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International Insider Trading: Reassessing the Propriety and Feasibility of the U.S. Regulatory Approach

George C. Nnona†

I. Introduction

This article attempts a critique of the U.S. approach to the regulation of international insider trading. It considers the appropriateness and feasibility of regulating international insider trading along the lines and scope sought by the U.S. Securities and Exchange Commission (SEC). It notes daunting conceptual and practical difficulties in that regard, and posits a different approach.

Part II outlines the essential features of the SEC’s domestic and international insider trading regimes, and the common policy leanings that animate both.¹ Part III articulates the normative and practical problems with the SEC’s approach, focusing particularly on the current state of the insider trading debate within the United States, the character of U.S. insider trading norms in the wider context of the peculiar activist jurisprudence of the U.S. courts that shapes such norms, and the impediments to insider trading regulation as a ban on the use of classes of information in a new age of heightened information mobility.² Part IV explores emergent themes in international securities regulation as applicable to insider trading, concluding that these present a more auspicious approach to international insider trading regulation, in the context of globalized and interlocking financial markets that increasingly constrain national regulation of the sort attempted by

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¹ See infra notes 4–86 and accompanying text.

² See infra notes 87–216 and accompanying text.
the SEC.\textsuperscript{3}

II. Contours of the Current Regulatory Regime

A. Background

In many jurisdictions the meaning of the term "insider trading" may be sought by reference to a statutory provision defining it.\textsuperscript{4} While such a definition may not be without problems, it provides a good starting point for analysis and a statutory anchor which prevents the offense from being in a perpetual state of flux. In the United States, no such statutory definition exists. The offense has largely been a product of patchwork judicial development, concocted principally with Rule 10b-5 of the Securities and Exchange Act of 1934 (the Exchange Act) as the principal source of authority.\textsuperscript{5}

Rule 10b-5 makes it unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

a) To employ any device, scheme, or artifice to defraud,

b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any

\textsuperscript{3} \textit{See infra} notes 217–240 and accompanying text.

\textsuperscript{4} \textit{See, e.g.,} The Criminal Justice Act, 1993, § 52 (Eng.), a British statute which defines the offense in the following terms: "An individual who has information as an insider is guilty of insider dealing if . . . he deals in securities that are price-affected securities in relation to the information." While this provision was a result of the European Community (EC) Directive 89/592, 1989 O.J. (L 334) 30, Britain had prior to 1989 regulated insider trading ("insider dealing" in British parlance) originally in Part V of the Companies Act 1980, and subsequently consolidated it in the Company Securities ( Insider Dealing) Act 1985.

security.

This rule was aimed primarily at the common law position which permitted corporate insiders (as well as outsiders) to purchase securities from a shareholder, based on "inside" information not available to such shareholder, since they owed no duty to the shareholder beyond the standard duty regarding fraud, as applicable to the purchase or sale of any chattel in the marketplace.\(^6\) It is one in a bag of tools aimed at protecting the investing public from fraud, to which the securities market has historically been quite prone, as evident in the chicanery leading to the restrictions on company promotions and stock transfers in the English Bubble Act of 1720.\(^7\) Adopting a rather creative approach, the SEC, with the full imprimatur of the courts, fashioned from this rule an affirmative duty upon insiders to disclose material non-public information before trading in the securities to which that information relates.\(^8\) As evolved, the duty clearly has a fraud-fiduciary duty underpinning, so that it is not enough that the person trading in the securities has material non-public information at the time of the transaction. In addition, there must be at least a fiduciary relationship of some sort between the trader and the issuer of the securities. It is the existence of this fiduciary relationship that gives rise to the duty to disclose or abstain from trading.\(^9\) For persons who trade on information

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\(^6\) See L. Loss & J. Seligman, Fundamentals of Securities Regulation 747-48 (1995). Loss and Seligman state that, with §10(b) nonself-operative, the combination of §17(a) of the 1933 Act and §§9(a)(4), 15(c)(1), and 15(c)(2) of the 1934 Act did not cover fraud in the purchase of securities by persons other than (1) brokers and dealers acting over the counter or (2) persons buying registered securities for the purpose of inducing their purchase by others. This was a serious gap because an issuer itself, or an officer or director or principal stockholder, could buy its securities by fraudulent practices without being touched . . . .


tipped by primary insiders (tippees), their duty to disclose or abstain is derived from the basic fiduciary duties of the insider (tipper). For such tippees, therefore, a duty to disclose or abstain is assumed only when the tipper has himself in disclosing the inside information, breached his fiduciary duties to the issuer, and the tippee is aware, or ought to be aware, of this fact. This element of awareness is important, as the liability under Rule 10b-5 requires a mental element—the so-called scienter requirement.

Given the antecedents of Rule 10b-5, the emphasis by the courts on fiduciary duties and the fraudulent breach of the same is not surprising, for there is a need to justify the distinction made between a sale or purchase of any chattel and a sale or purchase of securities. If inside information could be used to the advantage of an insider in the former situation, the prohibition of such a use in the latter situation also had to be justified, and the existence of a fiduciary relationship in the latter situation was latched upon as such justification. What is more, the breach of the insider’s duty under such circumstances, to the detriment of the unsuspecting third party, underscored the apparent fraud and inherent unfairness of insider trading, these being underlying notions supporting the prohibition of insider trading.

While it has aided the development of the prohibition against insider trading, the fiduciary duty-fraud concept has occasionally turned out to be an albatross around the neck of the SEC and the courts, especially in the context of their constant desire to reach whatever securities transaction smacks of unfairness or fraud (however subjective or broadly defined) under the general rubric of insider trading. Such was the situation in Chiarella v. United States. Here the defendant, Chiarella, was an employee in the composing room of a financial printing company retained by the acquiring corporation in a tender offer for the shares of another corporation. Notwithstanding efforts to conceal the identity of the target from the employees of the printer, the defendant by virtue of his job and ingenuity correctly identified the target and bought its shares through a broker. He subsequently sold his shares at a profit, when the tender offer was announced. He was indicted for violating Rule 10b-5. The Supreme Court, reversing the court of

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appeal, held that Chiarella’s conduct was not a violation, because no fiduciary nexus could be established between Chiarella and the corporation whose securities he traded. The Court concluded that the duty to abstain from trading arises from the relationship of trust between a corporation’s shareholders and its employees; such a relationship was lacking here.\(^\text{12}\) As an alternative theory to support Chiarella’s conviction, the government argued that he had violated a duty to the acquiring corporation by misappropriating information. The Court, however, declined to consider this alternative theory, as it was not submitted to the jury.

Under the misappropriation theory, any individual (not necessarily a corporate insider) may be held criminally liable for insider trading in violation of Rule 10b-5, not necessarily on the basis of breach of a fiduciary duty owed the issuer or its shareholders, but on the ground of his having misappropriated non-public information from an independent source, in breach of a duty owed to that source.\(^\text{13}\) The cases of *Carpenter v. United States* and *United States v. O’Hagan* explicate this theory.\(^\text{14}\) In *Carpenter*, Winans, a reporter for the *Wall Street Journal*, gave third parties advance knowledge of the contents of a column of which he was a co-writer, knowing that the market typically reacted to the contents of the column due to the column’s perceived integrity. Based on this advanced knowledge, the third parties traded in stock covered by the column, and split the gains with Winans. The lower federal courts easily found that Winans had knowingly breached a duty of confidentiality owed his employer, the *Journal*, under his contract of employment, by misappropriating the prepublication information concerning the column. The breach of this duty and concealment of the scheme amounted to a fraud and deceit on the *Journal*. Even though the *Journal*, the victim of this fraud, had no interest in the securities traded, the fraud was nevertheless considered by these courts to be connected with a purchase or sale of securities within the meaning of the Exchange Act and Rule 10b-5. The Supreme Court ultimately left the scope of the theory undecided by splitting four-

\(^{12}\) *Chiarella*, 445 U.S. at 235.

\(^{13}\) *Klein & Coffee*, Jr., *supra* note 6, at 156–58.

to-four on the Rule 10b-5 count and affirming the conviction on other counts. However, in the subsequent O'Hagan case, the Supreme Court addressed the misappropriation theory directly and affirmed its validity as a basis for insider trading liability. The Court recognized that in lieu of basing liability on a fiduciary relationship between company insider and the purchaser or seller of the company's stock, liability could be based on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information, even if these were not the persons with whom the insider had traded.

Following difficulties with the misappropriation theory in Chiarella and subsequent cases, the SEC promulgated Rule 14e-3, pursuant to the provisions of § 14(e) of the Exchange Act, to deal specifically with insider trading in the context of a tender offer. The Rule provides in pertinent part as follows:

(a) If any person has taken a substantial step or steps to commence, or has commenced, a tender offer (the "offering person"), it shall constitute a fraudulent, deceptive or manipulative act or practice within the meaning of section 14(e) of the Act for any other person who is in possession of material information relating to such tender offer which information he knows or has reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from:

(1) The offering person,

(2) The issuer of the securities sought or to be sought by such tender offer, or

(3) Any officer, director, partner or employee or any other person acting on behalf of the offering person or such issuer, to purchase or sell or cause to be purchased or sold any of such securities or any securities convertible into or exchangeable for any such securities or any option or right to obtain or to dispose of any of the foregoing securities, unless within a reasonable time prior to any purchase or sale such information and its source are publicly disclosed by press release or otherwise.

15 Carpenter, 484 U.S. at 24.
16 O'Hagan, 117 S. Ct. at 2206.
The idea behind this provision was to catch traders like Chiarella, in the context of tender offers, which are a veritable spawning ground for insider trading, such trading not being readily amenable to Rule 10b-5 as interpreted by the courts. This rule has however not proven to be a complete antidote to insider trading in the context of a tender offer, as the courts that have interpreted it have superimposed limitations thereon. In Camelot Industries v. Vista Resources for instance, the court dismissed an action against a stockbroker who received inside information about a planned business acquisition, given that there was no evidence that he had direct knowledge of the actual tender offer plan. In O'Hagan, however, the Supreme Court upheld O'Hagan's conviction for insider trading under Rule 14-e3(a), though the sole question before the Court was whether the SEC had exceeded its rulemaking authority under § 14(e) when it adopted Rule 14-e3(a).

Apart from Rule 14e-3, insider trading liability under the federal securities laws in the United States also flows from other provisions effectively subsidiary to the Rule 10b-5 prohibition. These provisions are: § 17(a) of the Securities Act of 1933, § 16b of the Exchange Act, and § 20(a) of the Exchange Act.

Section 17(a) makes it unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

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20 117 S. Ct. at 2205.
21 The proscription of insider trading in the Blue Sky laws of individual states has generally been overshadowed by Federal proscription and regulation under various securities laws. See LOSS & SELIGMAN, supra note 6, at 9–11.
23 See LOSS & SELIGMAN, supra note 6, at 741–43.
24 The mail fraud statute, 18 U.S.C. § 1341 (2001), and the parallel statute prohibiting fraud by wire, radio, or television communications, 18 U.S.C. § 1343 (2001), are also available for use in enjoining insider trading to the extent that it qualifies as interstate fraud. However, these have largely been overshadowed by the provisions of the Securities and Exchange Act and the rules made thereunder, starting with § 17(a) of the Securities Act, which marked an advance over the mail and wire fraud statutes in several respects, these being specifically tailored to the securities field. See LOSS & SELIGMAN, supra note 6, at 741–43.
(1) to employ any device, scheme, or artifice to defraud, or
(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.\textsuperscript{25}

This provision has been described as the grandfather of all the SEC anti-fraud provisions.\textsuperscript{26} While it is amenable to restraining insider trading in the sale of securities by dealers and others who purchase securities primarily for the purpose of resale, it is incapable of restraining insider trading in other contexts. This is not surprising, given that the Securities Act was primarily aimed at regulating the issue and sale of securities in the primary market, and was therefore skewed towards those who sold and distributed securities, rather than those buying beneficially for themselves. It was on account of this loophole that the SEC in 1942 promulgated Rule 10b-5 (formerly Rule X-10B-5) under the Exchange Act, by borrowing the language of § 17(a) and applying it to the purchase and sale of any securities.

Section 16(b) of the Exchange Act obliges officers, directors, and any person holding more than ten percent of any class of any equity security of a corporation to pay over to the corporation any profits made by them within a six-month period from any purchase and sale, or sale and purchase of the corporation’s stock. It is applied sharply in a near mechanical manner to penalize any pair of transactions (sale and purchase or vice versa) which occur within a period of six months. This is a prophylactic rule against insider trading by this group of insiders, since the aim is to dissuade such insiders \textit{ab initio} from making short-swing profits using inside information available to them solely by virtue of their relationship with the corporation. As noted by the Supreme Court, “[t]he courts have recognized that the only method Congress deemed effective to curb the evils of insider trading was a flat rule taking the profits out of a class of transactions in which the

\textsuperscript{25} U.S.C. § 77q(a) (1982).

