENCY § 302 (1957).

13. *Id.* § 304.

information, has merely performed in a business-like fashion.[14] Nor will it do, as one high official of the SEC tried, to distinguish these two cases on the not-so-obviously pertinent ground that "after all, one case involved land and the other securities."[15] Lawyers especially, it would seem, should be very circumspect about characterizing the utilization of superior information as immoral. That is, after all, their stock in trade.

III. Harm To Outsiders

A. Tricks with time

Repeatedly, academic lawyers made one fundamental error in economic analysis. The frequency of its appearance and the intensity with which it is presented suggest that this view may play an important psychological role in my critics' view of insider trading. The error, like so many in economics, has a superficial plausibility which most people never seem to get beyond. Almost at random one finds statements like, "[I]f [the shareholder] should decide to sell, he sells at a lower price than he would *if the facts were known* . . . . When the facts are known, he cannot but regret having sold."[16] Of course an individual with knowledge of forthcoming good news does not sell his shares; and manifestly he would be better off if he had the information than if he did not. Could anyone seriously think that I ever disagreed with that

14. This behavior was expressly condoned by the court of appeals in the *Texas Gulf Sulphur* litigation and presumably by the SEC. *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 850 n.12 ("valuable corporate purpose was served by delaying the publication of the K-55-1 discovery").

15. This remark was made by David Ferber, Solicitor of the SEC in a panel discussion during a symposium on federal and state securities regulation. Part of the panel discussion, not including this remark, is reported in *The Emergence of "Federal Corporation Law" and Federal Control of Inside Information,* 34 U. Mo. K.C.L. Rev. 228 (1966).

16. Painter, *supra* note 2, at 149. *See also* Jennings, *supra* note 2, at 1232; Mendelson, *supra* note 2, at 482; and Poser, *supra* note 2, at 754. Professor Schotland tried to delve deeply into this subject, but his discussion of the impact of insider trading on outsiders is incomprehensible to me. His principal error seems to result from his confusing the familiar "long-term investor" with my "time-function trader." ITSM, *supra* note 1, at 95. In specific instances, however, he turns around and confuses the long-term investor with the price-function trader. In fact neither price nor time-function trading has anything necessarily to do with how long shares have been held.

Schotland, *supra* note 2, at 1434, refers to trades being made "on the basis of time" and "on the basis of price." But time-function trading is not trading which occurs because the shares have been held for a certain period of time. They are trades that occur at a specific time independent of any change in the price of shares. *See* note 43, *infra*. It is difficult to understand how anyone who read the book carefully could make this error, which incidentally is also made by Mendelson, *supra* note 2, at 483.

proposition? The fundamental premise of the entire book is that information is a valuable good which will be sought after by human beings who prefer more rather than less of anything good.[17] It is gratifying to note that my critics at least understand that shareholders want valuable information, but they also seem to equate this simple human wish for more with some legal or moral claim and to assume that a denial of that wish constitutes an injury to those individuals.

The error, however, is not difficult to track down. To say that the shareholder would not have sold if he had had the information, in effect, switches the time of disclosure under the two rules. The critics assume a situation, without insider trading, in which the news is disclosed earlier than it is under the insider trading rule. That is, their position assumes that without insider trading the time of public disclosure will be the time at which the first insider would otherwise have traded, while a rule permitting insider trading will result in public disclosure after the insider has traded.[18] I believe that writers reached this conclusion because of what Professor Demsetz has called the "grass is always greener" fallacy derived from the "nirvana" approach to economics.[19] They are comparing the real, imperfect world of insider trading to a never, never land of perfect solutions to all problems, especially enforcement. They assume that a rule against insider trading is the equivalent of a full and timely disclosure rule perfectly enforced. Unfortunately, that would not be the case. Enforcement will be imperfect at best, and there is certainly no guarantee of early disclosure even with the complete absence of insider trading. The only reasonable approach is to compare the financial

17. This statement holds, of course, only if all other conditions remain the same. For a series of related economic postulates, see A. ALCHIAN & W. ALLEN, UNIVERSITY ECONOMICS 14-19 (2d ed. 1967).

18. Mendelson is quite insistent on making this error. He says we can only compare the case without insider trading in which "the information had been made public from the beginning." Mendelson, *supra* note 2, at 482. He does not explain why this is so.

19. Demetz, *Information and Efficiency: Another Viewpoint*, 12 J. LAW & ECON. 1, 2 (1969). This is a critique of Arrow, *Economic Welfare and the Allocation of Resources for Invention*, in NATIONAL BUREAU OF ECONOMIC RESEARCH, THE RATE AND DIRECTION OF INVENTIVE ACTIVITY 609 (1962). "Given the nirvana view of the problem, a deduced discrepancy between the ideal and the real is sufficient to call forth perfection by incantation, that is, by committing the grass is always greener fallacy." Demsetz, *supra* at 3.

Mendelson also tries to argue that while my logic might hold for traders with absolutely no knowledge, it is faulty for those with partial knowledge, such as mutual funds. *But cf.* Jensen, *The Performance of Mutual Funds in the Period 1945-1964*, 22 J. FIN. 389 (1968); Sharpe, *Mutual Fund Performance*, 39 J. BUS. 119 (1966) (both indicating, as have other studies, including some by Professor Mendelson's colleagues, that the knowledge Mendelson posits does not exist in mutual funds).

status of the average outsider under the two different trading rules with disclosure occurring at the same time in each case.

After that issue is settled, then one can turn logically to the question of whether the trading rule affects the time of disclosure. If indeed a rule against insider trading could be perfectly enforced, then, with good news as indicated above, there would be no profit to the insiders and there would be a saving to those who would otherwise have sold at a subsequent time. Again, nothing inconsistent with this proposition appears in my book. But I naturally spent more time on the more important and complex comparison of the situations with disclosure occurring at the same time.

B. The Economics of Partial Enforcement

Some authors explicitly argue that allowing insider trading delays public disclosure.[20] The superficially plausible explanation is that insiders will need time to transmit knowledge to friends, assemble needed financing, or otherwise arrange a large purchase of securities. That such a propensity may exist cannot be denied, though there is little reason to believe that this would normally take much time. Contrariwise, it should be noted that insiders will usually be in a very great hurry to use their information before others get it or before it becomes worthless for unforeseen reasons. Thus they may have a tremendous incentive to use it fast. And this is only a beginning, since we cannot properly assess this issue in terms of the ideal of perfect enforcement of a rule against insider trading.[21] We live in a real world, and unfortunately enforcement of a rule like that in the *Texas Gulf Sulphur* decision is going to be partial at best. The matter has been well argued by Professor Demsetz.

> [I]t is not clear that attempts to discourage insider trading will shorten the time between the acquisition of valuable market knowledge by the firm and its revelation to shareholders and the general public. By increasing the cost of using the direct and obvious methods of capturing some of the value of this information, the SEC will encourage insiders to rely in greater degree on the less direct and more time-consuming methods. The possible or probable result will be to lengthen the time period during which insiders attempt to keep really valuable information secret. Inside information that can be used profitably only if direct trading

20. *See* Mendelson, *supra* note 2, at 473, 489; Schotland, *supra* note 2, at 1448. If this period were anything near as long as Mendelson implies (though his time-period implications vary throughout his article), it is very doubtful that we could see a random walk in the stock market. *See* notes 40-43 *infra* and accompanying text.

21. For further discussion of the economics of partial enforeement, see note 28 *infra* and accompanying text.

methods are used may become available sooner or later depending on whether managers decide to reveal the knowledge or confine it to the next quarterly or annual report.[22]

Interestingly a number of aspects of the insider trading debate turn on the efficiency with which a rule against such trading can be enforced. This is a point which I discussed at length in my book[23] and have developed further in subsequent writing.[24] But with a sanguinity worthy of safer bets, my critics assure their readers that the SEC "good guys" always catch the "bad uns."[25] Professor Kripke thinks that the facts of cases like *Cady, Roberts*[26] are rare and that when they occur they are apprehended.[27] Perhaps no one whom Professor Kripke knows is guilty of a violation of Rule 10b-5; nearly everyone I know is. But the significant thing for present purposes is the failure of the opponents of insider trading to comprehend the economic and political effects of partial enforcement.

Enforcement of the rules, as well as the punishments to be meted out, will of necessity be discretionary and discriminatory. There is no way to avoid this. Decisions will have to be made about where the limited enforcement resources can be spent; they will inevitably be spent to oppose those least in favor with the Commission.

If we look at the great failures of liberal governments to maintain their principles, it will readily be seen that a significant danger has been laws which could not be or were not readily enforced against all violators. The most obvious example from modern history is the American experiment with prohibition. The breakdown of law began because the potential payoff from illicit activities was extremely high relative to the risk of apprehension and punishment. Effective enforcement on a broad scale would have required unacceptable police measures. Only partial enforcement was feasible. As a result a cancerous corruption of law enforcement officials resulted from the undoubtedly well-intended prohibition.

Political discretion in such government areas as zoning and occupational licensing have likewise lent themselves to corruption of

22. Demsetz, *supra* note 4, at 14.

23. ITSM, *supra* note 1, at 159-69.

24. Manne, *Prohibition on Wall Street?*, Barron's, Dec. 16, 1968, at 5.

25. Jennings, *supra* note 2, at 1232; Schotland, *supra* note 2, at 1456-57. While Schotland says enforcement is easy, he realizes that something that looks like insider trading regularly occurs and that the SEC does nothing about it. This is blamed on a shortage of funds! *Id.* at 1474-75.

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

27. Kripke, *supra* note 2, at 214. I wonder if Professor Kripke would really care to defend this proposition.

governments and demoralization of communities. And the blackmail and corruption potential of partially enforced rules against prostitution, gambling, and narcotics are too well known to need discussion.

The more decent, law abiding, and risk-averse members of the financial community will not knowingly engage in insider trading if it is a prohibited activity. They have the most to lose from apprehension and are thus the most vulnerable to charges by the SEC. But the scoundrels and those with little to lose—or perhaps just the very sharp and clever operators—will quickly fill any gap. Thus the absence of the more high-minded participants from a segment of the securities field makes it that much more lucrative and attractive for those we least want to encourage.

This phenomenon has been nicely described by Herbert Packer as a "crime tariff."[28] A tariff, of course, puts imported goods at a competitive disadvantage compared to domestic goods and to that extent protects the domestic producer. Partial law enforcement, similarly, gives a completely unwarranted competitive advantage to those against whom the law is not enforced.

Historically, it seems that this created a vicious cycle. Those who became richer by the illicit activity found it profitable to expend some of their resources to corrupt government officials in order to preserve their monopoly positions. That is, they try to guarantee enforcement against competitors while preserving their own sanctuary. The Volstead Act again affords the best-known illustration, though many more exist. Selective and partial enforcement by the SEC of the whole gamut of 10b-5 and related rules will in all likelihood result in some new group of insiders growing wealthier and eventually constituting a vested interest with strong influence over the very government regulatory agency created to protect the public. There is no reason to believe that individuals who can profit by partial enforcement of SEC rules against insider trading will not try to do so.