\textsuperscript{26} LOSS & SELIGMAN, \textit{supra} note 6, at 742.
possibility of abuse was believed to be intolerably great.\textsuperscript{27} While § 16(b) is based on a special relationship between the affected class of persons and the corporation it is, quite unlike other provisions governing insider trading, a strict liability provision, since liability thereunder does not depend on the defendant's state of mind at the time he dealt with the securities. Thus, there is simply no scienter requirement.

The potential of § 16(b) as a weapon against insider trading is circumscribed by the fact that action thereunder can only be brought either by the corporation itself or by a shareholder suing derivatively. This has left the SEC unable to take action under the provision.\textsuperscript{28} Quite apart from this limitation which has made reliance on Rule 10b-5 more necessary, the flowering of Rule 10b-5 itself as a flexible weapon against insider trading in all its ramifications, meant the relegation of § 16(b) to the background.\textsuperscript{29} Arguably, even without such limitation on § 16(b), Rule 10b-5 would still have been the weapon of choice, even against the class of insiders in question.\textsuperscript{30}

Section 20(a) of the Exchange Act imposes secondary liability on a control person for a breach of provisions of the Exchange Act. The same holds true for rules made in accord with the Exchange Act by a control person.\textsuperscript{31} Commenting on the similar provisions in § 15 of the Securities Act, Professors Loss and Seligman write that it was intended as a means to hold responsible those corporations or other entities who employed dummy directors.\textsuperscript{32} However, the provisions also encompass other categories of controlled persons such as a broker-dealer's registered representatives, of which the broker is clearly a controlling person.\textsuperscript{33} By virtue of this provision, a controlling


\textsuperscript{30} Id.


\textsuperscript{32} Loss & Seligman, supra note 6, at 742.

\textsuperscript{33} Id.
person is secondarily liable for insider trading, to the same extent as the controlled person. The same results could be achieved through the general principles of aiding and abetting.

The picture that appears from the foregoing survey is that of a panoply of legislative provisions aimed at enjoining insider trading in whatever form it may take, with Rule 10b-5 as the flagship. The constantly evolving nature of the legislation, quite apart from the liberality with which the courts have interpreted Rule 10b-5 over the years to make it amenable to diverse transactions, underscores the philosophy of the legislature as influenced by the primary regulator, the SEC: to enjoin all transactions in securities which appear fraudulent and offend a general notion of fairness. This approach is justified primarily on the ground that the activities enjoined are inimical to the integrity of the securities market, thus eroding public confidence in it.

To make these provisions, especially Rule 10b-5, amenable to its constantly changing notions, perceptions and views of which transactions amount to insider trading, the SEC has resisted attempts to statutorily define the offense. It has supported the view that such a definition would reduce flexibility and that it was advisable to await further judicial development of the area. This makes the offense a shifty one, crying "out for the kind of philosophic consistency that only studied legislation can provide." As the law currently stands, a defendant may be liable for insider trading on the basis of a transaction, the wrongfulness of which was not apparent at the time it was contemplated and executed. Recall the defendant's acts in Chiarella. The SEC prosecuted the defendant for the offense, even though the transaction complained of could not come within the ambit of the offense, as then judicially configured. Similarly, in Dirks, the act

34 The Supreme Court has referred to § 10b, the statutory basis of Rule 10b-5, as a "catch-all" provision. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 203 (1976).

35 LOSS & SELIGMAN, supra note 6, at 873. See also Donald C. Langevoort, The SEC as a Bureaucracy: Public Choice, Institutional Rhetoric, and the Process of Policy Formulation, 47 WASH. & LEE L. REV. 527, 531 (1990). Here, the SEC's aversion to bright-line rules and some of its other policy preferences are explained as consequences of its intent to jealously preserve "the largest degree of discretion to penalize conduct that it determines, after the fact, to have been improper." Id.

36 See supra notes 11–12 and accompanying text.

37 Dirks v. SEC, 463 U.S. 646 (1983). Dirks was an officer of a broker-dealer firm
complained of would have survived scrutiny even by an ecclesiastical council, at least at the point of Dirks' disclosure of the non-public information to the third parties that ultimately traded with it. Yet Dirks was charged with an insider trading violation.\(^3\)

**B. Current Approaches to the International Regulation of Insider Trading**

With the internationalization of the securities market\(^{39}\) in the last two decades, the SEC has increasingly felt the need to extend the reach of its insider trading regulation beyond the United States, in order to effectively protect the U.S. markets and investors from the impact of insider trading involving transactions with multi-jurisdictional features. In a 1988 policy statement,\(^4\) the SEC articulated the principles and goals which it views as necessary for the evolution of a truly global capital market system.\(^4\) Apart from efficient structures and sound disclosure systems, the policy emphasized fair and honest markets as being central to the process.\(^4\) It stressed the need for transnational agreements that

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38 Id.

39 This may be defined as the process of closer integration of the major capital markets of the world. For the current trends in this process, see HAL S. SCOTT & PHILLIP A. WELLONS, INTERNATIONAL FINANCE: TRANSACTIONS, POLICY AND REGULATION 11–13 (7th ed. 2000). The term is used interchangeably with globalization of the securities market. The indicia of this internationalization include the growth and development of other capital markets to levels comparable to the long-dominant U.S. market, the establishment of links permitting dealers in one market to affect transactions in another market, the capacity for twenty-four hour, round-the-clock trading, resulting largely from improvements in information technology, and the progressive listing of same securities in multiple markets. See John Thornell Thomas, Note, *Icarus and His Waxen Wings: Congress Attempts to Address the Challenges of Insider Trading in a Globalized Securities Market*, 23 VAND. J. TRANSNAT'L L. 99, 102–06 (1990).


41 Id.

42 Id. at 46,965.
will prevent inside traders from shielding themselves from the laws of the states affected by their activities.\textsuperscript{43} Underlying the SEC's move to articulate these principles and goals, is a wider belief "that it has a responsibility to assume a leadership role in international securities regulation."\textsuperscript{44}

It can hardly be doubted that the SEC is eminently qualified to assume such a leadership role, given its relative advantages in terms of experience and size over other national regulators.\textsuperscript{45} However, its primary objective in so doing is not an altruistic urge for a fair global securities order, but rather to protect U.S. investors and safeguard the integrity of the U.S. markets. While this limited objective may be excusable on account of the jurisdictional restrictions to which the SEC is necessarily subject as an organ of a state, it is paradoxical that the means by which it has pursued that objective are in no sense limited. Perhaps in no other area is its extended view of possible approaches to international regulation more manifest than in the area of insider trading regulation. In what is fast assuming the character of a crusade, the SEC has hardly exercised any restraint in trying to reach insider trading, actual or prospective, by action extending well beyond its jurisdiction, the United States. The diverse means by which it has carried out this crusade are examined below.

1. Invocation of the Jurisdiction of U.S. Courts Using Either the Conduct or Effect Test\textsuperscript{46}

Under the conduct test, the courts' jurisdiction is predicated on the fact of certain conduct having occurred within the United

\textsuperscript{43} Id.


\textsuperscript{46} While there are other potential bases for jurisdiction, such as nationality, these two bases are the most common. For a discussion of other bases, see Harvey L. Pitt et al., \textit{Problems of Enforcement in the Multinational Securities Market}, \textit{9 U. Pa. J. Int'l Bus. L.} 375, 393–95 (1987).
Thus, the fact of a transaction occurring in the United States is sufficient to sustain an invocation of the courts’ jurisdiction to entertain a suit involving insider trading implicated in that transaction. The main problem with this test in the context of a globalizing securities market, is how to determine the extent to which the different constituents of a transaction ought to be located within a particular territory, and indeed the method of determining their location, in order to sustain a conclusion that conduct has occurred in that territory. Concerning Rule 10b-5 in particular, U.S. courts appear divided on the nature of the conduct that must occur in the United States to sustain the assumption of jurisdiction. While it is certain that any significant conduct will suffice, it is not certain whether the constituent elements of a violation must occur within the United States, i.e., whether such conduct must causally be related to the fraud and resultant harm. The possibility has been noted, however, that conduct such as the use of U.S. professionals or American markets could sustain the courts’ jurisdiction under this basis. Given the state of information technology today, and the ease with which cross-border movement can be made, the potential reach of this test is quite wide, as it will increasingly be easier to find that a particular act or transaction has some connection to the United States.

Under the effect test, the U.S. courts will assume jurisdiction pursuant to any conduct, wherever occurring, which adversely affects U.S. interests. Along these lines, the purchase from a Canadian corporation of its shares by its controlling shareholders, arranged at less than fair market prices, has been held to sustain subject matter jurisdiction in a U.S. court, since such a purchase depresses the corporation’s stock listed on U.S. exchanges. U.S.

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47 Id.
49 Id.
51 Langevoort, supra note 50, at 185.
52 Id.
jurisdiction was assumed even though the transaction complained of was executed entirely within Canada.\footnote{53} In the new age, this is a very broad test indeed. There is nothing in the test to prevent its application where, for instance, an American citizen visits a free internet website, run from a server stationed in Egypt, and effects stock transactions which ultimately prove detrimental to his interests. Although he visited the website without any invitation or prior notice to the owner (the website being open to all comers), the U.S. courts can sustain their jurisdiction under the effect test by arguing that the harm to the citizen is a harm to U.S. interests.

The invocation of U.S. courts' jurisdiction in the context of cross-border insider trading has severe limitations, even though it has been effective in some cases. First is the problem of enforcement. Even where jurisdiction is successfully invoked and the necessary judicial remedy obtained, enforcement may prove difficult, unless the persons implicated are within U.S. territory or have substantial assets therein. While extradition may be a possibility in some circumstances, it is an extreme approach, which will likely involve litigation in foreign courts, thereby defeating or at least diluting the gains of invoking U.S. jurisdiction. Second, is the fact that such jurisdiction, when invoked, often involves compelling foreign banks and other institutions to reveal information that is otherwise protected under the laws of their countries of origin.\footnote{54} This leads to a breach of international comity and consequent resentment on the part of the foreign country and its institutions.\footnote{55}

Despite the success that may be achieved by the SEC in individual cases with this approach, the net result is resistance by these other countries, through the enactment of new non-disclosure laws (blocking statutes) aimed at strengthening existing bank secrecy laws.\footnote{56} The SEC appears, therefore, to have reconsidered its modus operandi, resulting in aspects of its 1988 policy statement, which acknowledge the necessity of international

\footnote{53}\textit{Id.}
\footnote{55}\textit{Id.} at 406.
\footnote{56}Pitt et al., \textit{supra} note 46, at 411–12; Brooslin, \textit{supra} note 54, at 405–06.
cooperation and sensitivity to cultural and sovereignty issues.\(^{57}\) International cooperation has largely taken the form of action under bilateral agreements aimed at facilitating access to information in the investigation and prosecution of cross-border offenses generally or insider trading specifically.\(^{58}\)

2. Action Under Various U.S. International Agreements

These principally take two forms: action under Mutual Legal Assistance Treaties (MLATs) and action under Memoranda of Understanding (MOUs).\(^{59}\) MLATs are bilateral agreements under which countries agree to assist each other in the investigation of criminal matters. The major problem with such agreements is that they usually have a dual criminality requirement, so that unless the act being investigated is a crime in both countries, the benefits of the agreement are not available. Given that insider trading is not prohibited in several countries, and that even when prohibited the differing enforcement regimes between countries create a daunting

\(^{57}\) Policy Statement, supra note 40, at 46,964–46,965. The statement declared thus:

In seeking solutions to common problems, securities regulators should be sensitive to cultural differences and national sovereignty concerns. As regulators seek to minimize differences between systems, the goal of investor protection should be balanced with the need to be responsive to the realities of each marketplace. . . . As access to international securities markets by brokers, issuers, investment companies, investment advisers, and securities traders from all countries has increased, the need for access by enforcement authorities to information about foreign trading activity and the capital raising operations of foreign companies has expanded. Pertinent information and evidence regarding such activities frequently is located outside of a particular regulator’s jurisdiction. Accordingly, securities regulators should continue to forge a network of bilateral and multilateral surveillance and information sharing arrangements that are effective from an enforcement standpoint and sensitive to national sovereignty concerns.

\(^{58}\) Id. at 46, 963–65.

\(^{59}\) Action under the Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, opened for signature March 18, 1970, 23 U.S.T. 2555, 847 U.N.T.S. 231 [hereinafter the Convention], is also possible, since the United States is a signatory to the Convention. The Convention provides for three common methods of foreign discovery, namely, letters rogatory, evidence taken by a consular official, and evidence taken by private commissioners. Pitt et al., supra note 46, at 430–31. Since the convention is available only in connection with actual litigation, the SEC cannot avail itself of the provisions in connection with an investigation. Id at 431. There are other limitations as well. Id at 430–31.
problem. Other limitations flow from the character of the MLAT as a treaty. An intergovernmental agreement requires much negotiation between each government involved. To circumvent the limitations of the MLAT, the SEC has entered into MOUs, which are specifically tailored toward insider trading investigation.

The MOU is essentially an agreement between the SEC and another regulator and is specifically structured to facilitate the exchange of information in the investigation of securities fraud and insider trading. Unlike the MLAT, the MOU takes less time to negotiate, does not need to be formally ratified by the legislature of both countries for it to be effective, and is generally more expeditious. Also, there is notably no dual criminality requirement. Although technically a non-binding agreement under which assistance with a foreign investigator is voluntary, assistance for SEC investigations under MOUs is more prevalent than under MLATs.

A standard feature of the MOU is that information received thereunder must remain confidential. To reinforce its capacity for obtaining foreign regulators' cooperation under the MOUs, the SEC sought for and obtained the adoption by Congress of the International Securities Enforcement Cooperation Act (ISECA) in 1990. This specifically authorizes the SEC to guarantee foreign regulators that it will maintain the confidentiality of any disclosed information and will not release this information under the Freedom of Information Act (FOIA). Thus the SEC is exempted

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61 Brooslin, supra note 54, at 416–17.

62 Id.

63 Id.

64 Id. at 417–18.

65 Id. at 417.

66 Id.


from adhering to FOIA if foreign regulators demonstrate in good faith that public disclosure of the information will violate their laws.\(^6\) As a result of this legislation, foreign authorities are more likely to cooperate with the SEC in its investigative efforts. Prior to ISECA, the SEC sponsored other legislation aimed at strengthening its capacity to investigate and penalize insider trading, especially in the international context: the Insider Trading Sanctions Act of 1984 (ITSA)\(^7\) and the Insider Trading and Securities Fraud Enforcement Act of 1988 (ITSFEA).\(^8\) The ITSA strengthens the SEC's enforcement powers by increasing the penalties for insider trading, while the ITSFEA achieves the same purpose by empowering the SEC to grant at its discretion, investigatory assistance to foreign securities authorities without need for reciprocity from such foreign authorities.\(^9\)

3. Exportation of Insider Trading Laws

The SEC has also exported U.S. insider trading laws to other jurisdictions, as part of the crusade to stem insider trading globally. In its 1988 policy statement, the SEC stressed its quest for minimization of the differences between national systems by regulators.\(^10\) In furtherance of this quest, the SEC has sought implementation on a global scale of securities legislation based on the U.S. model.\(^11\) It has achieved this through a combination of lobbying and pressure brought to bear on the regulatory authorities of different jurisdictions. Entertaining no illusions that these laws would be enforced with fervor in these jurisdictions, it is likely that in the short run at least the major benefit of such laws would be to criminalize insider trading, thereby facilitating the use of existing MLATs for which the dual criminality requirement would be satisfied by these new laws. Recent enactment of legislation


\(^{72}\) Thomas, supra note 39, at 117–26 (discussing the statute, its purpose and application).

\(^{73}\) Policy Statement, supra note 40 at 46,963–64.

\(^{74}\) Mahoney, supra note 44, at 305–06.
prohibiting insider trading in several developed securities markets, along lines similar to the U.S. model, is a result of missionary work performed by the SEC. An example of the SEC approach at work is the case of Switzerland:

[T]he SEC's ability to use enforcement actions to regulate insider trading in European markets could be hampered by the existence of bank secrecy laws, particularly in Switzerland, which has a tradition of stringent bank secrecy laws. The conflict between Swiss law and the SEC's insider trading program led the SEC to mount an aggressive, and ultimately successful, campaign to persuade the Swiss government to bring its insider trading legislation into line with U.S. law as interpreted by the SEC.

4. Residual Approaches

Apart from the foregoing approaches, the SEC may seek and rely on the voluntary cooperation of individuals and entities from which it requires information, on mutually agreeable terms. It may also rely on ad hoc approaches, such as the negotiation of new procedures for obtaining evidence in the course of an investigation. The latter is exemplified by SEC's resorting to the Attorney-General (AG) of the Bahamas in connection with the investigation of the investment banker Dennis Levine. In this case, the SEC, not wanting to get entangled with the Bahamian courts, approached the AG of the Bahamas directly, and was able to obtain his written opinion that the transactions conducted by Levine through Bank Leu International Ltd. were not banking transactions, and that criminal sanctions would therefore not apply to the release of the subpoenaed documents. On the strength of this opinion, the bank released the information sought by the SEC.

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76 Mahoney, supra note 44, at 317 (citations omitted).

77 Id.

78 Pitt et al., supra note 46, at 428.

79 Id.

80 Id.
Worthy of mention here is the question of a supranational securities regulator, whose powers would naturally include the enforcement of the prohibition of insider trading. The International Organization of Securities Commissions (IOSCO) and the International Federation of Stock Exchanges (FIBV) have been touted as possible candidates for such a role. However, there is little to indicate from their activities and pronouncements that they entertain such ambition. Others would tap the coordinating body for the world’s central banks, the Bank for International Settlements (BIS) established in 1930, as a candidate. Others have suggested an international fraud squad, a multinational team with the right mix of expertise, assembled to pursue questionable securities transactions in cases where national regulators are unable or unwilling to do so. However, the possibility of such a supranational body remains dim, for reasons ranging from the substantial start-up and maintenance costs to the difficulty of the same body dealing with highly diversified laws, regulations and trading practices around the globe. It is, however, not far-fetched to believe that given its pre-eminence among national regulators, and its declared wish to play a leading role in policing the international securities market, the SEC would play a major role in deciding what form such a body would take, if it ultimately is established. Indeed, if an existing association of securities regulators like the IOSCO became the chosen vehicle, the SEC should be able to imbue the body with its regulatory philosophy, with the same fervor that it has brought to bear on the exportation of U.S. insider trading laws.

In summary, the insider trading regime championed by the SEC has evolved through a process of continuous near-obsessive expansion of existing statutory provisions. The regime’s central theme is to eliminate insider trading as inimical to the proper functioning of the securities market. This process of continuous

81 Id.
84 See Millspaugh, supra note 82, at 373 n.122.
85 See id. at 371–72.
reinforcement saw the emergence of Rule 10b-5 as the major battle-axe in the SEC's war against insider trading. The chief attraction is its malleability, and consequent amenability, to use in characterizing unwanted transactions as insider trading, often ex post facto; a factor that gives the SEC immense flexibility in the choice of which transactions to prosecute and when to do so. The rule has constantly been subject to the overriding dictates of expediency. In effect, the rule expands the SEC's power through enhanced discretion. With the internationalization of the securities market, the SEC's power to control the securities market and insider trading in particular became compromised by the ability of market participants to effect foreign transactions of the type the SEC opposes within the United States. To maintain and expand its power, the SEC has adopted various measures aimed at ensuring that transactions occurring outside the United States, which have any effect on, or contact with, the U.S. market are well within its reach, irrespective of countervailing claims by the market participants involved or even other national authorities. The effort to enjoin insider trading internationally, and the force with which the task has been approached, is part of the same continuous process of regulatory (and institutional) power expansion.86

86 Taking for granted the desirability of insider trading prohibition, this mode of analysis assumes that there are other alternatives to the approach currently adopted by the SEC in enforcing the prohibition. In other words, it assumes that the SEC's belief "that it has a responsibility to assume a leadership role in international securities regulation," Mahoney, supra note 44, at 312 and accompanying text, even if not misconceived, does not necessarily justify its current near-unilateral approach to global insider trading regulation. Multilateral action among states, as exemplified by the European Community Directive 89/592 of 13 November 1989, 1989 O.J. (L 334) 30, on insider dealing, is a possible alternative, at least conceptually. On this point, see Lynda M. Ruiz, Note, European Community Directive on Insider Dealing: A Model for Effective Enforcement of Insider Trading in International Securities Markets, 33 COLUM. J. TRANSNAT'L L. 217 (1995). This mode of analysis is supported by the "confessions" of former SEC officials expressing how a measure of arrogance, and often, an inability to distinguish adequately between the public interest and institutional self-interest, affects the work of the agency. It is similarly in tandem with research in organization theory showing that large organizations over time inevitably begin to displace stated goals with more self-serving institutional goals. See JAMES COX, ROBERT HILLMAN & DONALD LANGEVOORT, SECURITIES REGULATION: CASES AND MATERIALS 14 (2nd ed. 1997).
III. Problems with the International Regulation of Insider Trading

A. Erosion of the Normative Foundations of Insider Trading Regulation

Economic regulatory schemes often are fashioned within the crucible of major economic disasters. The regulatory scheme of the Securities and Exchange Acts falls within this class, having been enacted in the wake of the Great Depression. As is often the case, legislative bills proposed in such circumstances are fuelled by public outcry and outrage, deprecating the ills leading up to the economic disaster. The legislation is ultimately passed, with more than ample provision for the extermination of these ills, real or imagined.

The hearings leading up to Congress’s passage of the securities laws show that these laws conform to this pattern. These hearings catalogued market abuses, especially manipulation and trading with insider information, preceding and precipitating the stock market crash. More recent research has come to question the existence of some of these abuses, indicating that they may have been exaggerated for political reasons. If indeed they were exaggerated for that reason, the possibility is then not far-fetched that some of the measures would be over-kill or superfluous. One cannot help drawing a parallel between these events and those leading up to the enactment of the English Bubble Act in 1720.

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87 Cox et al., supra note 86, at 6.

88 Id. Concerning the Blue Sky laws, Loss and Seligman similarly write of the relative strictness of Western and Midwestern securities statutes as a probable carry-over from the time "[w]hen an 'agrarian West' was bled by a 'Moneyed East.'" Loss & Seligman, supra note 6, at 9. Quite beyond the pitiable image of poor farmers losing their money to securities brokers and tricky investment bankers from the East, there is the political element of Western banks, bank regulators, and farmers who lobbied for the legislation for parochial reasons. These groups probably sponsored the statutes, starting with Kansas in 1911, to halt the drain of funds through general investment in securities, instead of bank deposits; a situation which had the effect of reducing the funds available for bank intermediation, impairing the influence of the state bank regulators and raising the cost of funds for the farmers borrowing from the banks. See Jonathan Macey & Geoffrey Miller, Origin of the Blue Sky Laws, 70 Tex. L. Rev. 347, 351 (1991).

89 Cox et al., supra note 86, at 6.

90 6 Geo. I, ch. 18 (Eng.).
in the wake of speculative market activities attending the South Sea Company’s bid to assume the public debts of England.\textsuperscript{91} Perceiving harm in this speculation and related activities, the government moved to halt them by enacting the Bubble Act, which was to stultify the formation of joint stock companies, especially those with freely transferable stock, for about a century.\textsuperscript{92} In so doing, the government showed a misapprehension of the factors fuelling the speculation; a point that is clear today, but was perhaps not so in eighteenth century England.\textsuperscript{93}

Given the foregoing scenario, it often takes a new generation, different from one in which the legislative scheme was established, to take a less emotional and more dispassionate look at the scheme and question the underlying assumptions, resulting from ex ante exaggeration or misapprehension of facts. Even if the assumptions are correct initially, they may no longer hold in the context of supervening developments. This has been the case with insider trading jurisprudence in the United States: A near-unanimous belief in the reprehensible character of insider trading dominated thinking from the very conceptual stage of the securities laws. This was coupled with an uncertainty as to the best approach to adopt in arresting the problem. This uncertainty manifests itself in the discretion given the SEC in the Exchange Act, to deal with insider trading and other securities fraud, following from the fact that the means and ends of dealing with the problems could not readily be articulated.\textsuperscript{94} This explains the multiple, alternative but mutually reinforcing approaches of the SEC to insider trading regulation, especially prior to the ultimate establishment with the judiciary’s support, of Rule 10b-5 as its flagship. Indeed, Rule 10b-5 itself was a fortuitous development, a result of an unsure SEC groping in its toolbox of legislative instruments, and mother luck smiling on its efforts. Loss and Seligman chronicling the circumstances of the Rule’s formulation write, “[t]he whole development was unplanned. Like the British Empire, which Eamon de Valera called ‘a domain created in a

\textsuperscript{91} Id.

\textsuperscript{92} Id.