C. Distributive Effects of Legal Rules

There would be real harm to outsiders if they were being deprived of something that we could normally characterize as their "property." That is, if there were an existing rule of law stating that all information belongs to shareholders or would-be shareholders, then to change that rule would be to deprive existing outsiders of something they had some

28. Packer, *The Crime Tariff*, 33 AM. SCHOLAR 551 (1964).

right to continue to enjoy. It is extremely doubtful that any significant part of the stock trading public assumed that any such rule existed. No one has actually claimed so. And no matter how loudly the contrary is shouted, at the time of the writing of my book there was no rule to this effect.[29] There were practices and warnings to be sure[30] (many people have noticed the pushy ways of federal regulatory agencies), but no rule existed whose change I was advocating. While my critics may claim that I am "seldom inclined to let facts interfere with theory,"[31]

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29. I certainly made it clear in my book that I was not referring to § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (1964). I was at some pains to explain that I had no great quarrel with that provision, since I did not believe that it was effective to counter the most significant form of insider trading, trading in a company's shares by an individual who has reliable information from an inside source but who is not, within the meaning of § 16(b), 15 U.S.C. § 78p(b) (1964), an insider himself. This is what Louis Loss has referred to as "tippees." I chose to use the more descriptive term for a trader with reliable information of "advisee." I bow now to a superior word popularizer. At any rate it is inconceivable that any careful reader of my book would not be aware that it was addressed to the problem posed by the pending interpretation of Rule 10b-5, 17 C.F.R. § 240.10b-5 (1969).

I did say about § 16(b), 15 U.S.C. § 78p(b) (1964), that it might possibly serve to prevent some manipulation in stocks by statutory insiders. Indeed this was the only real justification that I could find for it since its official justification has almost no persuasive force, even among its supporters. *See* L. LOSS, SECURITIES REGULATION 1042-43 (2d ed. 1961). As I stated, "Section 16(b) can be rationalized as an antimanipulation device but not as an effective prohibition of insider trading. . . .

[N]either legislative history nor the subsequent literature on the Section has viewed Section 16 as another of the antimanipulation devices Congress included in the 1934 Act." ITSM, *supra* note 1, at 30. Nonetheless Professor Jennings concluded that I claimed § 16(b), 15 U.S.C. § 78p(b) (1964), was "mainly aimed" at preventing manipulation. Jennings, *supra* note 2, at 1230-31 n.3.

30. *See* Fleischer, *Securities Trading and Corporate Information Practices: The Implications of the Texas Gulf Sulphur Proceedings*, 51 VA. L. REV. 1271 (1965).

31. Jennings, *supra* note 2, at 1232. Professor Jennings has also erroneously alleged that I would shrink from allowing insiders to sell information for cash. Jennings, *supra* note 2, at 1231. This is simply incorrect. What I said was that "[a]lthough there are no cases directly on the point, it is very likely that a court would hold the direct sale of insider information by an insider to be a breach of fiduciary duty." ITSM, *supra* note 1, at 60. I then mentioned 2 legal analogies that could be made and stated that I thought neither of them was analytically the same as a direct sale of information. The point I was making was about the obtuseness of legalists, not about the undesirability of selling information in an open market. Certainly if this right could be found as an implicit or explicit part of a contract between an insider and his corporation, I would not shrink from enforcing it.

In the same vein Professor Jennings, *supra* note 2, at 1233, wrongly asserts that I would also fault the holding in Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545 (1928). But I would view this case exclusively as a matter of defining an implicit contractual term. Had the matter been explicitly provided for in the agreement, it should have been enforced as written. Clearly I could not possibly have the same objection to that case that I have to *Texas Gulf Sulphur*.

While I am at it, I might just point out that Professor Jennings displays gross lack of familiarity with economic concepts when he states that neither is the question of allocation of resources pertinent—we don't allow stealing even though the thief may have a better economic

the thing that emerges much more clearly is their total unwillingness to allow either facts or theory to interfere with their wishes. Moral fervor, whether held by fundamentalist ministers or by law professors, is not easily shaken by rational argument. So much then for the argument that shareholders are injured by insider trading because they are losing a legal interest they have been led to believe was theirs.

The real analytical point at issue is the distributive effect of a rule allowing insider trading as compared to the effect of a rule effectively preventing it. There is of course some immediate distributive effect to changing any legal rule on which persons have relied. But that is a separate issue (and much less significant quantitatively) from that of how a rule will effect different categories of persons forever in the future. I spent at least two chapters in my book on this subject.[32] Unfortunately, I must have confused several reviewers of the book. Indeed, one confessed that, "[t]he reviewer (no economist or mathematician he) could not cope with the purported mathematical demonstration."[33] This confusion, however, did not deter him from concluding that it was "apparent on the face of things that the author's description of the stock market behavior of a stock uninfluenced by insider trading conformed to nothing existing on earth."[34] This sentence displays only his inability to comprehend a straightforward abstract model of a market situation, and his little amusement of having an anonymous mathematician look at the diagrams[35] certainly tells us far more about him than it does about my work. Why a mathematician? Why not an artist to criticize the aesthetic value of my drawings? The latter might have had more to offer.

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use for the money. Jennings, *supra* note 2, at 1223. See the index of any good micro-economic text to gain some feeling for my sense of frustration with this and similar views. *See* Mendelson, *supra* note 2, at 470.

32. ITSM, *supra* note 1, at 77-110.

33. Kripke, *supra* note 2, at 213.

34. *Id.* This may take the prize as the most disingenuous statement in any of the reviews. I somehow have the feeling that Professor Kripke joined a coterie of critics who tried to see who could laugh the loudest at my work. He may or may not have realized that this was more a matter of strategy than of serious critique. Professor Schotland reports that the former Chairman of the SEC, Manual F. Cohen, had agreed to review the book and then "understandably" changed his mind. Schotland, *supra* note 2, at 1425 n.2. SEC insiders, after an initial outburst of high-level fury, apparently concluded that either silence or laughter would be the most effective deviee for countering the effects of my insidious book. They were correct and, furthermore, this strategy has not been unsuccessful. But, while I cannot say that I have enjoyed being chided in public as a modern version of the village idiot, I believe there is evidence that my work is beginning to have significant influence on thinking in this field. Why, even Professor Jennings has referred to it as "the beginning of a counterrevolutionary effort." Henkel, *Codification—Civil Liberty Under the Federal Securities Law, Conference on Codification of the Federal Securities Laws*, 22 BUS. LAW. 793, 882 (1967) (remarks of Richard W. Jennings).

35. Kripke, *supra* note 2, at 213.

Several legal writers failed to comprehend that an economic discussion may (indeed, often must) be offered in terms of the performance of functions rather than in terms of real, identifiable human beings.[36] This, as we have seen, leads Schotland and others to confuse my "time-function trader" with the "long-term investor" of popular financial parlance.[37] Interestingly, Professor Schotland fails to mention once, a matter that I, as opposed to he, consider basic to my thesis. The crucial omission from this and other reviews is any mention of the so-called random walk hypothesis of stock market price movements, which is crucial to an understanding of this subject.[38] I

36. For a definition of functional analysis in economics, see A. ALCHIAN & W. Allen, *supra* note 17, at 21-22.

37. *See* note 16 *supra*. The elaborations of this error in Schotland's article are too extensive even to summarize. But I should like to repeat the point made in my book that the period of time for which shares are held has absolutely no necessary relevance to the question of whether a particular transaction is either a time-function or a price-function transaction. To repeat, the price-function trader is one who buys or sells securities exclusively on the assumption that he has received significant information from an observed price change, and time-function traders are everyone else. Manifestly one may be a price-function seller of shares he has owned for 50 years, and just as clearly one may be a time-function seller of shares he acquired yesterday. The error was constantly made of relating my time-function trader to the familiar long-term investor. This confusion completely skews the analysis since the price-function trader is making an assumption that he has new information about the company, while the time-function trader makes no assumption about having new corporate information. He trades for reasons exogenous to the market price of the shares.

38. Having missed a truly basic point, but sure that there is one, Schotland's error about functions leads him to conclude that "the prevalence of such an 'induced effect' is one of the basic assumptions of the Manne thesis." Schotland, *supra* note 2, at 1444. The reference is presumably to the existence of price-function traders, that is, those who base buy or sell decisions on changes in share prices caused by insiders' trading. I do not understand how Professor Schotland concludes that the "prevalance" of this trading is one of the "basic assumptions" of my thesis. The only reason such traders have any relevance for the discussion was to see whether anyone was injured as a result of insider trading, and that analysis would not be changed in any particular if no one traded on this basis since it would then be impossible to find a group injured by this kind of trading. Indeed, the very significance of the discussion of the "random walk" was that these traders do not have any real information. Consequently, their trades merely supplement the random movement of stock prices.

This is one of so many misstatements of my thesis as to have left me completely bewildered as to how to deal with this particular review. Time and temperament prevent my responding to every error. I hope that independent persons may in the future study both works carefully in an effort to straighten out my disagreements with Professor Schotland. Several economists to whom I have shown his work find it so uninformed and error-ridden as not to warrant serious attention. Less surprisingly perhaps, a Commissioner of the SEC has stated publicly that Professor Schotland has destroyed my thesis.

Professor Schotland's article was presumably prepared during the summer of 1967 when he enjoyed some sort of close and friendly relationship with the Securities and Exchange Commission in Washington. There is internal evidence of this relationship during the time of writing. *See* Schotland, *supra* note 2, at 1456-47 n.88. Professor Schotland quotes my statement that "rumors of the Texas Gulf discovery had already reached flood proportions in Washington." "In fact,"

referred the reader of my book to all the literature on the random walk idea existing up until that time, and I tried to explain it in fairly simplified terms to readers who might be unfamiliar with the concept.[39]

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says Schotland, "the 'flood' was not even a good flow, but a mere trickle." *Id.* He then cites a "reliable authority" to the effect that my statement was not true since "fewer than a dozen people in Washington *bought* Texas Gulf shares in the period in question." *Id.* But I had stated nothing about how many people in Washington actually bought shares, only what I had heard about the TGS rumors. Also, what is the "period in question"? Did it start in November 1963 or March 1964 or some other time?

Professor Schotland, presumably according to the same reliable authority, goes on to state that "[t]he SEC traced all the round-lot buying which originated in Washington, and even the buying done in New York by New York residents *known to have been phoned* by relatives or friends in Washington. Almost all of these purchases were traceable directly, or at one remove, to tips from the site geologist." *Id.* (emphasis added). When Professor Schotland says that the SEC traced all round-lot buying which originated in Washington, I presume that this means the SEC traced all round-lot buying placed by brokers in Washington. But unless every transaction in the stock were traced, the SEC could not know that Washingtonians were not utilizing non-Washington brokers for this purpose. Indeed there is strong independent evidence that many Washingtonians do their trading in that fashion. *See Leaky Capital: Washington Attracts Many Seeking to Profit from Inside Information*, Wall Street Journal, Mar. 14, 1968, at 1, col. 1.

But the most disturbing thing about Schotland's disclosure is the apparent claim that the SEC knows which New York residents purchasing Texas Gulf stock phoned or were phoned by relatives or friends in Washington. Alternatively Schotland could be saying that the SEC traced New York purchases they were told about by Washington sources. Then, of course, the statement would be of no significance whatever. It seems more likely that the former interpretation is correct. But if that is so, how could the SEC have this information? They may have means of which I am unaware, but it would seem necessary for them first to have the list of all individuals in New York ordering Texas Gulf stock. That might be a fairly sizable job and still not reveal the true beneficiaries of every transaction, but I will presume that the SEC did this. Then I presume that it would be within their frightening power to check telephone company records of Washington calls to and from these individuals. Of course, they might also find other interesting information in this way, such as that certain officials in Washington were holding telephone conversations with racketeers or that persons under investigation were in clandestine communcation with judges or with the White House, congressmen, or other public officials. In other words, the SEC, through Professor Schotland, now appears to admit the utilization of an extraordinarily dangerous police state tactic in the interest of what at best is a minor moral obsession. We hear regularly of the dangers of invasion of privacy from computer banks of information and other technological methods. Well, the danger is here, and the worst may be happening daily. Is it not ironic that my critics call me a conservative?