\textsuperscript{93} See PAUL L. DAVIES, GOWER’S PRINCIPLES OF MODERN COMPANY LAW 24–34 (1997).

\textsuperscript{94} See COX ET AL., supra note 86, at 7.
Since the enactment of the securities statutes in 1933 and 1934, and the subsequent adoption of Rule 10b-5 in 1942, a lot has changed in the scenario described above. First is the articulation of more intellectually rigorous justifications for insider trading regulation, countering the indignation and intuitive feelings of unfairness which attended the congressional hearings preceding the legislation; where the use of insider information was described as “immoral,” “unscrupulous,” “unfair,” and a betrayal of fiduciary duties. Though the rhetoric of regulation is replete with allusions to the development of fair and orderly markets, fairness in the intuitive sense is no longer the major philosophical underpinning of insider trading regulation. Quite apart from such notions of fairness, the major justifications of insider trading regulation can be subsumed under four headings, each of which has variations in theme, the detailed exploration of which is immaterial to the thesis of this article.

1. Harm to Investors

Those who hold this view contend that when insiders trade with inside information, the price of the securities changes to the detriment of subsequent traders in those securities. Even if it can be claimed that the actual party with whom the insider trades is not harmed, subsequent traders are prejudiced to the extent that if the insider buys, there is an upward movement in the price, leading to increased cost for the subsequent purchaser, and if the insider sells, the price is depressed to the detriment of subsequent

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95 See LOSS & SELIGMAN, supra note 6, at 777. For a brief introduction to Rule 10b-5 see id. at 777–80.


97 In CHIARELLA, 445 U.S. 222, 249 (1980) (Blackmun, J., dissenting), Justice Blackmun spoke of the inherent unfairness of insider trading. But such an allusion lacks credibility, even among supporters of deregulation “since the concepts of what is ‘fair’ and what is ‘unfair’ are given no content.” Id.

98 This may be seen as unreasonable, given efficient markets and the fact that the subsequent price resulting from the insider’s trades reflects all available information and is therefore the right price. (Indeed, this is one of the arguments of those opposed to the prohibition of insider trading.) However, the efficient market hypothesis itself and the extent of its influence on the markets are intensely debated issues. See JOHN F. MARSHALL & M. E. ELLIS: INVESTMENT BANKING AND BROKERAGE 166–67 (1994).
Variations on this theme are common currency.99

2. Public Confidence or Integrity of the Market Theory

The contention here is that insider trading harms the market by eroding public confidence. At its root, this contention is related to notions of fairness, since the erosion of public confidence in the market is furthered by the public's perception that trading on inside information is unfair. However, it differs by emphasizing not the intrinsic inequity, badness or immorality of insider trading but rather its effect, which is concrete, more measurable, and conceptually independent of the act's perceived inequity, immorality, or badness. What is more, the theory transcends the possible justification of insider trading through a case-by-case approach, which looks at the circumstances of particular transactions. It does this by emphasizing the prohibition of insider trading as significant, not because it compensates individual investors for identifiable losses but because it deters general economic harm.100

3. Impairment of the Market's Allocative Efficiency

This posits that insider trading engenders delay in the release and dissemination of material information by corporate insiders, who benefit from such delay because it enables them to trade first with it.102 This in turn distorts the capacity of the market to redirect resources promptly, through appropriate pricing of securities, to those firms who, from available information, have


the best prospects of using such resources productively.\textsuperscript{103}

4. Property Rights Argument

The theory here is that inside information is corporate property belonging to the company that invested resources in its development. As is the case with other corporate property, the insider is not entitled to appropriate this information to his personal benefit.\textsuperscript{104}

Soon after Rule 10b-5 came into force, the courts gradually adopted the rule, starting with the 1946 decision in \textit{Kardon v. National Gypsum Company},\textsuperscript{105} which found for the plaintiff in a claim for accounting by shareholders who purchased stock from other shareholders without disclosure of material information.\textsuperscript{106} The rule received further impetus from SEC’s 1961 administrative decision \textit{In re Cady, Roberts & Co.}.\textsuperscript{107} But not long thereafter, while the SEC and the courts continued to nurture the rule and other provisions aimed at stemming insider trading, the prohibition itself began to be questioned in some quarters.\textsuperscript{108} Led by Henry Manne, a movement gradually developed that opposed the prohibition of insider trading on various grounds.\textsuperscript{109} The members of this movement, the “anti-prohibitionists,” argued that the rationale, method, and scope of the prohibition were misconceived.\textsuperscript{110} The grounds of their opposition, just as those

\textsuperscript{103} \textit{Id.}

\textsuperscript{104} \textit{See Loss & Seligman, supra note 6, at 772–73. For a variation of this theme which likens insider trading to secret profits, see Clark, supra note 100, at 273.}


\textsuperscript{106} \textit{Id.} at 803.

\textsuperscript{107} 40 S.E.C. 907 (1961).

\textsuperscript{108} It has been observed that intellectual criticism of the SEC’s policy-making has come in two waves. The first, marked by the scholarship of Louis Loss, sought to align doctrine with the philosophical underpinning of regulation, as well as other historical “first principles.” Langevoort, \textit{supra} note 28, at 527–28. It took for granted the aims of securities regulation. The second wave came in the 1960s, and was initially championed largely by economists. It questioned the assumptions underlying securities regulation, such as the virtues of mandatory disclosure. This second wave (to which the critical works on insider trading belong) dominates today. \textit{See id.}

\textsuperscript{109} \textit{See Henry G. Manne, Insider Trading and the Stock Market} (1966), for a more in-depth exploration of Manne’s viewpoint.

\textsuperscript{110} \textit{Id.}
given by the supporters of insider trading regulation, the "prohibitionists," come with variations to the basic themes which are not germane to this paper. However, it is noteworthy that most of these grounds directly oppose those of the prohibitionists, which is quite different from merely providing alternative arguments thereto. The grounds may be grouped as follows:

\[ a. \text{ No Harm to Investors and Related Constituencies} \]

The argument here is that insider trading does not harm the investor who trades with, or at the same time as an insider, nor does it harm shareholders of the corporation whose stock is traded, nor society generally.\(^{111}\) Insider trading, it posits, is a victimless crime. The investor who trades with an insider is usually a willing trader who would have traded anyway. If the insider had not come along, she would have sold (or bought) from another person.\(^{112}\) Indeed, by trading with her, the insider probably affords her a higher price than she would otherwise have obtained; or in the case of a sale by an insider, a lower price than the purchaser could have had otherwise. More generally, such trading adjusts the price of the securities for traders in the whole market.\(^{113}\) Also, it is argued that there is no evidence indicating that shareholders of corporations whose managers engage in insider trading are bothered by such transactions.\(^{114}\) They seem more concerned with appreciation in the corporation's distributable profits. Along this


\(^{112}\) Id.

\(^{113}\) See N. Arshadi & T.H. Eyse1l, THE LAW AND FINANCE OF CORPORATE INSIDER TRADING: THEORY AND EVIDENCE 132 (1993). It is arguable that there is no advantage really to the seller in these circumstances, since she could even get a higher price if the insider fully disclosed the information to the whole market. The problem, however, is that without the personal gains from insider trading as an incentive, the insider would have no impetus to disclose the information to the market at all. Therefore, a demand for full disclosure or abstention from trading as the law currently requires, if heeded by the insider, would lead largely to abstention rather than full disclosure. Effectively, current information will not be disclosed to the market at all for a long time, during which the market will continue to trade on the basis of outdated information. Indeed, a company's internal policies might even favor the non-disclosure of such information over a substantial period, if keeping it secret enhances the company's strategic position vis-à-vis its competitors. Only an inside trader, given the strong personal incentives to trade, can then save the market from outdated information.

\(^{114}\) Id.
line it has been argued that if companies were much bothered by insider trading by the rank and file of corporate employees, companies would have prohibited such trading contractually through clauses in the employment contracts of their managers, even before the general prohibition of insider trading, but this has not been the case. Concerning society generally, it is argued that insider trading causes no harm, but is instead beneficial, along the lines discussed under "allocative efficiency" below.

b. Allocative Efficiency

The argument here is that instead of impairing the allocative efficiency of the market, insider trading actually enhances it. It does this by giving insiders the impetus to promptly reflect available information in the market price of securities through their trading. Material information may, due to corporate policy or for some other corporate reasons, be withheld from the public after it becomes known to insiders. During the period it is withheld, the market price of the company's securities is inaccurate since it does not reflect available information concerning the true state of affairs. When insiders trade during this period, such trading allows the information to be reflected in the market price.

c. Compensation for Insiders

It has been argued that insider trading is a means of adequately compensating insiders who are corporate entrepreneurs, thereby ensuring that those with the requisite entrepreneurial skills remain in the corporate world as managers of enterprise. It permits them to share in the gains they produce for the company (which include inside information) thereby providing added impetus for

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116 MANNE, supra note 109, at 101–02. A closely related argument is that insider trading smooths price changes. It does this by allowing information to permeate the market gradually when insiders trade, leading to gradual and timelier adjustment of the price of securities, especially in response to piecemeal, incremental changes in corporate affairs. See Henry Manne, Insider Trading and the Law Professors, 23 VAND. L. REV. 547, 573–74 (1969). Thus, by the time the full information or complete picture becomes publicly available, the change in price will be less sudden and drastic than would have been the case without the preceding insider trading.

117 MANNE, supra note 109, at 110.
them to be more productive. Without the prospect of additional income from insider trading, such persons may not be optimally motivated to put in their best in terms of innovation and galvanization of modern enterprise. Worse, they may even decide to try their skills in other areas of endeavor, outside business management.\(^{118}\)

\[d. \text{ Property Rights and Private Ordering}\]

Inside information, it is asserted, is similar to other forms of corporate property. Instead of regulation by law, it is better and simpler that the corporation be at liberty to dispose of the information by contractual arrangements. Such arrangements can permit insiders to trade with inside information, if the corporation so desires, or prohibit it if not desired.\(^{119}\)

For the purpose of this paper, the most noteworthy point on the state of the debate between the prohibitionists and the anti-prohibitionists is the fact that both sides now command substantial followship. It is no longer a lopsided debate, with Henry Manne and acolytes laboring against well-entrenched notions on insider trading. So strong have the anti-prohibitionists become that a commentator (himself a prohibitionist) noted, “even those who are pro-regulation have tended to backslide.”\(^{120}\) This was made in reference to an acknowledgement by other writers that they “have become less and less convinced that it [insider trading] is the

\(^{118}\) Id.; Macey, supra note 115, at 45–47; W.D. Carlton & D.R. Fischel, The Regulation of Insider Trading, 35 STAN. L. REV. 857, 861–72 (1983). A countervailing argument is that such a compensation scheme for insiders is arbitrary, since an insider’s compensation would be limited by the amount of securities he is capable of purchasing. The insider’s returns from his trading activities would be a function of the capital at his disposal rather than the value of his contribution to the company. Another problem with this compensation scheme is that there is no way of ensuring that only the insiders who contribute to the production of information get to trade with it, since it is difficult to isolate specific persons to whom the production of any piece of valuable information may be ascribed. Finally, the scheme has a negative incentive built into it, since it would allow insiders to trade in good news, as well as bad news, the latter involving no value-added to the company.


heinous and immoral act which it is often represented to be. 121
The ground won by the anti-prohibition movement was not
achieved by sudden flight, but rather through the dogged
deployment of arguments based largely on economic theory to
counter the established position of the opposition. While there
remains currently a credible economic case for the continued
prohibition of insider trading, the case is no longer overwhelming
and is at best at par with the economic case for deregulating it. 122

The fact that the arguments of the anti-prohibitionists are
largely, if not solely, economic in character, may be thought of as
a weakness, since the prohibitionists deploy both economic and
non-economic arguments 123 in support of their position. However,
this weakness is mitigated by the fact that the SEC’s regulatory
activities as well as court decisions have in recent times been
substantially premised on economic justifications. 124 The efficient
market hypothesis is notable in this regard. Concerning this
hypothesis, Gilson & Kraakman write: “it structures debate over
the future of securities regulation both within and without the
Securities and Exchange Commission.” 125 Additionally, it has
served as the intellectual premise for a major revision of the
disclosure system administered by the Commission; and it has
even begun to influence judicial decisions and the actual practice
of law. In short, the efficient capital market hypothesis “is now
the context in which serious discussion of the regulation of the

121 Rider & Ashe, supra note 111, preface.
122 McVea, supra note 120, at 392; See also Merrit B. Fox, Insider Trading in a

123 Fairness in the intuitive sense and related purely ethical arguments fall within the
class of non-economic arguments. So also, and more importantly perhaps, does the
argument that insider trading erodes public confidence in the markets. While such
erosion of confidence has economic effects, it is doubtful whether its occurrence (as
distinct from its effects) is a necessary economic result of insider trading. It may well be
that insider trading actually has no other negative economic consequence, and yet the
public still erroneously perceives it as being wrong, thereby leading to loss of confidence
in the markets.