39. My attempt to introduce this material and explain its importance was evidently overlooked by Professor Schotland when he stated that my book does not "cite or draw upon any empirical studies to support its thesis, nor itself offer any new data." Schotland, *supra* note 2, at 1443 n.59. It is, of course, a favorite gambit of reviewers to criticize an author for not writing the book they would like but also have not written. I must respectfully decline the gambit. I had no intention of preparing a statistical study of insider trading, nor would I be qualified to do so.

The clear implication of Professor Schotland's reference to my failure to cite empirical data is that I was hiding evidence contrary to my thesis. *See* Schotland, *supra* note 2, at 1443 nn.59 & 60. I do not apologize for not finding unpublished theses, but one of the works cited by Professor Schotland, that of Professor Wu, *Corporate Insider Trading in the Stock Market, 1957-1961*, 2 NAT'L BANK REV. 373 (1965), came to my attention when my book was in galley proof. I concluded then that since Professor Wu had devoted himself exclusively to instances of insider

Without going into great detail, readers should understand that the existence of random walk in stock market pricing is generally taken by economists as an indication that the market is functioning very efficiently,[40] that is, that the market assimilates new information quickly and accurately. Significant time lags in the assimilation of new information would presumably show up as nonrandom movements. If every outside purchaser or seller of securities confronts a random walk—and it must be remembered that if the hypothesis is correct, this condition will exist for every trader other than one who actually has inside information—then for any given transaction he cannot know whether he would benefit or be harmed by either of the rules on insider trading. That is, he cannot know at point X whether he will be benefited or harmed at point $X + Y$ by a rule allowing insider trading or by a rule forbidding it. By hypothesis, he has no basis for predicting

transactions reported under § 16(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(a) (1964), his work was not actually relevant enough to my thesis to warrant the expense of changes at that point. I had heard of the book by E. SMITH, MANAGEMENT TRADING: STOCK MARKET PRICES AND PROFITS (1941), and that the same thing was true there, but I was unable to locate that book in any library in Washington, D.C., including the Library of Congress. I did not try to use the library at the SEC.

But none of the works cited by Schotland contained data of the sort that I "repeatedly deplore the lack of." The data I requested, ITSM, *supra* note 1, at 63, easily within the power of the SEC to ascertain, would almost conclusively settle much of the controversy, since it would have shown the amount of *indirect* insider trading. *See* note 44 *infra.* The second thing to note about Professor Schotland's remarks is that he apparently read Professor Wu's findings quite the opposite of what they are. *Compare* Schotland, *supra* note 2, at 1445, *with* Mendelson, *supra* note 2, at 479.

The truth is that I was wrong about the propriety of Wu's and Smith's approach. I assumed, that indirect insider trading was so tremendously important that no statistically significant amount of direct trading by insiders in the stock of their companies would show up. Since the publication of my book, the most scholarly and exacting study yet on the subject of direct insider trading has appeared. *See* Lorie & Niederhoffer, *Predictive and Statistical Properites of Insider Trading,* 11 J. LAW & ECON. 35 (1968). Their conclusion is unmistakable and convincing. "Insiders tend to buy more often than usual before large price increases and sell more than usual before price decreases." *Id.* at 52. This study is actually a devastating blow to anyone who wants to proclaim that insider trading has not regularly been occurring or that it does not continue even now.

There are various other works as well which support this and other aspects of my total thesis, though not quite so directly. *See* Mendelson, *supra* note 2, at 479 nn.21-23. *See also* note 43 *infra.* But one of the more ironic must be mentioned now. Professor Wu, the very one Schotland most relies upon, has, in a subsequent work, made the strongest plea since the appearance of my book for allowing insider trading because it is economically beneficial. He concludes that "the arbitrary short-term trading restrictions provided by Section 16(b) and the recent vigorous attempt of the SEC to apply Rule 10b-5 to insider trading may be harmful to the economy." Wu, *An Economist Looks at Section 16 of the Securities Exchange Act of 1934,* 68 COLUM. L. REV. 260, 269 (1968).

40. *E.g.,* Samuelson, *Proof that Properly Anticipated Prices Fluctuate Randomly,* 6 INDUS. MGT. REV. 41 (2d pt. 1965). *See also* Mandelbrot, *Forecasts of Future Prices, Unbiased Markets, and "Martingale" Models,* 39 J. BUS. 242 (1966).

in advance (without information, as he is) what his ex post position would be. Since he cannot know what these two positions would be in advance, he has no way of comparing one to the other.[41]

My critics should realize, however, that the existence of a random walk does not necessarily militate against the view that no insider trading is occurring. Indeed, if there were instantaneous recognition of new information by all participants in the market, as would be the effect of perfect enforcement of a rule requiring timely disclosure and no insider trading, a random walk would still appear.[42]

I take the random walk as support for my proposition because I cannot conceive of information being disclosed and assimilated that perfectly by a broad spectrum of investors in the market. I believe that the random walk is better explained by the existence of large scale insider trading than it is by the general absence of this practice.[43]

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41. Consider a bettor at the race track who looks over the odds and sees Romper Roy at 10 to 1. We can assume that those are correct odds in the sense of accurately measuring the probability of Romper Roy's winning. If this is the case, it makes no difference to the bettor that someone else actually *knows* that Romper Roy ran his early morning test mile in record time and has a better tban usual cbance of winning today, even though the odds are correct at 10 to 1. Presumably the odds, like the stock price, will at race time reflect all information known about the horse. If the morning workout had been skipped, the odds might or migbt not be 10 to 1 now, but we cannot say that a casual bettor is better or worse off because someone else in fact knows the information. Rossett, *Gambling and Rationality,* 73 J. POL. ECON. 595 (1965) (an important article with perbaps more significancc for the insider trading question than would appear at first glance).

Part of the confusion probably results from the different frames of reference of the economist and the lawyer. When I say that no individual trader faced with the random walk can predict his future position under tbe different insider trading rules, I refer to one individual taken as representative of the entire class of all traders. It would not be fair for instance to pick out the single individual who by bappenstance would be the one selling to an insider with undisclosed good news. *Accord,* Loss, *The American Law Institute Federal Securities Law Project,* 25 BUS. LAW. 27, 35 (1969); Painter, *Inside Information: Growing Pains for the Development of Federal Corporation Law Under Rule 10b-5,* 65 COLUM. L. REV. 1361, 1377 (1965). Now it is true that one individual or more must occupy that position, but in advance no one can know who that is, and an individual would certainly be foolish to stay out of the market because insider trading was allowed, or to enter it because it was forbidden.

42. *See* note 40 *supra.*

43. *See* Fama, Fisher, Jensen & Roll, *The Adjustment of Stock Prices to New Information,* 10 INT'L ECON. REV. 1, 20 (1969), where the authors conclude that the stock market is so efficient in reflecting new information that no one without inside information could benefit from almost immediate purchases of stock upon announcement of a stock split (whicb is followed by higher subsequent dividends per sbare). We can choose one of two explanations for this efficiency. Either the market, through public disclosure (or magic), instantaneously rcflects the new value, or insiders are causing the price change. Which explanation would you choose? Othcr studies are equally convincing on this matter of the stock market's phenomenal efficiency in reflecting new information. Since it is very doubtful that mucb of this is caused by direct insider trading, my hypothesis about a market for information and indirect insider trading seems strongly substantiatcd. The best current summary will be found in Fama, Efficicnt Capital Markets: A

IV. Existential Mysteries of Insider Trading

When I wrote *Insider Trading and the Stock Market*, I believed that the SEC was probably fairly efficient in preventing any direct insider trading. Certainly the requirement that direct trading in his own company's shares by an officer, director, or ten percent shareholder be reported under 16(a), plus the sanction of 16(b), would effectively discourage most of this obvious kind of insider trading. And yet, the first significant study of this phenomenon indicates beyond any doubt that a significant amount of *direct* insider trading continues to the very present, though presumably without a purchase and sale occurring within six months of each other.[44]

At this point I should like to deal with another common error in my critics' reviews. Repeatedly, they become confused about how I was using the word "insiders." I tried to make it clear that I was referring to *any trading* by any individual based on information which had not yet been publicly disclosed or completely exploited by other traders.[45] I did not intend to qualify the term in the usual ways that lawyers might think of. I certainly did not limit my definition to officers, directors, and ten percent shareholders,[46] nor did it make any difference in my view whether the individual who ultimately traded knew what the facts were or merely traded on the basis of informed advice which he trusted.[47] I spent an entire chapter discussing various methods by which the value of information could be transferred without an actual transfer of the information itself.[48] Discretionary accounts and straight recommendations to buy (without further explanation) are two of the

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Review of Theory and Empirical Work, Jan., 1970 (unpublished manuscript, University of Chicago). *See also* Scholes, A Test of the Competitive Market Hypothesis: The Market for New Issues and Secondary Offerings, (1969) (unpublished Ph.D. thesis, University of Chicago) (strongly suggesting insider "knowledge" by pointing out that secondary offerings by control persons are more profitable to sellers than secondaries sold by anyone else); Jensen & Benington, Random Walks and Technical Theories: Some Additional Evidence, Dec., 1969 (unpublished paper presented at American Finance Association Meetings, New York).

44. Lorie & Niederhoffer, *supra* note 39. The astounding thing is that so much insider trading shows up even though stock must be held for a minimum of 6 months after it is purchased, since the insiders reporting in the study by Lorie and Niederhoffer would have been liable for any gains made by a purchase and sale within 6 months under § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (1964). I would still believe that the vastly greater source of knowledgeable trading is done by those at least once removed from statutory insiders.

45. *See* ITSM, *supra* note 1, chs. IV, V.

46. Not too surprisingly, it was an economist who seemed most to have confused § 16(b), 15 U.S.C. § 78p(b) (1964) and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1969). *See* Weston, Book Review, 35 Geo. Wash. L. Rev. 140 (1966).

47. ITSM, *supra* note 1, at 63.

48. *Id.*, ch. V.

more obvious. Since writing the book, I have come to understand that I should have included limited partnerships in investment banking houses and a variety of mutual funds as well.[49]

It would be relatively easy for the SEC to perform the statistical test necessary to answer the question of how much indirect trading occurs. They need only get an appropriate set of tax returns showing stock market trading profits for individuals who could be identified as likely to have access to information about companies. The results of the trading of these individuals would then be compared to that of a control group such as security analysts or professors of finance, who certainly have considerably sophistication but who do not necessarily have access to new information.[50]

If the results of such a test showed the former group to be doing significantly better in the stock market than the latter group, we might then have confirmation of my thesis of how new information gets transmuted into the proper stock market price. But, as I have said before, until such a test is performed, it should not be assumed that people with access to tremendous wealth would let it slip through their fingers like sand. The opposite assumption is vastly more in keeping with our knowledge of human nature and business institutions.[51]

I am neither a statistician nor a mathematician, but I urge any reader to try the following simple test that I and students of mine have conducted on several occasions: write down for some period of time

49. Text accompanying notes 108-12 *infra*.

50. Somehow Mendelson, *supra* note 2, at 473, assumes that security analysts will have inside information because they have thoroughly familiarized themselves with the company. Apparently he and I have a different kind of information in mind.