Rev. 549, 549–50 (1984). It should be noted, however, that the efficient market
hypothesis has come to be the subject of much debate. See Marshall & Ellis, supra
note 98, at 166–67.

125 Id.
financial markets takes place."  

Given the foregoing state of affairs, the policy considerations underlying insider trading regulation are properly due for thorough reassessment by the SEC itself. Such reassessment should be consultative, and should probe in a well-rounded manner the necessity for continued regulation, as well as the method and scope of regulation if indeed a necessity is established. The situation does not provide a basis for the continued strengthening of enforcement mechanisms and penalties against insider trading, as the SEC has done in the recent past.  Beyond this, it provides even less credible a basis for the extension of the prohibition into the international scene. A domestic scene in dire need of a review is politically, intellectually, and even morally inauspicious for the exportation of insider trading regulation to the global arena. It is ideally a point for stock taking rather than expansion in the enterprise of regulation. Extension to the global markets is a question that should crop up only after the domestic aspect has been resolved. Even if a reassessment were ultimately to favor the retention of the prohibition in the United States, its extension to the international scene through SEC activities would still merit independent consideration.

Apart from its interest in protecting U.S. investors from insider trading, irrespective of wherever such trading is effected, the SEC has executed its global crusade against insider trading on the assumption that such transactions are inimical to the development of other national markets, and hence the international market. However, no consensus exists among other national regulators and market participants that such transactions have an overall negative effect on their markets. This is most evident from the laxity with which insider trading laws have traditionally been enforced in many of these jurisdictions. Cases in point are Japan, where insider trading laws were instituted under U.S. influence

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126 Gilson & Kraakman, supra note 124, at 550 (emphasis added). See, for example, the dicta of Judge Easterbrook in *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 510 (7th Cir. 1989), relying on the efficient market hypothesis and stating that "the Securities and Exchange Commission believes that markets correctly value the securities of well-followed firms, so that new sales may rely on information that has been digested and expressed in the security's price."

after the Second World War, and Germany where such laws were grudgingly passed pursuant to a directive of the European Community. While lax enforcement may be argued to be a result of inadequate resources in some countries, this does not explain the near-total lack of criminal convictions (or even prosecutions) in other countries. In these other countries, even with inadequate resources, enforcement agencies have managed to keep a tab on other crimes and offenses. Why not insider trading? The fact remains that national regulators do not all regard insider trading the same way. They are known to have been openly divided over the necessity of its regulation. Beyond this, it has been argued that

[t]he most plausible explanation for the failure of the major securities markets to adopt regulations patterned on the American Model is that investors have not demanded them as a precondition to committing funds, even as internationalization has increased the number of competitors for investors’ capital.

Perhaps even more interesting is the willingness of U.S. investors to withdraw money from the U.S market to invest in the Tokyo stock market, which has long been noted for extremely lax enforcement of insider trading laws. . . .[I]f rampant insider trading destroys investor confidence, then the Tokyo investors should be a demoralized lot. It is difficult to explain the level of enthusiasm evident in the Tokyo market’s rise without assuming that these investors cannot rationally evaluate the losses they suffer as a consequence of insider trading, or that they do not perceive such losses to be

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129 See Standen, supra note 28, at 177–78, 206.

130 Mahoney, supra note 44, at 313 nn. 38–39. The 1989 annual conference of the International Organization of Securities Regulators (IOSCO) was for instance, marked by the reluctance of participants to change key aspects of their regulatory schemes. German Stock Exchange Federation Executive Vice-President Ruediger von Rosen is reported to have emphasized that value should be attached to giving investors a choice between different regulatory regimes. The conference having been held before the reluctant enactment of insider trading legislation by Germany in 1994, insider trading obviously was a major issue with the German regulatory scheme, from the SEC’s point of view.
This underscores the point that given the same transactions and fact patterns, results which may validly be opposed in the United States as harmful to market confidence may not be similarly opposed abroad. So, while in the Japanese markets, there likely exist several transactions capable of eroding public confidence, it just happens that insider trading is not one of them.\textsuperscript{132}

An issue worth considering at this stage is whether a resolution that the insider trading prohibition be retained domestically in the United States would not necessarily justify its automatic extension to the global arena, since in the internationalized securities markets, the prohibition can be neutralized by transactions originated offshore. An answer would be that such a line of reasoning is a weak normative basis for the extension, as it emphasizes no principle other than self-interest. Indeed, it is a recipe for anarchy given the possibility, even if only notional, that other states and their regulators may adopt the same approach. It is also arguable that the possibility of neutralization by transactions originated offshore should \textit{ab initio}, be a major factor in the ultimate decision to proscribe or legitimize insider trading domestically. If such neutralization is assessed to be immitigable, or capable of mitigation only with significant difficulties, then the prohibition may well have to be reversed or otherwise modulated, at least to provide domestic market participants a level playing field with foreigners.

More generally, it may be noted that as the world’s economies become increasingly inter-linked through unstoppable technological innovations and changes in the demands of the market, occasions will increasingly present themselves for cross-border neutralization of domestic economic policies. Changes in labor legislation and practices in one country for instance, can have great impact on industrial investment in another country, as manufacturers move their production facilities in search of low-wage countries where profits can be maximized.\textsuperscript{133} The very labor

\textsuperscript{131} Mahoney, \textit{supra} note 44, at 307-08. The Tokyo markets took a fall in the events leading up to the Japanese “Big Bang” reforms of 1996. \textit{See} SCOTT & WELLONS, \textit{supra} note 39, 8-39 to 8-74.

\textsuperscript{132} \textit{Id.}

\textsuperscript{133} Contentious labor practices in several developing countries have led to the displacement of U.S. workers, resulting from the relocation of employers’ facilities to
practices eliciting such relocation of facilities may be objectionable, ethically or otherwise, to the latter country, but this would not by itself justify unilateral moves by her regulators to enjoin the labor practices in ways similar to those adopted by the SEC in its global crusade against insider trading. Indeed, such an approach could with time lead to a plethora of quixotic domestic agencies in a chimerical chase around the globe, with grave costs and implications that will be explored below in Part IIIB of this paper. Suffice it to say that what is required is instead a more cosmopolitan view of international economic issues, or at least a form of positive nationalism. The former affords a sense of global citizenship that is devoid of zero-sum nationalism, and the latter though primarily geared towards enhancing national well being, assiduously avoids doing so at other nations' expense. The SEC should therefore view itself as having in this new age, responsibilities towards a global citizenry—secondary perhaps, but nonetheless worthy of attention.

Whatever may be said in favor of a review, it is clear, however, especially from its 1988 policy statement, that the SEC is not intent on a total reassessment of its stance on insider trading whether in the domestic or international context. It serves the SEC’s purposes to take for granted the necessity of insider trading regulation in either context. It has been suggested that the SEC’s reluctance to encourage debate over the structure of securities regulation in the United States, of which insider trading

such developing countries. The labor practices in issue cause indignation and loss (economic and otherwise) to domestic workers and related interests. See Dani Rodrik, *Sense and Nonsense in the Globalization Debate*, FOREIGN POLICY, Summer 1997, at 29–30. Yet, aggressive, unilateral, extraterritorial action of the type undertaken by the SEC in its insider trading crusade has not been a major component of the U.S. response so far. Instead, worker retraining and redeployment have for instance been undertaken as major responses to such externally generated impact.

134 Id.

135 See ROBERT REICH, THE WORK OF NATION: PREPARING OURSELVES FOR 21ST CENTURY CAPITALISM, ch. 25, especially at 306–11 (1991), where this approach is explored in relation to the proper and most efficient attitude of states to contentious trade issues in a globalized world. “History offers ample warning of how ‘zero-sum’ nationalism—the assumption that either we win or they win—can corrode public values to the point where citizens support policies that marginally improve their own welfare while harming everyone else on the planet . . . .” Id. at 306.

136 Policy Statement, supra note 40.
regulation is perhaps the most orchestrated aspect, is because it "is generally perceived as a model regulatory agency and because there has been no repeat of the economic conditions that led to the adoption of the federal securities laws."\textsuperscript{137} It appears then that reinforced by public confidence in its work, the SEC has grown somewhat insensitive to the pressures to which similar agencies are usually amenable. A former SEC Commissioner bluntly confessed that much, stating:

\begin{quote}
[T]he SEC's tradition of excellence and independence has made it proud, but parochial. As a commissioner, I found that the Commission's staff was hardworking and sincerely dedicated to the public interest. However, staff members sometimes forgot that they were public servants and lapsed into an arrogance that I believe is intolerable in a democratic government. Further, the agency too often failed to distinguish adequately between the public interest and its institutional self-interest.\textsuperscript{138}
\end{quote}

Quite apart from this bureaucratic insensitivity, the agency's behavior is perhaps better explained by public choice theory. This posits that

\begin{quote}
[Fl]ar from seeking any independent conception of "public good" regulators simply and rationally seek to maximize their own level of external support, and thus frequently allocate wealth (in
\end{quote}

\begin{flushright}
\textsuperscript{137} Mahoney, supra note 44, at 305.
\textsuperscript{138} COX ET AL., supra note 86, at 14-15 (citing ROBERTA KARMEL, REGULATION BY PROSECUTION (1981)). Concerning this kind of inner-directed, less-than-rational bureaucratic behavior Donald C. Langevoort writes:

\begin{quote}
[C]lassic works such as Anthony Downs' Inside Bureaucracy [1967] maintain that large organizations will over time inevitably begin to displace stated goals with more self-serving institutional ones. Decisions made within the bureaucracy come to reflect a cognitive content that, in the words of one author who has studied the interplay between law and organization theory, is "the product of widely dispersed informational sources and diffused individual interests and attitudes, all mediated by structures, processes and chance in ways that defy translating or tracing the organizational decision into its individual sources." Loss of control extends even (perhaps especially) to those who are supposed to be running the organization. Such diffusion of authority is the source of institutional biases that value conservatism, risk avoidance, "turf protection," and routine. Such behavior is especially pronounced in government agencies, which lack the discipline imposed by a competitive marketplace, and whose line personnel are protected from rapid replacement by civil service regulations.
\end{quote}
Langevoort, supra note 35, at 529.
the form of regulatory subsidies and/or restraints on competition) to those groups that bid the highest in terms of such support.139

Often these groups are the best organized and most effective ones, able to pay sufficient “rent” for the subsidies/restraints, in the form of support to the regulators.140 These groups notably include corporate managers, market professionals (i.e., investment bankers, financial advisers),141 and securities lawyers. The first two groups (especially the market professionals) benefit from insider trading prohibition, as it enables them to profit from the trade, semi-exclusively and far more substantially than would be the case if it were not prohibited.142 Securities lawyers on the other hand, benefit from interpreting and advising on the

139 Langevoort, supra note 35, at 528. Though the SEC has made recent proposals for changes in insider trading rules, these have not involved any fundamental reassessment of the need for and scope of insider trading regulation. Its recently proposed Rule 10b-5-1 merely enables a person who trades while in possession of material non-public information to avoid liability by relying on four exceptions outlined thereunder. Proposed Rule 10b-5-2, on the other hand, merely seeks to clarify the kind of relationships that can ground liability for insider trading under the misappropriation theory. This question seems to have arisen after the O'Hagan case, 117 S. Ct. 2199 (1997), which accepted that a fiduciary relationship between the insider and a third party who is not the issuer can be the basis of liability under the misappropriation theory. The proposed rules are set out in Selective Disclosure and Insider Trading, Securities Act Release No. 42259, at http://www.sec.gov/rules/proposed/34-42259.htm (Dec. 20, 1999) (on file with the North Carolina Journal of International Law & Commercial Regulation).