51. I made the precise point of this last sentence in a concluding paragraph of Chapter V of my book. I began that paragraph with the following sentence: "The important proposition of this chapter is that the market for valuable information described actually exists." ITSM, *supra* note 1, at 75. I then mentioned that the chapter had examined the evidence to substantiate this proposition and concluded as I have in the text above. This paragraph sent Professor Schotland gyrating to dizzying literary heights: "I find this paragraph astonishing. The leap from the *opening assertion that the case has been proved* to the very different conclusion that at least its opposite has not been proved is dazzling—the blur of fact, allegation and assumption, dizzying." Schotland, *supra* note 2, at 1432 n.22 (emphasis added). This is followed by a characteristically "cute" quote from Lewis Carroll, the characteristic being Schotland's, not Carroll's.

I found this footnote of Schotland's not astonishing, but puzzling, mainly because I could not understand the italicized phrase. Finally it dawned upon me that Professor Schotland did not know the meaning of the word "proposition." For his edification I quote from WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY (1961): "something proposed or offered for consideration, acceptance, or adoption . . . , the point to he discussed or maintained in argument usually stated in sentence form near the outset . . . ." *Id.* at 1819.

No wonder Professor Schotland has such difficulty understanding insider transactions; he doesn't know a proposition when he sees one.

every story appearing in *The Wall Street Journal* which could be expected to have a truly significant impact on a company's stock price; then go through the price reports well before and after that disclosure to find when the correlating price change seemed actually to occur.[52] My somewhat unscientific evidence to date suggests that in a very large percentage of cases the stock price reaction occurs before the news appears in print. And this is at least consistent with every statistical study relevant to the same question.[53]

We should not be fooled by the scarcity of SEC enforcement actions[54] into believing that there is not much insider trading and that the SEC apprehends that little bit when it occurs—though that is what we are told the facts are.[55] That is like pleas to New York City cab drivers to treat Harlem like any other section of the city since the police do not make any more arrests for muggings there than elsewhere.

There is no reason to believe that the use of valuable information, albeit perhaps in the indirect fashion which I discussed in my book, has changed in any significant degree in the years since *Texas Gulf*

52. This is not a rigorous test; at best the results should be termed impressionistic. There are very great difficulties in trying to correlate new developments with stock price changes, since prices are changing for a variety of reasons at all times and one cannot be certain that the information which seems to be desirable will actually be taken that way. As Lorie and Niederhoffer state, "[u]nfortunately, analysis of insider trading around such events in isolation from the price movements of the company can never reveal whether insiders profited from their information. For example, the price of the stock frequently increases consistently before and after the announcement of a divided reduction and a decrease in earnings." Lorie & Niederhoffer, *supra* note 39, at 46.

53. Again, the best thing on tbe subject is Lorie & Niederhoffer, *supra* note 39. They analyzed insider trading before large price changes in a stock (defined as changes of 8% or more) and found insiders to be considerably superior forecasters of large changes. In fact, such a difference betwcen insiders and non-insiders could occur incidentally only in 1 out of 10,000 cases. Their other tests gave similar results. *Id.* at 46, 47, 49. Indeed, anyone interested in the subject of insider trading must study this article carefully. This is also consistent with the interesting study of Bellemore & Blucher, *A Study of Stock Splits in the Postwar Years*, 15 FINANCIAL ANALYSTS J. 19 (1956). They report findings that from 8 weeks before to tbe day after the announcement of a desirable stock split, 86 out of 100 stocks registered percentage price increases greater than those of the Standard and Poor's Stock Price Index for the relevant industry group. From the day after to 8 weeks after the announcement date, however, only 43 stocks registered percentage price increases greater tban the relevant industry index. There must be some reason for this disparity, and the most likely is certainly insider trading. *See also* S. Pratt & DeVere, Relationship Between Insider Trading and Rates of return for NYSE Common Stocks, 1960-1966 (1968) (unpublished manuscript available from Professor Shannon P. Pratt, Portland State College, Portland, Oregon).

54. Since the much heralded *Texas Gulf* litigation began, there have been only 2 announced matters involving indirect insider trading. SEC v. Golconda Mining Co., CCH FED. SEC. L. REP., ¶ 92, 504 (S.D.N.Y. Oct. 30, 1969) and the Merrill Lyncb matter involving Douglas Aircraft stock, SEC Securities Act Release No. 8459 (Nov. 25, 1968).

55. *See, e.g.*, Kripke, *supra* note 2, at 214. *See also* note 106 *infra*.

Sulphur. The truth of the matter is that the much touted, highly sophisticated, computerized detection techniques used by the SEC to ferret out insider trading do not work very well. This may explain why they have not publicized these techniques, though it is said that their machines pick up any dramatic shift in price or volume in trading in a particular stock.[56] This must be a long, long way from proving, or perhaps even suspecting, which individuals are exploiting new information. The peculiar thing is that the SEC has announced so few cases. While I do not believe their enforcement techniques are nearly as good as they say, I find it difficult to believe that they could be as bad as their track record would indicate. Perhaps the Commission does not fully investigate every insider trading case. It could be that already this extremely potent device is being used arbitrarily or politically.[57]

V. STOCK MARKET EFFICIENCY

There are still at least two good reasons for defending insider trading aside from the point that ultimately there is no loss to outsiders from the practice. The more controversial of the two arguments is that insider trading provides an appropriate form of compensation for entrepreneurial activity in large corporations. The other argument, that insider trading makes the stock market function more efficiently, is probably the more obvious economic argument.

The efficient functioning of the stock market is actually one of the strongest arguments for unfettered insider trading, though at first blush it may appear to have little relationship to the issue at hand. I must confess that the significance of this point escaped me at the time I wrote my book, even though the point itself was recognized.[58] For this reason I cannot take my critics to task for not realizing that there was a very significant additional argument for insider trading. Of course, they were not exactly looking for arguments in its favor.

Efficiency in the stock market refers to both the speed and accuracy with which the market integrates new information into the market price of a security.[59] All other things being equal, the more

56. Jennings, *supra* note 2, at 1232. *See also* 1966 SEC ANN. REP. 8-9.

57. *Cf.* M. SHULMAN, THE BILLION DOLLAR WINDFALL 219 (1969) (reporting the whispered suggestion that this explains the appearance of the *Texas Gulf* case in the first place).

58. *See, e.g.*, ITSM, supra note 1, at 88. *See also* Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 266 (1967). For a slightly different version of this thesis, see Wu, *An Economist Looks at Section 16 of the Securities Exchange Act of 1934*, 68 COLUM. L. REV. 260 (1968).

59. *See* Benston, *The Effectiveness and Effects of the SEC's Accounting Disclosure Requirements*, in ECONOMIC POLICY AND THE REGULATION OF CORPORATE SECURITIES 26 (H. Manne ed. 1969).

efficiently the stock market functions, the better off everyone is for many reasons. An efficient market is one in which capital will be allocated to its highest-return uses, thus ensuring that capital goes into those uses with the greatest individual and social utility. This significance of the stock market as an allocator of capital has long been recognized.[60] More recently recognized, however, is that stock market prices may also serve to allocate management and the control of corporations.[61] The price of a company's stock is the best indicator of the performance record of existing management and the potential profitability of a takeover. Thus to the extent that the stock market is functioning efficiently, both the capital markets and the market for corporate control function more effectively.

The ultimate social significance of market efficiency is somewhat difficult to assess. It is, of course, an oft-stated goal of the SEC, though that alone does little to establish its significance. Ultimately, the desirability of efficiency in a market relates to individual goals. If we assume that individuals can maximize their own trading positions or diversify investment portfolios more accurately with information than without, then it follows that the most rapid and correct reflection of new information in quoted prices will allow each individual the maximum opportunity to help himself. Delays in the reflection of new information, or the inaccurate reflection of information, must increase uncertainty in the market and thereby make beneficial trading more costly and less likely than would otherwise be the case. But it is the nature of the case that at any one moment, no individual knows whether the market is operating efficiently or not for the security he contemplates buying or selling. The gains from efficiency are diffuse and often specifically unidentifiable. If it were otherwise, commentators would probably not treat the SEC so nicely when it lessens that efficiency.

A. Market Speed

Quite clearly there is a time lag between the development of new information and its ultimate publication to outsiders, even if we could assume perfect compliance with a rule against insider trading. But, as

60. A. BERLE & G. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 280 (1932).

61. Manne, *supra* note 58, at 265; Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965). *See also* Bromberg, *The Securities Law of Tender Offers*, 15 N.Y.L.F. 459 (1969); Schwartz, *The Effect of the 1934 Act on Sales of Control*, 15 N.Y.L.F. 674 (1969).

discussed earlier, perfect enforcement is not possible, and therefore subterfuges and devices to circumvent the rule against insider trading will be discovered and utilized. Of necessity these devices will consume time, and to the extent that time is expended in order to avoid compliance with the SEC rule, all other individuals who benefit from an efficient stock market are injured.

Nonetheless, we have it on the affidavit of Professor Schotland that

> *[a]llowing any* trading on undisclosed material information makes improper delay of disclosure more likely . . . . To ensure timely disclosure—an end to which the SEC and the self-regulatory bodies are equally dedicated—it is obvious that we must avoid encouraging motivations for improper delay, however subconscious they may be. If we abandon restraints on insider trading, we tempt insiders to delay disclosures so that they can buy more shares or arrange financing for more buying; we also invite the timing of disclosure to get maximum market response.[62]

Perhaps this need not detain us, however, for in the very next sentence, just in passing, Professor Schotland contradicts himself: "[O]n occasion the concern for insider trading profits might cause disclosure to be made earlier than it would be without insider trading; but they may not be in the best interests of the corporation. . . ."

There are several errors in the principal quote that should be exposed, since Schotland is not the only one who makes them. First of all he implies, without any supporting evidence, that present restraints on insider trading are completely effective. Obviously, if they are not completely effective then Professor Schotland cannot know that the time spent in circumventing rules would not be greater than the time spent in "arranging financing" or whatever else needs to be done to capitalize legally on information. The presumption would seem to be the opposite, but Schotland never notices the impact of partial enforcement, and consequently his position is unrealistic.

He did, however, take note of the obvious proposition that the disclosure time for a great deal of news cannot be controlled and therefore is not delayed by allowing insider trading. But then, in what seems like a fretful nonsequitur, he responds that it is no "answer to allow unfettered inside trading by personnel who have no role in deciding upon the timing of disclosure . . . ."[63]

Another thing that Professor Schotland fails to realize in his conclusion is that any insider trading must cause an improper delay in

62. Schotland, *supra* note 2, at 1448-49 (emphasis added).

63. *Id.* at 1449. Professor Scotland has in this response apparently shifted the ground away from the point at issue, the timing of disclosure, back to the propriety of insider trading.

disclosure. People with accurate and reliable information will generally be well advised not to risk their almost certain profit by delaying the exploitation of that information. That is, their incentive will be to move very quickly, with whatever resources are at their command, to profit from their information. Even if news were 100 percent reliable and correct, with each additional minute, hour; or day the probability of a new event occurring to cause a decline in the same stock's price rises rapidly. It will generally be a poorer but wiser insider who fails to take immediate advantage of reliable information. It should be noted that disclosure must in any event occur fairly shortly after insider trading if the insider is to make any profit. While his own trading and that of other traders may drive the price up, it would ordinarily be extremely expensive to maintain such a high price unless new information justifying it is disclosed. In the short run, then, insider trading may have the same effect as disclosure, but in the longer run, unless there is very substantial money supporting the market, disclosure will have to occur very quickly.[64]

Possibly Professor Schotland and the SEC could adduce individual cases in which some form of delay in disclosure occurred while insider trading was or might be occurring. But once again, perhaps with a need for more patience than I have, one is constrained to point out that social policy should not be made on the basis of episodic vignettes taken from the annals of SEC enforcement actions. We must either utilize hard, accurate data or we should proceed on the assumptions dictated by the most logical economic doctrines. Lawyers simply must get over their bad habit of assuming that because they can conjure up one horrible case, it must reflect the general behavior of humanity; otherwise, someone eventually will be tempted to say that social policy is too important to be left to the lawyers.

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64. This point, I believe, explains the rough going Professor Mendelson has in trying to establish outsider injury. His "long run," where he posits some injury, probably *never* occurs. Mendelson, *supra* note 2, at 476-77. His argument is as follows: Since all shares of stock are readily substitutable and investors plan their portfolios based on diversification of anticipated rates of return (discounted by risk) insider purchasing of securities on undisclosed information would seem to have an undesirable effect. As insiders purchased without disclosing reasons why, other investors would continue to evaluate the shares as they previously had, and thus would want fewer of those shares at the new higher price and relatively more of all outsiders and a general depression in the price of the stock. Q.E.D. Insider trading on good news causes lower prices for shares. Mendelson's error, apart from the fact that it is blatantly contradicted by every empirical study ever made on the subject, derives from his failure to realize that insiders will disclose the information long before the secondary effect he describes can take place. Schotland makes exactly the same mistake, *supra* note 2, at 1448.

B. Market Accuracy

1. *Feasibility of Disclosure.*—The second functional relationship between insider trading and an efficient stock market might be termed accuracy. The point most simply stated is that insiders are generally in the best position to weigh new information accurately and assess its future impact on market price. To some degree, however, speed and accuracy become intermingled, for ultimately the proper weight to be attributed to any information becomes evident to others in the market. One may indeed have to wait months or even years until the true value of the information shows up in the form of changed earnings, but ultimately the truth will come out. The most important question is who is in the best position to do this weighing at the time the information actually develops.

The answer to this question has far reaching significance. It calls into doubt not simply the rule about insider trading, but the entire "philosophy of full disclosure." This so-called philosophy has captivated many observers of government regulation. The popularity of the notion accounts in large measure for the almost religious fervor with which politicians, bureaucrats, and professors adore the SEC. After all, who can be against full disclosure? The very suggestion smacks of condoning fraud, lying, and deceit. Nor need one join the radicals to favor a regulatory philosophy of full disclosure since it is simply designed to make free markets function better.[65] Thus, proponents of this idea can appear at one and the same time to be practical hard-headed men of affairs and yet idealists concerned with the commonweal.

Historically, the idea traces back to the early part of this century,[66] but it was just a bit of academic rhetoric until the advent of the Securities Act of 1933, the "Truth in Securities" law. At that point a great innovation was proclaimed, an administrative system designed, not to regulate, but to make promoters and underwriters tell the full truth about new securities. Even today the idea of direct securities regulation makes a dedicated SEC partisan frown. He knows that direct regulation—unless it happens to be of investment advisors, stock brokers, stock exchanges, holding companies or mutual funds—is futile

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65. It also allows such nonsense statements as that "any friend of the free market . . . almost certainly should urge additional regulatory steps." Schotland, *supra* note 2, at 1468. The problem becomes the solution.

66. W. RIPLEY, MAIN STREET AND WALL STREET (1927) is the best-known work on the subject.

or even harmful, and he prefers not to be involved with petty administration that is better left to state Blue Sky administrators.

Over the years, adherents of the disclosure religion have had it very easy, psychologically speaking. No one has seriously questioned their belief. Indeed, whole new generations of lawyers have been brought up to appreciate the beauty of the disclosure arrangement. But "full disclosure" should no longer enjoy this sanctuary. In the Age of Aquarius, some troubling questions simply must be raised. For instance, what is the cost of administering a full disclosure system *as compared to the benefits actually gained*; what private interests are actually benefitted, and at what cost to others; what is the effect of the present system of disclosure on the production of valuable information; and to what extent is the service provided by the SEC merely a subsidy to a financial group who would otherwise have to pay their own way?

For now, however, we must limit ourselves to another very fundamental question, so fundamental indeed that one is almost embarrassed for his profession to report that prior to the publication of *Insider Trading and Stock Market*, no one had ever raised it. The issue is whether full disclosure is in any meaningful sense feasible! Can it even be done?[67]

We start by recognizing that there are two kinds of information in the world: (1) information which has been previously disclosed or evaluated in the market, and (2) information which represents a move to a new objective circumstance, that is, change. I denoted these as first and second category information. I apologize for such prosaic titles, and if that is why the reviewers have ignored the point, perhaps they were justified.

First category information has no market value as such, since the present market price fully reflects all the past events leading to the present position. It is a free good[68] and is of no direct interest to this discussion, though it is of some derivative interest, as we shall note shortly.

New information relevant to a security's price, second category information, may be of many different sorts. Although some of this information does not lend itself to full disclosure in the usual sense at all, it is the only kind of information relevant to individual stock price changes. We may organize interesting bits of information about change

67. The discussion following is not intended to be an exhaustive catalog of all disclosure feasibility problems. The effort is merely to note some of the highlights.

68. A free good has been defined as one for which nothing at all need be sacrificed to acquire as much as one wishes. *See* A. ALCHIAN & W. ALLEN, *supra* note 17.

into several broad categories. First, we might look at the familiar kinds of financial information. The financial news most commonly affecting share price is a significant change in annual earnings. Yet, even the least sophisticated market hibitues are familiar with cases where apparently excellent earnings are met by a neutral or even negative market response. Conversely lower earnings may not cause what would seem to be a sufficient decline in price. Simply having the new earnings figure might not be sufficient to allow informed trading.

There are numerous possible explanations for this phenomenon. The most likely is that the information has already been anticipated in the market. That is, the new earnings report is not actually news at all, and only those with blind confidence in the SEC's disclosure philosophy could be misled into losing money by following such a disclosure. More important for immediate purposes, however, is the possibility that the current earnings, while not previously discounted, are still insufficient to change the market's estimate of the present value of potential future earnings. Sometimes this may be evident to a good securities analyst, but there must be a significant number of instances in which the best guess about the company's present worth is based not on current earnings but on information that has not been or indeed could not be legally divulged in any SEC-regulated financial statement.[69]

There is another kind of information which the SEC seems absolutely determined to hide from the world. This is the true value of the capital assets used in a business. The familiar rule, rigidly enforced by the SEC, is that assets must be carried by the company at the lower of cost or market, minus depreciation.[70] No matter how much inflation has occurred and no matter how much a particular asset may have appreciated, the SEC generally forbids publication of the true value.[71] Asset values would seem to be first category information and therefore not of great interest. However, in some specialized instances they may become extremely relevant. If for instance the useful life of a particular asset is about to expire, analysts may be very interested to know the replacement cost. More important is the possibility that always exists for an asset to be sold at a high profit.[72]

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69. *E.g.*, Rule 14a-9, 17 C.F.R. § 240.14a-9 (1969) (forbidding predictions as to "specific future market values, earnings or dividends" in proxy solicitation materials).

70. *See generally* 11 BUSINESS ORGANIZATIONS—SECURITIES REGULATION, H. SOWARDS, FEDERAL SECURITIES ACT § 8.01[3] (1965).

71. I say "generally" because apparently when it suits their purpose the SEC will change rules in midstream. *See* Manne, *Some Accounting and Administrative Law Aspects of Gerstle v. Gamble-Skogmo, Inc.*, 15 N.Y.L.F. 304 (1969).

72. The SEC in Gerstle v. Gamble-Skogmo, 298 F. Supp. 66 (E.D.N.Y. 1969), tries to

This is not the appropriate place to enter a lengthy discussion of problems of asset value accounting.[73] But it is proper to make one simple observation: insiders in a company or an industry are frequently the only people who can possibly make realistic valuation assessments. Of necessity, they will generally be able to do this more accurately and efficiently than anyone else, and there may be no accurate or efficient way of passing this information along to the public.[74] Consequently, allowing those individuals to trade on this information would necessarily improve the efficiency with which the stock market assimilates new information into stock prices. *A fortiori*, the same analysis holds for the SEC's other big bugaboo, earnings estimates.[75]

There are many other accounting issues about which the same point can be made. For instance, there are all those accounting questions on which there is more than one generally accepted accounting standard. One need only wander lightly over issues such as inventory accounting, treatment of tax credits, allocation of overhead costs, merger accounting, and accounting for economic risk (e.g., leases or stock options) to realize that a science of accounting is still an idle dream. Basing a regulatory system on the idea that such an ethereal concept is scientific guarantees either that the public will be deceived or that the market cannot function efficiently, or both.

Frequently, new developments in a firm or industry cannot be the subject of full disclosure. The development may be a new product, a new mineral discovery, an important government or private contract, a finding of a health hazard in a product—or any of these things happening to a competitor. For a variety of reasons it may be impossible to make a straightforward, useful disclosure to the public. Obviously this need not be true in every case, but there will be a significant number of such cases, and we know almost nothing about the magnitudes involved. Not surprisingly, nothing is ever said about these instances by proponents of the full disclosure philosophy.[76]

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make a classification of assets for which "a ready market exists." *See* Manne, *supra* note 71, at 320. But since that likelihood, at least in the real world, is always a function of the price offered in the market for the asset, the test will probably not yield helpful results.

73. *Id.* at 314-27.

74. Consider, for instance, whether one should use replacement value or liquidation value, and how to compute these? *See generally* R. CHAMBERS, ACCOUNTING, EVALUATION AND ECONOMIC BEHAVIOR, chs. 9, 10 (1966).

75. Rule 14a-9, 17 C.F.R. § 240.14a-9 (1969).

76. Presumably a few lawyers who practice actively in the area are sophisticated about these problems when they arise. But their knowledge relates more to techniques for dealing with the SEC on the matter than to the policy or quantitative questions left hanging in this area. In the

For example, a new defense contract may inevitably lead to an actual loss for a company, even though the unsophisticated public's reaction to the news would be to bid up the price of the stock. New product announcements have frequently occasioned this sort of difficulty.[77] Who can know how much start-up costs will be, or what the market might be for a new product, or what the competition has up its sleeve? It would be far better to allow those insiders who understand these matters in detail to "make the market" for these companies' shares. True, a good securities analyst may discover much of this information, but equally true, he will rarely be in the same position as insiders to assess all of the relevant factors. Furthermore, information can be processed and acted upon much more quickly by an insider than by the public, and, of course, the insider can hire outside expertise as well as the next man. The list of problem disclosure areas could be enlarged indefinitely, yet all one hears about are developments which *in retrospect* the SEC argues were appropriate for full public disclosure.[78]

The final type of information which does not lend itself to full disclosure might be termed management news. In this category occur some of the most significant events ever affecting business. High on the list would be the problem of personal animosities developing within a corporation which threaten to tear apart a smoothly functioning organization. Certainly no one seriously proposes public disclosure of such sensitive, and often private, information. The benefit to competitors would far outweigh any benefits others might receive from the information. But the effect of a full disclosure rule in these circumstances is necessarily to maintain an artificial price until the disruption in management has caused severe deterioration in the earnings of the company or some other dramatic event has occurred. During that entire period of time the market price of that company's securities could be wrong. Can anyone seriously suggest that the harm to the public from this is somehow less than it would be from allowing insiders to assure an informed current price for the company's shares?