140 Langevoort, supra note 35, at 528.


142 With the prohibition, investment bankers have economies of scale advantages over other groups, for example secretaries or office boys, who are almost as likely to come across material non-public information. Given their ample resources, investment bankers can exploit such information fully by trading secretly, in a way that the secretary or worse still, an office boy with the same information might not, except with external financial assistance. Yet obtaining such financial assistance is hardly possible in the context of the trade’s illegality. Also, even if the office boy can successfully execute a small trade with personal resources, imprisonment upon conviction for the offense (as distinct from disgorging the profits) is unfortunately not a function of the size of the trade. Yet, the size of the trade and profits therefrom make a big difference in the trader’s ability to hire a good team of lawyers and take other actions to defend himself against conviction and imprisonment. In the circumstances, the office boy may well be disinclined towards taking the risk involved in trading, thus leaving the arena to the big boys.
mysterious theology of regulatory statutes and rules.\textsuperscript{143} Anyone viewing this analysis as largely theoretical should witness the resistance of influential sections of the Bar to the repeal of apparently otiose aspects of the insider trading laws.\textsuperscript{144}

\textbf{B. Limitations on the Effectiveness of International Regulation}

"Of all black markets," wrote Manne, "the one in ideas and knowledge is the most difficult to suppress."\textsuperscript{145} This statement underscores the difficulties inherent in regulating the dissemination and use of information, which is at the core of insider trading regulation, national or international. Having transcended the question of whether insider trading should be regulated, Congress realized this fact when it reduced the scope of § 16 of the Exchange Act as originally proposed.\textsuperscript{146} The section as conceived had proscribed not just short-swing profits by insiders, but more broadly, disclosure to others and profiting by third parties to whom disclosure had been made. "Congress refused this broad coverage on the grounds that enforcement of such a provision was not feasible. Attention was thus focused on the so-called statutory insiders—officers, directors, and beneficial holders of 10 percent of an equity issue."\textsuperscript{147} Subsequently, however, the SEC, emboldened by the confidence reposed in it by the legislature and the public, and aided by the courts, began to run where angels feared to tread, following its promulgation of Rule 10b-5 and the subsequent cases prosecuted thereunder.

Focusing first on the domestic perspective, the major impediments to effective insider trading regulation appear bifurcated: first, insider trading is difficult to detect, and second, it

\textsuperscript{143} Langevoort, \textit{supra} note 35, at 531.

\textsuperscript{144} \textit{See Report of the Task Force on Regulation of Insider Trading: Part II: Reform of Section 16}, \textit{42 Bus. Law.} 1087, 1091–92 (1987). This task force of the American Bar Association’s Committee on the Federal Regulation of Securities opposed the repeal of § 16b which in the opinion of commentators had become a trap for the innocent, apart from being irrelevant, given the development of Rule 10b-5. Its major recommendation in this regard, was ultimately a shortening of the active period of the section’s prohibition from six months to three months. \textit{Id.} at 1088.

\textsuperscript{145} MANNE, \textit{supra} note 109, at 169.

\textsuperscript{146} LOSS & SELIGMAN, \textit{supra} note 6, at 556.

\textsuperscript{147} MANNE, \textit{supra} note 109; \textit{see also} LOSS & SELIGMAN, \textit{supra} note 6, at 556.
is costly to enforce.

1. Difficulty of Detection

Writing in 1966, Manne noted that the insider trading prohibition in § 16 of the Exchange Act could easily be evaded without detection, through shares held in street names, secret accounts, accounts held in the names of relatives, and similar devices.\(^{148}\) He further stated that even such evasion was not necessary, as liability could simply be avoided by the use of inside information to trade in the shares of companies other than the insider’s.\(^{149}\) Manne focused on insider trading under the relatively limited provisions of § 16, apparently because Rule 10b-5 and other paraphernalia of SEC regulation were not yet well developed, if developed at all.\(^{150}\) However, his analysis is still valid even with regard to other provisions on insider trading in their current configuration. That this is so is borne out by the constant adjustments to insider trading laws initiated by the SEC to reinforce the prohibition.\(^{151}\) Some of these adjustments may be said to be aimed not at detection, but rather at the better definition (or rather description) of insider trading.\(^{152}\) Yet there are others directly related to the strengthening of detection.\(^{153}\) Perhaps the best example is the bounty program created for insider trading informants under § 3 of the Insider Trading and Securities Fraud Enforcement Act (ITSFEA) of 1988.\(^{154}\) This promises informants up to ten percent of insider trading profits, at the discretion of the SEC.\(^{155}\) The idea is to provide an incentive to make people come forward with information on insider trading activities, which the SEC cannot by itself discover. This desperate move underscores

\(^{148}\) Manne, supra note 109.

\(^{149}\) Id. at 163–64.

\(^{150}\) Id.

\(^{151}\) Id.

\(^{152}\) See, e.g., 17 C.F.R. § 240.14e-3 (1986).

\(^{153}\) It is still arguable that these are indirectly aimed at reinforcing detection, since a re-definition or re-description of an offense may well be such as to give it characteristics capable of easy detection. Indeed, this is clear from aspects of the SEC release proposing new Rules 10b-5-1 and 10b-5-2, supra note 40.

\(^{154}\) See supra note 71.

\(^{155}\) Id.
the fact that without independent information, the SEC by itself often cannot ferret the evidence to set it on the track of an insider trading transaction.

One may well ask whether there is anything so novel in this approach as to make it indicative of any special investigative difficulties on the part of the SEC. After all, the police offer bounties routinely to informants in murder and other cases. The answer would be that the novelty lies not in the fact of the bounty itself, but the way in which it is applied. Here, the bounty is offered not for a specific incidence of crime and over a definite period\textsuperscript{156} as the police are wont to do, but for a class of activities on an indefinite basis. The inference, then, is that the special investigative difficulties which usually impel the police to offer bounties on occasions is a characteristic feature of this class of activities covered by the SEC bounty. Furthermore, in most cases, police investigation is initiated at the instance of an affected or aggrieved party. This obviates the need for the police to go in search of the initial leads independently. By contrast, the SEC cannot depend on such initiation, since the victims of insider trading in the public markets are not easily identifiable, and grievances of the type common with the usual crimes are not a normal feature of insider trading. It must depend on informants who often do not feel as deep a compulsion to report suspected insider trading cases as would normally be the case for police crimes. Its prospects are enhanced when the informant is a self-regulatory organization like the exchange on which the trade is effected, or some other institution operating in the securities market, even though they also act on their own impetus.\textsuperscript{157}

Perhaps a corollary of the difficulty of detecting insider trading activities is the fact that the deterrent effect of insider trading sanctions is very limited. The steady increase in insider trading penalties, starting with the amendment of § 32 of the Exchange Act in 1975 to increase the maximum fine and prison term to

\textsuperscript{156} For example, bounties can be offered from the beginning of investigations to the arraignment of a suspect.

\textsuperscript{157} Thomas, supra note 39, at 110–11. In Carpenter v. United States, 484 U.S. 19 (1987), the SEC investigations and prosecutions were the result of initial inquiries instituted at the brokerage firm of Kidder Peabody, where correlations between Winans' column in the Wall Street Journal and the trading activities of his fellow conspirators at the brokerage firm were first noted. See supra notes 14–15 and accompanying text.
$10,000 and five years respectively, has been noted\textsuperscript{158} and juxtaposed with the increased prosecutions of the 1980s which were marked by the Chiarella decision.\textsuperscript{159} Empirical analysis was carried out, using data from the National Archives on insider transactions in publicly held firms.\textsuperscript{160} The study covered only insiders' open market sales and purchases within a fourteen-year period from 1975 to 1989.\textsuperscript{161} It examined gains from such trading, anchoring the identification of insider trading on the statistical significance of gross abnormal profits from the transaction.\textsuperscript{162} From the analysis, the volume of insider trading activities showed no decline in the periods after major increases in penalties.\textsuperscript{163} Trading continued as before without even a temporary decline.\textsuperscript{164} It is well known in criminal jurisprudence that when the chances of detection are slim, the penalties for a crime are ordinarily heightened to compensate for the reduced probability of detection. Drafters of corporate and securities codes have not overlooked this principle.\textsuperscript{165} The SEC, through the increases in penalties, therefore implicitly acknowledges the difficulties of detecting violators of the insider trading prohibition and enforcing the law against them. The difference, however, lies in the optimism it shares that the activity is being or can nevertheless be effectively checked, quite unlike other schools of thought.

2. Cost of Enforcement

The cost of enforcing the insider trading prohibition may be separated into two categories. The first category would be those costs which are incurred \textit{ab initio} and directly in the course of enforcement. The second would be those costs which are incurred

\textsuperscript{159} See supra notes 11–12 and accompanying text.
\textsuperscript{160} Seyhun, supra note 158.
\textsuperscript{161} Id.
\textsuperscript{162} Id. at 156–60.
\textsuperscript{163} Id. at 157–58, 169–71.
\textsuperscript{164} Id. at 169–71. The analysis showed, however, that concerning two specific areas of potential insider trading, takeovers and earnings announcements, court cases against insider traders had a deterrent effect, especially on top executives. Id. at 176–77.
ex post, as a fallout of enforcement. The former naturally includes the funds budgeted for enforcement activities, while the latter includes the sometimes unanticipated fallouts of enforcement, such as the violation of citizens' right of privacy in order to facilitate investigation.\textsuperscript{166} In this regard, the major questions become whether the SEC can afford to fund enforcement to the degree that it would wish and whether society can afford some of the certain consequences of enforcement.\textsuperscript{167} Put differently, how far can available resources take insider trading regulation and enforcement, and how much of its fallouts are tolerable given that the benefits are not undisputed? Regarding funds, the SEC obviously has the constraints that every agency has in managing finite resources. So, theirs is not an infinite capacity to fund investigation to whatever extent is desired. The fact, for instance, that the payment of the bounty promised informants is made conditional on the SEC's own discretion, shows that it anticipates a possible run on its resources if free reign is given. The constraints on resources have been captured by a writer in the following terms:

[F]ighting insider trading involves significant SEC resources. The already overworked SEC spends part of its annual one hundred thirty-five million dollar budget enforcing prohibitions against such trading. Due to the SEC's limited resources, there is a significant opportunity cost incurred when the SEC personnel are redirected away from other SEC functions such as reviewing registration applications for new issue... Aside from litigating "some splashy securities-fraud cases," the SEC has had trouble keeping up with its other less glamorous duties. In the last ten years, the SEC has been unable to thoroughly examine registration statements, thus compromising the purpose of the 1933 and 1934 Acts. As long as the SEC concentrates on policing insider trading there will be a question whether it can determine "when its enforcement efforts are costing more than

\textsuperscript{166} The latter costs are likely to be more substantial. Such costs include the cost of private compliance with insider trading regulations and deterrence to market participants resulting from inconsistent prosecution of insider trading under ambiguous statutes and cases.

\textsuperscript{167} "Certain consequences" mean those that are less likely to be disputed, as opposed to those likely to cause debate, like the claim that the prohibition is allocatively inefficient. A certain consequence would be, for instance, the deterrence to market participants resulting from inconsistent prosecution.
they are worth."\textsuperscript{168}

The foregoing indicates that enforcement is selective, as a direct result of funding constraints. While it is arguable that the same cost problem besets the enforcement of other crimes, the case for insider trading is worsened by the doubts about the need for its prohibition in the first place. Such doubts do not exist about stealing and driving while drunk, for example.

Funds aside, the public may however be inclined toward accommodating the other costs of enforcement, given the influence that the SEC wields and the fact that the virtues and values of the insider trading crusade have become internalized in many citizens, who hardly would question it. Yet, as a matter of logic, there is a limit beyond which peoples' tolerance would wane. As Manne wrote in relation to his review of the possibility of using police-state tactics to check insider trading effectively,

\begin{quote}
[a] much more important objection however, is that such police state tactics are simply intolerable. Spying on social meetings, computerized friendships, total disclosure of all financial affairs and decisions, the necessity to explain every profit—these are unthinkable in a civilized democracy. The costs, financially, morally, and politically, are too great, and we should never anticipate truly effective policing of insider trading by trying to ferret out every proscribed transaction as it occurs.\textsuperscript{169}
\end{quote}

Difficulty of detection and the associated costs appear to be the primary limitations on the SEC's enforcement of the insider trading prohibition. Being rather basic in character, in the sense that they are likely to be replicated in any other jurisdiction, the relative rarity of these limitations reflects the fact that the prohibition against insider trading has a relatively firm footing in the United States.


\textsuperscript{169} MANNE, supra note 109, at 165–66.
3. Difficulty of Detection and Enforcement Costs on the International Plane

How do these two limitations play out in relation to the international regulation of insider trading? First consider the difficulty of detection. How detectable is cross-border insider trading in which the interests of the United States or its investors are implicated in any of the ways that worry the SEC, given its broad conception of such interests? Under such a conception, for instance, insider trading effected on the Tokyo stock exchange in Japanese yen by a Japanese national on the securities of a Japanese firm, would be recognized as having a negative impact on U.S. investors, to the extent that the same securities are traded on a U.S. exchange or over the counter (OTC) market. Taken a step further, it may even be argued that even if not listed on a U.S. exchange or an OTC market, the interests of the United States and its investors are implicated to the extent that a U.S. investor deals contemporaneously on the Japanese exchange in the same securities as the Japanese insider. That U.S. interests are implicated, especially in the former scenario can hardly be in dispute, given the activities of arbitrageurs and other links that make the financial markets interconnected.