Other managerial developments might have the same effect. The most common is probably the case of failing health of a key executive.

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camaraderie of intra-professional conversation most lawyers admit that many of the most significant facts relating to the value of a company stock never pass through the SEC's disclosure mill. *But see* Mendelson, *supra* note 2, at 476.

77. *See, e.g., In re* Cady, Roberts & Co., 40 S.E.C. 907, 908 (1961).

78. The two signal cases in this regard are Texas Gulf Sulphur, 401 F.2d 833 (2d Cir. 1968), and Gerstle v. Gamble-Skogomo, Inc., 298 F. Supp. 66 (E.D.N.Y. 1969).

The problem of failing mental faculties could never be objectively reported, though they might be clearly observed by others around the executive. Again, how much smoother and more efficient it would be to allow insiders to register this news in the market, even though actual disclosure would not be possible.

The point should now be clear. Asset valuation problems, accounting issues, competitive positions, potential earnings and managerial developments are examples of news items that will always prevent the philosophy of full disclosure, no matter what its theoretical merit, from existing in the real world. The time is past for assuming on faith that the amount of disclosure which does actually occur as a result of SEC rules is either significant or by itself helpful.

2. *The Market-Smoothing Effect of Insider Trading.*—The suggestion that insider trading gives us a more efficient stock market leads to still another advantage which I did not discuss in my book.[79] There I was concerned exclusively with the exploitation of news about significant events.[80] In fact, however, it is desirable to have all ups and downs smoothed out to the extent possible by an efficient market mechanism that reacts sensitively to even small inappropriate movements. This suggests the desirability of allowing insiders in corporations to do something on the order of "making a market" in their company's shares. As indicated above, they are in the best position to do that job effectively, and, in spite of some expressed fears that they would spend all their time trading in the market, there is really no reason to believe that this practice would have undesirable effects on their managerial skills. It would remain true that good management would bring the greatest profits to the managers. The time necessary to exploit information, or correct misconceptions as they appear in the market, would in all likelihood be considerably shorter than the time required to circumvent rules against insider trading.

In over-the-counter stocks, where market makers may still occupy positions on boards of directors, this is almost exactly what occurs, and it is difficult to see the market maker as anything other than a privileged insider.[81] Would it not at least be a good idea for the SEC

79. *See* note 58 *supra*.

80. I took these to be events causing a 10% or greater change in the stock's price. For a while, perhaps under the influence of *Texas Gulf Sulphur*, I felt that I had been too optimistic and that I should have considered changes in the range of 20% to 30%. Lorie & Niederhoffer, *supra* note 39, however, used changes of 8% to indicate significant price movement. The point in the text is that the figure really makes no difference, since if it is large enough to motivate insiders to trade, that is the trading we are talking about.

81. He is, however, exempt from the usual short-swing insiders' profit rule. 1934

to know whether underwriters make or losé money in their market making function? Does anyone seriously believe that market makers have no more information than public investors, or less than the chief executive of the company? And how are we "nuts"[82] supposed to think they get it—through research?

C. *Market Manipulation*

To complete the discussion of whether or not allowing insider trading would give a more efficient market than do post-*Texas Gulf Sulphur* legal rules, we must still look at one additional factor that may vary with the rule. That additional factor is market manipulation. No one defends this, and there is general agreement that manipulation does add a high cost to the functioning of the market. It causes the market to function less efficiently, that is, to reflect objective values less accurately. Moreover, individuals are directly injured by manipulative activity, as with any fraudulent behavior.

Manipulation differs dramatically from insider trading, just as a reliable tip on a winning horse differs from having the race "fixed". If all insider trading could be effectively prevented, there would probably be no fraudulent manipulation of stock prices, since no one could gain from it. But that does not decide the underlying issue about insider trading, for clearly there may be policing costs which are too high for anyone to accept. After all, outlawing horse racing is the surest method of preventing fixed races.

No evidence has been adduced by the SEC or its spokesmen that allowing insider trading actually encourages manipulation. Professor Schotland[83] is hard pressed to say anything meaningful about manipulation. He conjures up one single situation in which insiders have bought shares well in advance of disclosure of the information and then manipulated the market to keep the price high over a lengthy
so that they would not lose on their purchase. Among other
does not explain to us why insiders in these circumstances
at all when they did. Perhaps more important, he does not
ey will perform the particular manipulation involved, or
ld not make the disclosure earlier. If in fact they are able
is task without detection, they have every interest in doing

.S.C. § 78p(d) (1964). *See also* SEC Securities Act Release No. 7905 (June
, SECURITIES REGULATION 3084, 3089 (1969).
, as applied to me, originates with the SEC official quoted in Schotland, *supra*
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so *regardless of the rule against insider trading*. For that matter, people who are not insiders would have just as much interest in doing so. Therefore, even if such activity really does go on, which is highly doubtful, its relationship to the rule regarding insider trading is not proved.

Even more mystifying is Professor Schotland's second and concluding reason why insider trading makes manipulation more likely: "As seen earlier, insider buying in itself does not have any significant impact on share price. But the contrary may well be the case, if a group of insiders intentionally time their buying so as to affect the price. It is an old tactic of manipulation to intentionally time orders to have such effect . . . ."[84] It is an old tactic of polemical debate to use obfuscation as a conscious means of argument, and we have here a perfect example. Even apart from the volte-face on the price impact question, this statement as an argument against insider trading is meaningless. At best, it only says that manipulation of stock market prices is possible. To give it one more bit of credit, it also says that this may be done by insiders. It certainly does not say that it may not as well be done by others or even that such action is not more likely to be done by outsiders. The case used to illustrate the point, *SEC v. Georgia-Pacific Corp.*,[85] is actually inapposite since it does not even deal with an insider's utilizing undisclosed information to gain an edge in stock trading. It is a case of stock price manipulation to which the insider aspect is purely incidental.[86]

D. *The SEC's Confidence Game*

Supporters of the SEC have voiced one further argument against insider trading. It is an all-purpose argument which undoubtedly originated in the earliest days of federal securities legislation. In its general form it seems to say that unless the public knows that the market is being regulated by the government, they will be afraid to invest in the public securities market. The specialized variant for insider trading purposes says that if the public believed that insider trading was occurring regularly, they would lose all confidence in the stock market and cease investing funds there.[87]

84. *Id.*

85. [1964-1966 Transfer Binder] CCH FED. SEC. L. REP. ¶ 91,692 (S.D. N.Y. 1966).

86. *See* SEC v. Golconda Mining Co., CCH FED. SEC. L. REP. ¶ 92,504 (S.D.N.Y. Oct. 30, 1969) (while not providing reliable evidence of the impact of insider trading rules on manipulation, this case at least illustrates the point Professor Schotland had in mind).

87. Marsh, *supra* note 2, at 1320; Poser, *supra* note 2, at 754; Schotland, *supra* note 2, at 1475; Sommer, *supra* note 2, at 692.

There are several things wrong with this line of argument. The first and most obvious is that the public has never shown any signs of losing confidence in the stock market because of the existence of insider trading. No one cognizant of the history of the twenties could claim otherwise. In 1929 there were over twenty million shareholders on the books of American companies,[88] though the actual number of individual investors was, of course, much smaller. Nonetheless, it is doubtful that direct shareholders during the bull markets of 1962 or 1968 actually were a larger percentage of the total population than those of 1929.[89] Moreover, all of this occurred with the widest publicity and notoriety imaginable being given to bull pools and other insider trading devices. In fact, stories of these activities were the normal daily fare of the pre-crash financial press. The loss of public confidence in the stock market is not visible. The public, it would seem, is less gullible than spokesmen for the SEC.

The next problem with the confidence argument is the implicit proposition that insider trading is not occurring today. As we have already seen,[90] there is little evidence to warrant that assumption. But publicizing such an idea may have troublesome consequences. Some unsophisticated members of the investing public must believe that the SEC has removed all risk of loss from the securities market, or at least lessened it in some meaningful sense by stopping insider trading. That, of course, is not the case. The risk to an outsider is unchanged in any significant degree by the insider trading rule adopted. Therefore, some investors are lured into the stock market by an SEC-instigated notion that the risk is less than is actually the case.

I doubt that a great many people have been sandbagged by the government in this way, though a reliable informant at the Commission tells me that a substantial amount of mail is received by the Commission and Congress from individuals complaining that they have lost money in the stock market even though the SEC was supposed to prevent this.

There is undoubtedly some problem of public confidence in the integrity of the participants in the stock market. The disclosures of fraud and manipulation by the Pecora Hearings[91] in 1933 were by no

88. R. SOBEL, THE GREAT BULL MARKET 73 (1968).

89. NEW YORK STOCK EXCHANGE, ECONOMIC EFFECTS OF NEGOTIATED COMMISSION RATES ON THE BROKERAGE INDUSTRY—THE MARKET FOR CORPORATE SECURITIES AND THE INVESTING PUBLIC 13 (1968).

90. *See* notes 39 & 43 *supra*.

91. *Hearings on Stock Exchange Practices Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. (1933).

means without foundation. But the actual fraud and manipulation publicized by the hearings never involved just trading on inside information, and in numerous instances there was no insider participation whatever. The public does have a real interest in knowing whether fraudulent types of criminal behavior are being effectively policed. Unfortunately, it is impossible to assess how good or bad a job the SEC does on this, as they do not publish adequate data from which a reliable conclusion could be drawn. Probably their detection and prevention of truly harmful behavior could be improved upon. Certainly if they would devote more of their resources to such clearly justifiable activities, everyone would be better off.[92]

There is one other aspect of the confidence argument which should be examined. It is the questionable assumption that there is some clear social interest in having people channel their savings into investments in the stock market. Of course, stock exchanges, brokers, and underwriters are benefited by any encouragement a government agency can give their particular efforts, but that is not necessarily true for the public. Any savings will eventually become invested, and the money does not have to be channeled through the stock market to effect this. Commercial banks or any number of other intermediaries might serve as well.

This is not to suggest that the stock market is not a highly efficient and desirable means for channeling investment. It is to say, however, that it is unseemly for a government agency to gear its regulatory activities to encouraging business for the industry it is supposed to regulate. In principle, at least, the SEC should be indifferent to whether the public prefers stocks to savings accounts or mutual funds to brokers. It is well recognized, however, that agencies do come to "represent" their industries—usually to the public's detriment,[93] and they do this typically under the guise of keeping the industry "healthy," so that the public will not lose confidence in it.

VI. Entrepreneurial Reward

My principle affirmative argument for insider trading was that it provided a meaningful form of compensation in large corporations for

92. Actually the SEC seems to be bucking a trend, since elsewhere the direction of criminal law is away from enforcing purely moral codes such as those involved in the prohibition of pornography, marijuana, prostitution, and insider trading.