What is in doubt, however, is the chance that the activities of the Japanese trader will be detected. First, impediments similar to those noted above in the detection of domestic insider trading apply, these being a function of the intrinsic character of the insider trading prohibition as a ban on the use of ideas and information. Second, other factors peculiar to the foreign jurisdiction, in this case Japan, supervene. In Japan, detection in the circumstances is highly unlikely, given cultural peculiarities. It is a widely acknowledged fact that the Japanese see nothing wrong with insider trading. In fact, tipping inside information for them is a time-honored means of cementing business relationships. Admittedly, one of the elements of the Japanese "Big Bang" reforms of 1996 is "active punishment for violations of rules." However, this is likely to make a difference only in

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170 Kehoe, supra note 75, at 374.
171 Id. at 355.
172 Id.
173 SCOTT & WELLONS, supra note 39, at 8-69.
the enforcement efforts of the Japanese regulators, which has indeed become heightened generally. Changing the established beliefs and market habits of the average Japanese investor is a more intractable problem. Yet, this is the most essential factor in the effective prohibition and policing of insider trading. An attitude similar to the Japanese's is also noticeable in other jurisdictions, such as Germany. This is notwithstanding the proscription of insider trading since the Second Financial Market Promotion Act, passed in 1994. The established habit of German insiders to pass material information to relatives and friends is a more difficult problem to solve.¹⁷⁴

Under the circumstances, the major means upon which a regulatory agency like the SEC relies for the identification of a violation, namely independent reports of suspicious trading, becomes even further circumscribed and largely unavailable, as people see no need to make any such reports. Indeed, even a bounty program like that initiated by the SEC under the ITSFEA of 1988 is unlikely to help much in this scenario, as the community, seeing no harm in the proscribed activity, is likely to frown on such a report. Anyone who has lived in a traditional society like Japan, which tends towards strong communal ties with subterranean codes of honor operating in ways that sometimes oppose and dominate formal and more apparent laws, would realize the difficulties of detecting an activity like insider trading, which the people feel is merely mala in prohibitum and not mala in se.

The foregoing scenario involves a developed market and a variant of insider trading that is perhaps relatively easy to detect, since a professional trader is quite a conspicuous player in the market. The possibilities of detection become more dismal if we take a hypothetical removed from this. Assume for instance the same securities in the above scenarios, but that the securities are those of a mining corporation with operations in several developing countries by way of subsidiaries that are closely-held companies. On the board of directors of one of these subsidiaries

¹⁷⁴ See Standen, supra note 28, at 177, who writes: "German banks and major corporations have long been accustomed to passing on inside information to select groups of analysts and journalists via their legendary 'fireside chats.' Moreover, there is little sign of any real desire on the part of 'insiders' to change this rather cozy arrangement." Id.
sits a local chieftain, who is a director by virtue of a minority shareholding in the subsidiary. At the last directors' meeting in every financial year, the chief executive officer of the subsidiary briefs the directors about the earnings outlook for the next year. Occasionally, he gives facts and figures indicating new discoveries and planned market developments. Because it is as yet for purposes of internal planning, and due to other strategic reasons, this information is not released to the public. These facts and figures, from previous experience, are certain to affect the parent company's stock whenever released to the public. The local chieftain typically trades in the parent company's stock on a Japanese stock exchange, using such information. He also trades on the stock of the U.S. parent company's competitors with such information. As an experienced investor, he avoids trading in such quantities as will lead to a jump in the prices of the securities. All this he does immediately, a year or more ahead of the time the subsidiary's projections are made public. What are the chances of detection under these circumstances? He is not a conspicuous market participant or trader. He has effected his transactions using inside information well ahead of the hullabaloo that will ultimately attend the announcement of the information to the market. He has traded in a market (Japan) relatively removed from the prying eyes of the U.S. market participants. The chances of detection appear rather slim. They become even slimmer if the chieftain tips some other party totally unconnected with the corporation, who then trades immediately on the information. Variants of this scenario can be replicated all over the world, and most people who have had close dealings with the boards of subsidiaries of multinational corporations in developing countries and emerging economies know how real and common the situation is.

Money managers now circumvent the exchanges, using automated electronic trading systems to trade in securities off the board. Sometimes they simply trade directly among themselves. "This development is causing alarm on Wall Street and in other financial centers as large volume institutional traders, in particular, seek to minimize transaction costs."\(^{175}\) How does the SEC, or any other regulatory agency for that matter, detect insider trading off the exchange when the parties to the transaction, as is the case in

\(^{175}\) Millspaugh, \emph{supra} note 82, at 361.
many jurisdictions, see nothing wrong in such a practice, taking it as an expected risk of trading? None of these parties certainly has any incentive to report such transactions, more so in the long run, when every party would most likely have had a chance or two of trading with inside information. As the world increasingly takes to the Internet, the opportunity for such transactions multiplies in a way that will strain the capacity of an SEC intent on detecting insider trading, wherever and by whomever undertaken, once U.S. interests are implicated. The statement of Choi and Guzman, made in the more general context of securities offerings is apposite:

\[\text{[E]fforts to regulate all transactions that impact the American market regardless of where they occur potentially lead to a policy subjecting any securities transaction in the world to U.S. law. . . . The problem is dramatically demonstrated by what is sure to become an important venue for trading in securities, the Internet. Although the position of the United States towards trading on the Internet is still being developed, its current jurisdictional approach is expansive. The United States appears to believe that its jurisdiction should be asserted over any offer made on the Internet that is transmitted to the United States. Given that the offeror does not control the location of those who visit the offeror’s web pages, any Internet offering may become subject to the laws of the United States, regardless of the offeror’s intent.}\]

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If insider trading is conducted in the course of such a securities offering, detection will be a major problem for the SEC unless the proprietor of the site does not wish to conceal information pertaining to such trading. Yet concealment of such information and a generally less restrictive and cheaper transctional environment are potential selling points for such Internet sites. This is more so if the international or regional markets demand for such. It may not be too far fetched to imagine a web site that advertises openly that insider trading thereon is permitted.177 The

176 Choi & Guzman, supra note 48, at 914–15.

177 One may be tempted to ask why anyone would be interested in trading systems that permit insider trading. It should be noted that stock traded on such systems will be discounted for its higher risk, implying higher returns when such risks do not materialize. There should also be savings that flow from lower regulatory costs on such systems. If there are, as may be expected, restrictions on the sale of such “insider-
task of scouring the Internet to locate sites where such trading occurs will undoubtedly prove a daunting one, given the ease and speed with which sites can be replicated and the limitlessness of the medium. Some sites may even be established and operated by a closed circle of people, for the purpose of trading exclusively among themselves, with no advertisement to the general public. The difficulties that such trading will pose in terms of detection are captured in the words of a Harvard Law School Web Systems Administrator:

If a site is not indexed by the major search engines & [sic] directories (i.e., Alta Vista, Yahoo, etc.) and there are no links to it from other sites, there's no way to know it even exists, let alone index it. So a comprehensive directory of all web pages on the Internet would be technically unfeasible. And even if such a thing were possible, the fast pace of changes to Web sites would make such a directory obsolete before it could even be fully compiled.\textsuperscript{178}

traded\textsuperscript{"} stock on other exchanges or systems, then all other things being equal, we have a unique mix that should attract those interested in diversification, hedging, or simply higher returns for higher risks. More generally, such systems are likely to be primarily targeted at specific communities whose ethos accommodates such trading. Patronage by those from outside such communities would be possible, but only incidental to the calculus of those who establish such trading systems.

\textsuperscript{178} E-mail interview with Mary Ellen Nagle, Web Systems Administrator/Analyst, Harvard Law School Information Technology Services (ITS) Systems (Feb. 25-26, 1999).

One may be inclined to think that such sites would not receive many or even any visitors, since they are not indexed by the major search engines. The reality, however, is that such sites, as mentioned in note 177 above, will usually be primarily for trading among members of specific communities or regions, much in the same way that hundreds of little-known Internet Service Providers (ISP) currently provide web access to consumers in different parts of the world. Because they are not America Online (AOL) or other established names in the business, few persons outside their communities or regions know about these ISPs. Advertisements in local newspapers and a mailing list are used to establish awareness about the ISP or Internet site within a community. Outsiders, including U.S. citizens, would occasionally stumble upon such sites and trade thereon. Stock thereon may even be dollar-denominated. Perhaps several months or years after it is set up, the SEC eventually would become aware of its existence, and move against it. The site is re-established weeks later, and mailing lists and phone calls are used to recreate awareness. Ultimately, trying to stop such a site could become like an attempt to capture a guerilla radio station in mountainous territory. The peaks make tracking more difficult, and when tracked, the terrain makes rapid movement difficult. Meanwhile, by their very nature, guerilla broadcasters and their equipment are constantly on the move.
The implementation of the SEC’s global policy on insider trading will therefore, as far as detection is concerned, be significantly impeded by the lack of initial leads that are so critical to commencement of investigations. The same goes for any other foreign regulatory agency that is inclined toward assisting the SEC in its detection efforts. Such leads will not be forthcoming, to the extent that insider trading is not viewed negatively by the public in other jurisdictions, but is in fact viewed positively. The SEC will therefore have to be content with those transactions effected on U.S. exchanges or the OTC market (subject to the fact that detection is even in this context intrinsically circumscribed as previously explained), and reports from the occasional citizen who is unhappy with his transactions on a non-U.S. exchange or other extraterritorial fora like the Internet.

The issue of costs naturally follows, in the context of the extensive efforts that must attend, and consequences that will be entailed by, the detection (and enforcement) efforts of the SEC at the global level. What will be the costs of such global efforts and how will they be borne? Considering the resource aspect of costs, it is clear that the SEC can ill afford to fund the global detection and investigation of insider trading in such a manner and on such a scale as to effectively extirpate or meaningfully control it, even assuming that such detection and investigation are feasible.

Costs were for instance a major concern in the debate preceding the ITSFEA, which by § 6 thereof empowered the SEC to give investigatory assistance to foreign securities authorities conducting investigations over the violations of their securities laws. Many people concerned about the additional cost to the SEC, pointed out that U.S. budgetary constraints may make the implementation of the provision unfeasible. Not surprisingly therefore, the authority of the SEC to receive compensation for expenses incurred on behalf of foreign governments was a feature of the subsequent ISECA when the bill was proposed. Those opposed to the SEC’s willingness to bear these costs clearly labored under the notion that the SEC was in so doing, granting the foreign securities agencies a favor, especially given that

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179 Thomas, supra note 39, at 121.
180 Id. at 127.
reciprocity was not a condition for such assistance. However, the scheme properly viewed, was an exercise in self-help. The then SEC chairman, David Ruder in his testimony before the House Energy and Commerce Committee, defended the non-reciprocity of the provision on the ground that the SEC might nevertheless, desire to aid a foreign agency in a situation in which the SEC needs to protect directly threatened U.S. interests, and in a situation in which the SEC wants by means of such assistance, to encourage future cooperation from the foreign agency. Effectively therefore, when the SEC aids such investigations, it would in many cases be because of ancillary benefits it hopes to derive from such help. It follows that to some extent the cost of such investigations are properly its own cost, and not that of the foreign agency, and that in trying to shift it, the SEC seeks a subsidy of its own enforcement activities.