93. For an excellent inside story on regulatory agencies, see *The Regulators Can't Go On This Way*, Business Week, Feb. 28, 1970, at 60. Incidentally, Ralph Nader is quoted therein as saying that stock tips are used to pay off agency staff members in Washington. *Id.* at 65.

the entrepreneurial function. This occasioned the greatest and most vociferous opposition of any point in the book. In a way, this was quite surprising, since the principles I drew upon constitute the most fundamental and basic postulates known to economic theory; people would rather have more of a good thing than less, and normally there is a point at which a person will give up some amount of one good to gain an amount of another which he values more highly.[94] That is, human wants are infinite, and all demand curves have negative slopes. As a corollary, the amount of the goods offered goes up as the price offered increases.

In terms of the thesis of the book, one need note only, as Professor Schotland said, some "simple economics." If any service presently being purchased by the corporation is compensated more highly, more of that service will be offered. Valuable information is an economic good that can be substituted for other media in which the higher compensation can be paid. If the service performed is or can be one which gives access to valuable information, less of other forms of compensation must be paid in order to secure the same amount of the service.

This is true regardless of the nature of the employment. It is true of clerks, accountants, lawyers, or someone performing an entrepreneurial service. Clearly, if some entrepreneurship is being performed for publicly held corporations, more of it will occur if the potential pay-off is greater. One may argue about identifying the performers of this function or controlling access to information. But the basic point stated above simply cannot be denied or disparaged. There are economic laws, and they are not repealed by anyone's ignorance of them, whether participants or observers.

The news may not impress my critics, but I for one still cannot understand why anyone finds it to be unfair, unjust, or immoral to allow a voluntary arrangement in which individuals are given an additional incentive to produce more of a valuable commodity by sharing in the new value they produce. Lawyers familiar with the contingent fee should scarcely be surprised. But law professors apparently are not comfortable with abstract ideas of economic functions, like entrepreneurship.

A. The Moral Imperative

In some ways the most disconcerting thing about many of the reviews of my book was the strange belief that we *must* decide whether

94. A. ALCHIAN & W. ALLEN, *supra* note 17, at 16.

everyone will act in one way or the other; either every corporation must allow insider trading, or none may. Why the note of compulsion? Why the moral imperative? Why not the liberty of choice?

It is difficult to understand the origins of this particular attitude. Perhaps it derives from a notion that the exprcss contractual terms of an employment relationship must describe all aspects of that relationship. Thus, if an individual enters into a contract providing a straight salary and no other form of compensation, then it is argued that he is entitled only to that salary and nothing else. Any additional income is, as various proponents of the *Texas Gulf* rule have declared, "covert," "unjust enrichment," or "unnecessary to secure performance." As Professor Hetherington in his generally logical and insightful piece states:

> [T]here is a strong argument that the innovations produced by these persons have already been bought and paid for. Their employer gives them salaries, bonuses, stock options, retirement plans and freedom from the distracting worries of running a business, worries that beset the small inventor attempting to exploit his idea.[95]

While more calmly stated than most, this is typical of the underlying notion that the terms of an employment relationship in a corporation must be set either by regulatory authorities or explicitly in a fully integrated contract of employment.

Manifestly there is no such doctrine of contract law, and yet none of the usual legal approaches to the question of intent or implied rights are discussed.[96] No effort is made to show that the parties either by their actions or their ambiguous words intended salaries, bonuses, and other benefits to be the total means of compensation. Silence does not usually have that effect.

Why then is everyone so quick to insist what the implied provision in an insider's employment contract must be? Why do they assume that the implied provision is so different today than it per force was before the development of Rule 10b-5? And why finally do they assume that anyone advocating no government rule against insider trading is necessarily saying that it may not be banned in a private contract? All the evidence seems to lean in the other direction—or at least it did before *Texas Gulf Sulphur*.

I think that part of the answer goes to a set of attitudes characteristic of many academics and their students. We live, as Professor Hetherington eloquently points out, in a period of "moral

95. Hetherington, *supra* note 2, at 727.

96. *See* 3 A. CORBIN, CONTRACTS § 561 (1960).

escalation."[97] But what Professor Hetherington fails to note about this condition is how often moral indignation is used as a cover for unanalyzed conclusions. While it is certainly the province of professors to identify and explain such developments as moral escalation, it is their ultimate responsibility to seek rational, logical answers to social problems. As much as they might like to don the mantle of high priests of moral theology, this is neither their assignment nor their skill. Theirs is a difficult job, but it will not long be respected unless the academic profession stands foursquare behind the idea of rational inquiry.

At no point in my entire book do I express the belief that corporations should be *required* to tolerate insider trading.[98] As an economist or objective analyst, I do not care what any corporation may do in this regard. I personally would prefer to invest in the shares of corporations which did allow insider trading. But if through legal means a corporation properly indicates that its rule is no insider trading, that should be the business of that corporation and its shareholders and the courts if a violation is alleged. I wish that I had said this earlier, but all I am pleading for is a *rule of full disclosure.* If the SEC were faithful to its stated philosophy, it would simply require every corporation to state whether or not insiders will be allowed to use information in the stock market or under what conditions this will be allowed. No more need be done.

Government regulators, however, do not like to take the risk of having the regulated sector and the free market sector so easily compared by the public. With regulatory philosophies as vacuous as those which have been offered by friends of the SEC, it is no wonder that they seek refuge in moral laws. And moral laws, unlike the rules of government in a free society, can admit of no choice contrary to their dictates. If one is to be moral, HE SHALL NOT ENGAGE IN INSIDER TRADING. Deviant behavior, whether condoned by the board of directors, the shareholders or anyone else, remains immoral and unjust. The main trouble with moral escalation is that it is so frequently fatuous.

97. Hetherington, *supra* note 2, at 734.

98. Manifestly that would be contrary to my whole economic philosophy. The only point of my book was to defend individuals and corporations from the coercive mandate of a government agency. Not one single reviewer noticed that while I am *allowing*, they would all *forbid absolutely*. Ironically Professor Schotland states "that the Manne thesis miscasts the issue by stating the question in terms of black and white: Shall insider trading be free, absolutely, or banned absolutely?" Schotland, *supra* note 2, at 1439. The rest of the discussion on the same page bears reading by anyone interested in the logical quality of this work, but I will not trouble the reader with it further.

B. Enough Is Enough

Professor Schotland says that there is "no reason to believe that available forms of compensation are inadequate to stimulate [entrepreneurial activity]."[99] I believe that he reads into my work attitudes and thoughts that are foreign to it. I never talk about adequacy or inadequacy in a vacuum. I do not know the distinction between an adequate and an inadequate amount of entrepreneurial activity. Like the economists, I can only say that if a larger amount of compensation is offered for the performance of a function, more of it will be forthcoming. I will stand by that statement until some evidence is shown to the contrary. I might add that that proposition has stood the test of time as well as anything known to the social sciences.

A related point, which piqued nearly all the reviewers, was that the individuals who will exploit the news may not truly be entrepreneurs.[100] I discussed this point at length in my book and explained many reasons why non-entrepreneurs would have access to new information.[101] The treatment of this material in the reviews was highly selective and frequently inaccurate, and I see nothing to be gained by rehashing the same points. Rather, I should like to try a different tack and suggest to my critics that it really does not make any difference who gets unexploited information or whether we can pin the tag of "entrepreneur" on him. To reach the general conclusion of my thesis, it will be sufficient merely to posit that the flow of information to individuals without legal constraint is *not random*. About this, there should be no argument, for if the flow is random, everyone has an equal chance to benefit from it, and there would be no significant "insider" problem. Thus, presumably everyone agrees that in an unregulated or partially regulated information market, the flow of new information will to some extent be directed.

If the allocation of information is in fact purposive, individuals can make behaviorial decisions based on the expectations created thereby. The additional wealth (or some positive probability of achieving this wealth) will still be viewed as additional compensation by those to whom it will be directed or allowed to flow. If other compensation remains the same, more of their function will be offered

99. Schotland, *supra* note 2, at 1457.

100. Brudney, *A Note on Chilling Tender Solicitations*, 21 Rutgers L. Rev. 609, 625 (1967); Hetherington, *supra* note 2, at 727; Jennings, *supra* note 2, at 1233; Kripke, *supra* note 2, at 213; Marsh, *supra* note 2, at 1319; Painter, *supra* note 2, at 151.

101. *See, e.g.*, ITSM, *supra* note 1, at 65, 66, 69, 70, 153, 156-58, 160, 161, 171-89.

by them or by others and their incentive to produce new information or to cause more to be produced will be greater.

Since they have the most to gain thereby, the individuals receiving information will already have or will eventually gain some power to encourage new developments. This, I take it, is the quintessential function of the entrepreneur in classical theory,[102] and it is what I had in mind in my book. But it should have been clear to any reader that I did not wish to suggest that all recipients of information would necessarily be this kind of entrepreneuer. I was at great pains to point out[103] that leakage of confidential information is quite common and that normally it would not pay insiders to invest in perfect policing. I also pointed out that information might be used to pay off a variety of debts, thus making it appear that the information was being used by individuals with no important connection whatever to the corporation. It is somewhat astounding to see some of these very points turned around and used as criticisms of the thesis in which they appear.[104]

Much of this dispute relates to the question of whether one can assume a detectable, controllable, non-random flow of information within a corporation. By implication the critics seem to be saying that while it is not random, it *always* goes to the wrong people. Schotland, for instance, states that it is an "ineluctable fact . . . that the use of confidential information, if permitted at all, cannot be kept from running rampant."[105] This, incidentally, is followed by the ineluctable proposition that it is "comparatively easy for the SEC and the self-regulatory bodies to detect insider trading on undisclosed material information."[106] Why it is so much easier for the SEC than for people

102. *Id.* at 115-19.

103. *Id.* at 169.

104. *See, e.g.,* Schotland, *supra* note 2, at 1456.

105. *Id.*

106. *Id.* Professor Schotland is not alone in this claim. *See* Jennings, *supra* note 2, at 1232; Kripke, *supra* note 2, at 214. *See also* Posen, *supra* note 2, at 754. Professor Schotland tells us at some length about the SEC's "stock watch" program which has "no problem" in tracing buyers and sellers whenever there is suspicion of insider trading. Schotland, *supra* note 2, at 1456.

Professor Schotland proceeds then, as he does on several other occasions in his article, substantially to contradict himself. On the very next page he concedes that tracing may be made impossible by the use of "straws" or Swiss bank accounts. I presume by "straws" he means literally everyone that I include in my discussion of indirect trading on undisclosed information. But this doesn't worry him since "there are not likely to be many such people. Compared with most activity that must be made unlawful, enforcement here is as easy as it is for a young family to figure out who ate the cookies." Let's see how easy it is to figure out who has to eat crow.

Schotland fails to recognize that the amount of violation of any law is a function of the benefit to be gained by the violation. He then calmly proceeds to contradict himself by citing a

who have a real economic interest in detecting this loss is not made clear.

My prediction of SEC ineffectiveness in policing insider trading would have been even more accurate had all participants in the stock market realized how poorly the SEC enforces its rule. But Wall Street is terrified of the SEC, and this definitely changes some individuals' behavior.

There is, however, one thing on Wall Street which will overcome even terror—money. The potential for profits in the utilization of previously undisclosed information is enormous. I do not know of anyone who has ever totaled up the full value of all the new developments in a year for listed companies, but it must be in the tens or even hundreds of billions of dollars, every single cent of it adding to the incentive to find a way to avoid the terrible plight of the *Texas Gulf Sulphur* insiders. With odds like that it is not surprising that they have been fairly successful. Their very success may have created whole new institutions in the financial community and had international repercussions and countless personal effects. But succeed they undoubtedly have, for if they had not, there would not be, as Professor Schotland reminds us, such a high "frequency with which significant corporate news is preceded by a notable rise in share price . . . followed by 'selling on the news.' "[107]

C. *Adjustments to the New Rules—The Interesting Case of Mutual Funds*

Interestingly, it is possible to find in the mutual fund industry examples of personal, institutional, and international adjustments to rules about insider trading. It is well known, of course, that this industry has had an enormous growth in the past fifteen to twenty years, and in the last five years we have seen the rapid expansion of the hedge funds and in the last year or two, a veritable mushrooming

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point with which I could not agree more, "the frequency with which significant corporate news is preceeded by a notable rise in share price and then is followed by 'selling on the news.'" Schotland, *supra* note 2, at 1474. And as topping for the dessert, just a few pages later we have confirmation of this very point from none other than former SEC Chairman Manuel F. Cohen: "We have recently received indications that premature disclosure of corporate information to limited groups of people who are in a position to act on it may be more prevalent than we had supposed." Schotland, *supra* note 2, at 1478. So my critics no longer have to take my word (and that of the economists cited in footnotes 39 and 43 *supra*) for the existence of a substantial amount of insider trading. They also have it on the authority of Professor Schotland and Mr. Cohen.

107. Schotland, *supra* note 2, at 1474.

of "off-shore funds." Perhaps there is some link between each of these developments and the need to find acceptable modes for marketing new information.

Even though the value of new information in American companies every year is enormous, it is obviously difficult for a small number of insiders to exploit all this news. Some mechanism is needed which will allow this information to be marketed profitably to masses of people. It could be sold directly in the form of investment advice, and it could be added to the value received from brokers who charge more than a competitive price for their service. Finally, it could be marketed on a truly grand scale through investment companies. It is this last hypothesis which we examine here.

If mutual fund management companies are in some sense "selling" new information to mutual fund shareholders, we might look for compensation arrangements which would reflect this fact. Since the value of a specific bit of information remains constant regardless of the size of the mutual fund, any given bit is worth less to each mutual fund shareholder as the total fund is larger. Thus, a given piece of information, worth say one million dollars, results in a net improvement of ten percent in a ten million dollar fund and of one percent in a hundred million dollar fund. But as the new information is used by a smaller fund, that fund naturally grows larger. The ideal arrangement, therefore, would allow fund managers to be compensated on the basis of growth of the fund up to a certain point and then to switch over to compensation on the basis of total asset size. At that point it would pay the fund managers to manage the enlarged fund conservatively so as to give investors adequate diversification of risk but no growth from actual new information. Any new information would then be channeled into a new small fund, and the entire process would be repeated time and again.

If this hypothesis is true, we should anticipate that smaller funds generally would tend to be less conservative than large ones and figure more prominently in the annual list of high performance funds. But we should not anticipate many years repetition of high performance by any one fund.

Every aspect of this hypothesis seems to conform to what we know about the recent history of mutual funds.[108] The only problem with the thesis is that it would hold true equally for fund managers who either

108. *See* Manne, *Offshore and On—The SEC's Reach Threatens to Exceed its Grasp*, Barron's, Nov. 3, 1969, at 1; Glenn, *"Heads We Win . . ." Performance—Fee Mutual Funds Have Had Their Ups and Downs*, Barron's, March 2, 1970, at 5.

"guessed" correctly about which stocks to buy or ferreted out their solutions by so-called technical analysis. The latter hypothesis actually seems easy to rule out since every study indicates the near impossibility of succeeding in the stock market with this approach.[109] The guess hypothesis is a little more difficult, since obviously the moves of guessers will be pretty much random—some will go in one direction and others in another. Since there will be a successful and an unsuccessful direction, some will win and some will lose. The winning guessers will look just like the managers hypothesized to be using inside information rationally. But there will still be ways of distinguishing the two. A fruitful approach to this question, for instance, might be to examine the performance records of new funds established by successful managers of funds which have already become large. If a pattern appears, and the same individuals consistently turn in a better performance than others and tend to establish new funds over and over, the indications would be very strong that the inside information hypothesis is correct.

Success of mutual funds as a channeling device for information may account for an even more specialized version of the same thing. The so-called hedge funds began life, as their name implies, with power to do more than simply buy and sell securities in the market. Although hedging is normally thought of as a conservative, risk covering operation, it came to stand for the actively trading, high risk, go-go funds of the late 1960's. With only an insignificant exception or two, all hedge funds have one important characteristic: they are all exempt from SEC regulations under the Investment Company Act of 1940 and the Securities Act of 1933. Typically, the exemption from the 1940 Act resulted from their having fewer than one hundred participants. But one hundred offerees might still be sufficient to require a registration under the Securities Act of 1933.[110] Consequently, to avoid that result the participants in these funds are typically important businessmen, frequently the very individuals who might typically have access to valuable information. It is quite possible that the hedge funds of the sixties are very similar in their economic impact and operation to the famous—now infamous—bull pools of the late twenties.[111] That is, hedge funds may be nothing more nor less than efficient devices for exploting information and exchanging its values among a select group.

109. *See* note 19 *supra.*

110. 1 L. LOSS, SECURITIES REGULATION 653-65 (2d ed. 1961); 4 *id.* at 2621-47 (Supp. 1969).

111. *See* ITSM, *supra* note 1, at 73.

In my book I argued that devices like discretionary accounts and priority lists had become the post-SEC version of the bull pools outlawed by the Securities Exchange Act of 1934. I also suggested that the pools were actually a far more efficient device for exploiting new information than were the other devices. Incidentally, I certainly should have included in the list of devices limited partnerships in investment banking houses, since frequently these were really invitations to share in trading profits. There was, after all, a time when people thought that reliance on *Blau v. Lehman*[112] was still safe.

But all of these practices are suspect today, mayhap because I pointed out the possibility that discretionary accounts and related devices had obvious implications for insider trading. My hypothesis about hedge funds would appear very strong if a simple survey (even by the SEC) turned up the information that the increased participation in hedge funds in recent years correlates with a steady decline in invitations to invest in discretionary accounts or to become a limited partner or in the use of priority lists by investment banking houses. One caveat: I am not saying that every hedge fund was established for the sole purpose of trading on inside information. Undoubtedly many of them have been formed for other purposes. But it should be realized that an occurrence, to be statistically significant, does not have to appear in every possible case. Each cigarette does not produce lung cancer.

A final and most interesting possible relationship between mutual funds and insider trading occurs in connection with the rapid expansion of so-called off-shore funds. The phrase actually has no hard and fast technical meaning. It refers generally to mutual funds established outside of United States territory, largely investing in American securities, operated by American managers but selling their fund shares to foreign nationals only. These funds are outside the jurisdictional ambit of the Securities and Exchange Commission. They are technically corporations established under and domiciled in countries other than the United States, and the mere fact that foreign corporations may buy shares in American markets is generally not considered sufficient to bring them under our regulatory jurisdiction.

My hypothesis is that the tremendous increase in the number of such funds reflects efforts of fund managers to escape the American law of insider trading. If the United States declares valuable information a kind of contraband goods, it would seem most natural

112. 368 U.S. 403 (1962).

to export it to countries where it is not illegal. Even during prohibition, American whiskey barreled in bond was legally exported.

The growth in the number of off-shore funds can be explained very simply by the increased popularity of such investments with foreign nationals. But it would still seem peculiar, if that were the case, that American managers would take such extreme precautions to avoid any jurisdictional tie to the United States. Careful study of the identity of the individuals actually managing these off-shore funds might reveal interesting data. Until some evidence to the contrary is adduced, it is at least a logical supposition that some of the movement off-shore has simply been a device to export inside information in a fashion that allowed American banking houses, through their brokerage operations and the management of the funds, to profit by this device. The odd thing, if this hypothesis is true, is that investors in foreign mutual funds will be able to profit by information which American mutual fund shareholders are prevented from enjoying. The irony is perhaps even further compounded when it is realized that any strenuous effort by the SEC to police this flow of information by curtailing off-shore investment in American securities would probably meet with strong objection on balance-of-payments grounds from the Treasury Department.

VII. SHOULD WE GO BACK TO THE TWENTY-FIRST CENTURY?

One of the *least* irritating digs that I found in the various reviews is that I want to turn the clock back, that I want to return to a period of jungle warfare in the stock market, and that I want to erase the moral gains which have been made in dealing with the financial enemies of the public. I must demur and point out to my friends that, for whatever reason, they have misstated my position. At no time did I advocate a change in the law that existed as of the time my book was written. The *Texas Gulf Sulphur* case had not been decided, even in the district court, at the time I wrote, though it was decided approximately three months before the actual publication date of the book. At that point I did begin to advocate a change in the law. But up until that point there was no rule against insider trading of the sort with which I was dealing. Certainly it was not known that there was any liability for someone who did not have a "special relationship"[113] to the corporation, nor was it known that there did not have to be "special circumstances" creating some duty.[114]

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

114. *Id.*

Certainly there were commentators who proposed that courts should decide the matter this way, but even they recognized that this was not then existing doctrine.[115] Nor did I advocate repeal of Section 16(b). On the contrary, I offered for the first time a reasoned argument for that provision. I concede that I was not too concerned about it, however, for the obvious reason that I did not and do not think that the provision is effective in dealing with insider trading as I defined it. I was extremely careful to state that I was not dealing only with statutory insiders, that is, officers, directors or ten percent shareholders. That would have been contrary to the very foundation of my argument that there is a functioning market for information and that unexploited information may get into the hands of anyone for a variety of reasons before it is actually used in the market.

The real trouble, as I have said before, is that my critics are confusing their ethical preferences with the law. What they mean when they say that I was advocating a change in the law is that I was advocating a rule (no mandatory prohibition on insider trading) which violated their moral precepts of what federal law ought to be on the subject.

Of course, they probably meant that my position was contrary to the direction in which the law seemed to be moving. In this sense I had proposed a change in what Adolf Berle has called the "inchoate" law.[116] To this, of course, I must plead guilty. Had I not believed that the law was heading in that direction, it would have seemed useless to write such a troublesome book.

But I do not feel that my responsibility ends with predicting how the courts will move. Nor do I feel obliged to flow along with the tide of opinion. My effort was to give a rigorous analysis of a field that had been treated in a most superficial, moralizing fashion. I still maintain that such an approach violates the responsibility of serious academics, to say nothing of the love feast so apparent between certain law professors and a government agency. I find it very troubling to hear a professor of law argue that "the SEC in its suit against Texas Gulf Sulphur is entitled to escape the wise impatience with administrative expertise which has appeared recently in the Supreme Court and which suggests a new mood there."[117] Such special pleading on behalf of an agency which has never shown sincere interest in

115. *E.g.*, Fleischer, *Securities Trading and Corporate Information Practices: The Implications of the Texas Gulf Sulphur Proceeding*, 51 VA. L. REV. 1271 (1965).

116. Berle, *Corporate Decision-Making and Social Control*, 24 BUS. LAW. 149 (1968).

117. Schotland, *supra* note 2, at 1478.

utilizing economic expertise to analyze its own regulatory area is as unseemly as it is incorrect. It is frustrating to be a minority of one on any issue in the legal academic community. But it certainly would be worse to be in the majority for the reasons that some members seem to be there now.