If the SEC is facing budgetary constraints for its insider trading crusade, the constraints on regulatory agencies of less endowed nations can only be imagined. Even if such agencies detect and are willing to investigate insider trading, the facilities for such investigation may be inadequate or simply lacking. This is more likely to be the case in the emerging markets and developing countries, where societies face problems that are considered far more basic and deserving of resources than the elimination of insider trading. For such places the SEC must be willing to go beyond measures like the MOU or the exportation of insider trading laws, and be able to back it up with funding and other forms of technical assistance. Otherwise, it may have to be content with selective prosecution of a few splashy cases originating from such jurisdictions, leaving the mainstream of insider trading unrestrained. A good example is Nigeria, where, by rules made pursuant to the erstwhile Securities and Exchange Commission Decree of 1988, the Nigerian Securities and

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181 Id.
183 See Chapter 406, Laws of the Federation of Nigeria, 1990. Although the impetus for the promulgation of the Rules is not clear, one notes that it occurred in the 1980s, when the anti-insider trading campaign of the SEC became heightened with major investigations and prosecutions internationally. On the other hand, the more recent insider trading provisions under the 1990 Companies and Allied Matters Decree are
Exchange Commission established an anti-insider trading regime in terms similar to the U.S. regulations. No case has, however, been instituted under these rules to date. In 1990, the rules were apparently reinforced by the prohibition of insider trading in Part XVII, Section 614-621, of the Companies and Allied Matters Decree of that year, but this has made no difference. Meanwhile, the Nigerian government has since 1995 pursued an economic liberalization policy, an aspect of which is the internationalization of the securities market. In fact, the Nigerian Stock Exchange in September of that year, released the “Guidelines for Foreign Investment Through the Nigerian Stock Exchange,” spelling out relevant details. The effect of this is to open the capital markets for investments by foreigners either more likely a result of the efforts of some academics who genuinely believed that insider trading was unfair and indeed "evil," and whose views proved influential with the Nigerian Law Reform Commission at the consultative stages of decree making. See infra note 184. In sharp contrast, the only stock exchange then, the Lagos Stock Exchange, also known as the Nigerian Stock Exchange, did not favor the regulation of insider trading on a standing basis. It preferred instead the ad hoc intervention of the Finance Minister if and whenever the need arose; which occasion is unlikely to involve routine insider trading cases. (It should be noted that at the time of the consultations concerning the 1990 Decree, the Rules of the Nigerian SEC were yet to take effect, as they were undergoing review by the Justice Ministry.) See THE NIGERIAN LAW REFORM COMMISSION WORKING PAPERS ON THE REFORM OF NIGERIAN COMPANY LAW, VOL. I (REVIEW AND RECOMMENDATIONS) PART TWO, paras. 155-163, especially para. 160 (1987).

184 Nigeria's capital market laws and regulations were recently revised and codified by the Securities and Investments Act of 1999. Part XVII of the Companies and Allied Matters Decree 1990 was repealed by section 263(1)(d) of this Act, its provisions being embodied effectively in scattered parts of the Act. Part VII of the Act now deals with the registration of securities, while Part X thereof deals with trading in securities, including insider trading. (A careful reader of the Act would note the misidentification of Part X 'Trading in Securities' as Part IX in the arrangement of sections.) See Foreign Investment Requirements and Protections: Foreign Investment Requirements, at http://www.nipc-nigeria.org/fir.htm (last visited Dec. 30, 2001) (on file with the North Carolina Journal of International Law and Commercial Regulation).

185 See, for instance, section 26 of the Foreign Exchange (Monitoring and Miscellaneous Provisions) Decree No. 17 of 1995, which was one of the statutes that launched this initiative by permitting anyone, irrespective of citizenship or residence, to invest in the Nigerian capital market. Other provisions of the Decree allow for free importation and exportation of funds through normal banking channels. See Foreign Investment Requirements and Protections: Foreign Investment Requirements, at http://www.nipc-nigeria.org/fir.htm (last visited Dec. 30, 2001) (on file with the North Carolina Journal of International Law and Commercial Regulation).
publicly or by way of private placements. Beyond these the government in February 1999 announced the privatization of thirty-seven major enterprises including those in the key sectors of telecommunications and energy. Major U.S. and international bankers and financial institutions were appointed as consultants to these enterprises for this purpose, evincing a desire on the government’s part to earn scarce foreign exchange through the sale of these enterprises’ securities abroad, as was successfully done in neighboring Ghana with Ashanti Goldfields Company (listed on the New York Stock Exchange) and related establishments. If the securities of these privatized enterprises are traded simultaneously on Nigerian and international exchanges, or even exclusively on the latter, they are likely to be the subject of insider trading in the manner to which players in the Nigerian securities market have become accustomed. Even if not traded on U.S. exchanges, the chances that they will attract the attention of U.S. investors cannot be ruled out. The SEC will certainly need nothing less than the establishment of a Nigerian branch office in order to police the magnitude of insider trading that is likely to occur in relation to U.S. investors and interests. Given that this is impermissible, its leeway would be to fund and otherwise aid its financially anemic Nigerian counterpart. Its ability to fund such a venture in the long run is, however, doubtful.

Funds and resources aside, to what extent is the international community willing to bear the costs of insider trading regulation in the form of the fallouts which the average U.S. citizen is apt to tolerate? Will the Swiss as individuals tolerate violations of the age-long privacy of bank accounts, if the demands of insider trading go beyond the current trend towards violating the privacy of foreigners’ accounts in their banks and begins to affect accounts held by the Swiss themselves? Will it be tolerated if it begins to have an overall negative effect on their banking industry? Without the kind of public outrage that greets insider trading violations in the United States, how long will market participants in other jurisdictions tolerate routine questioning of large sales or


\[187\] These include Merrill Lynch International, First Boston, Credit Suisse, Salomon Smith Barney, Citibank, Warburg Dellon Read, and Arthur Andersen International.

\[188\] Traditionally, the yield from the Nigerian stock market has been attractive.
purchases each time a stock shows a substantial movement in price or other statistics? And how long will the society tolerate the deterrence to market participants resulting from inconsistent prosecution of insider trading activities under broad, ambiguous statutes and cases?

Manne's statement\textsuperscript{189} regarding the potentials of police-state tactics in the detection of insider trading readily comes to mind here. This is because the longer one looks at the matter the more plausible it becomes that, short of such tactics, detection of insider trading will be practically impossible outside the United States, in those places where information relevant to detection will not readily be forthcoming from the public. Yet these are the places where such tactics are least likely to be tolerated for the sake of insider trading detection. Assailing long-established bank secrecy laws in other jurisdictions, as the SEC has tended to do, obviously smacks somewhat of such tactics. The resistance that has greeted such moves, even at the official level in these jurisdictions,\textsuperscript{190} albeit often subtle and covert, is instructive. Therefore, notwithstanding their entry into MOUs or similar arrangements with the SEC (a fact they can hardly often resist given the importance of the U.S. markets) these jurisdictions at best have a lukewarm attitude towards insider trading regulation, and this will in the long run prove an insurmountable obstacle for its meaningful regulation globally.

This discussion of the fallout costs of detecting insider trading internationally, is closely related to the more general issue of effective enforcement. Conceptually, the difference may be simply stated: Detection comes before enforcement, of which investigation may be said to be an aspect. The linkage, however, is that many of the factors which impede detection will also often impede enforcement. A further distinction lies in the intensity of the impediments presented by these factors which, in the international context, is likely to be higher at the enforcement stage. Conversely, this stage would present almost no problems for the SEC on the domestic scene since, following the detection of a domestic violation, very few impediments would constrain enforcement efforts, except perhaps a paucity of resources.

\textsuperscript{189} See \textit{supra} note 169 and accompanying text.

\textsuperscript{190} See \textit{supra} note 56 and accompanying text.
So, how does international enforcement fare with factors such as funding constraints and cultural bias against insider trading regulation? The issue of funds can be summarily dispatched by noting that the SEC’s funding constraints and those of the less-endowed agencies in other jurisdictions can only be more acute at this stage. The stage would often involve expensive litigation undertaken in foreign jurisdictions, some of which run less-than-ideal judicial systems, to enforce violations affecting U.S. interests as broadly conceived by the SEC. Even if an extradition treaty exists, it would also usually involve litigation in the foreign jurisdiction to determine the propriety of a violator’s extradition in each case. Assuming all cases detected are prosecuted and decided in favor of the agency, the expense that would be involved, given what would be the number of violators in the various markets, is mind-boggling.

Regarding cultural bias against (or indifference towards) insider trading regulation, we may revisit the hypothetical of the local chieftain given previously. Assuming that his transactions are eventually detected, what are the chances of prosecution, leading to conviction or extradition? To start with, the decision to prosecute him will be a very political one, because irrespective of the government’s objectivity concerning the propriety of prosecuting him, the government would nevertheless be wary of a political backlash resulting from public perception that the chieftain is merely being persecuted for no good reason. Very likely, he will not be prosecuted. Even if ultimately prosecuted, the chances of punishment ultimately are low. Judges everywhere are members of a community, who share in the ethos of the community. In cases of this nature where society perceives nothing wrong in a proscribed activity, a judge is likely ab initio to be under considerable self-pressure not to convict, and if she convicts, not to punish. For this purpose, it is noteworthy that in most jurisdictions outside the United States, the jury system is not used. The magistrate or judge sitting alone at first instance, decides questions of fact and law. And if the judge does punish the “offender,” the punishment may invoke further public outcry and a call for executive intervention through the exercise of the prerogative of mercy, or similar fiat that permit government to pardon convicted persons. Prosecution for insider trading in the circumstances, is likely to attract the same attention and outcry as
prosecutions for bigamy in several jurisdictions where, as a colonial legacy, the western notion of monogamy was statutorily but unsuccessfully superimposed on the age-long polygamous conception of marriage.

It is quite instructive in this connection, to note the public support received by Franz Steinkuhler, a prominent German labor leader and member of the supervisory board of Daimler-Benz AG, who in 1993 traded with inside information on the stock of an affiliated company.\textsuperscript{191} "Public support for Steinkuhler remained considerable, however, and Steinkuhler himself, while confirming that he had engaged in the trading, admitted no wrongdoing, dismissing the charges as 'attempts to discredit my person.'"\textsuperscript{192} While cases involving chieftains and other personages will almost certainly attract public attention, there is nothing indicating that cases involving less popular figures will not similarly be opposed if prosecution becomes extensive.

The point here is that insider trading is a long way from being admitted into the hallowed class of crimes \textit{jure gentium}, which by the operation of \textit{jus cogens} (custom or usage) in public international law have become globally accepted as reprehensible, and have therefore been effectively criminalized internationally. Only a few crimes like enslavement, piracy, and lately, genocide fall into this pedigree. Until insider trading comes within or approximates this class, enforcement in the manner and scale necessarily entailed by the SEC approach will remain a phantasm. Incidentally, many commentators realize, at least on a general level, the difficulties which beset international enforcement efforts of the SEC. For instance, it has been written that the "lack of consensus on insider trading, procedural obstacles and difficulty enforcing sanctions impede international enforcement of insider trading prohibitions. When other countries do not consider insider trading a crime or a violation of a civil duty, they resist cooperating with American enforcement officials."\textsuperscript{193} In fact, many foreign states view any effort to apply U.S. laws beyond U.S. borders as a violation of the foreign state's sovereignty and


\textsuperscript{192} \textit{Id.}

\textsuperscript{193} Ruiz, \textit{supra} note 86.
as an improper effort to export American economic, social, and judicial values. Historically, the U.S has attempted to enforce domestic law prohibiting insider trading internationally in spite of the extraterritorial jurisdiction problems and the conflicts with principles of international law and comity that this policy creates.194

The defect in many of these analyses is, however, that they see the problem as principally a result of the extraterritorial application of U.S. law, and from this go on to assume, erroneously, that once the other countries amend their laws and enter into well structured MOUs or similar bilateral or multilateral arrangements, the enforcement problems will largely become amenable to solution.195 Others seem to assume that while such adjustments are laudable, the efforts of the SEC will pay off in the long run, even if the traditional jurisdictional approaches are used, perhaps with some strengthening.196 But, as has been shown above, to transcend the objections of states and get them, perhaps unwillingly, to promulgate anti-insider trading laws, is to scratch the surface of the problem. The realities on the ground in many jurisdictions mean that enforcement, even with the close supervision and assistance of the SEC, will often meet with substantial resistance.

Indeed, also implicit in some of the analyses is an assumption that the threat of insider trading is one that emanates largely from the major financial markets with which the SEC has had to deal so far. (On this assumption it is easier to imagine that given the more structured nature of these societies, the international obligations assumed under MOUs or like arrangements will readily be translated into effective enforcement efforts. Experience has of course not shown this to be always true, especially when the authorities in these countries bow to pressure in acceding to such arrangements.) There is however conceptually little to stop such

194 Id.


196 See Pitt et al., supra note 46, at 375; Harvey L. Pitt & Karen L. Shapiro, Securities Regulation by Enforcement: A Look Ahead at the Next Decade, 7 YALE J. ON REG. 149 (1990); Thomas, supra note 39.
insider trading from being initiated in say, Nepal.\textsuperscript{197} When such countries are involved resistance to enforcement may come in unexpected ways, unless a proscribed activity is in line with the society's ethos, or the incidence of enforcement is minimal and therefore insignificant and inconspicuous—hardly the kind that will accord with the SEC's desire for a comprehensive check on insider trading.

Given that the exportation of anti-insider trading laws based on the U.S. model is a major approach adopted by the SEC it would be worthwhile to examine at this stage how such laws might in the long run assist the campaign against insider trading. For this purpose, assume that there is no resistance in the foreign country against moves to sanction insider trading, and that such activities are detected and routinely prosecuted in the courts, with no need to extradite the offenders to the United States for prosecution in U.S. courts. Will this have the effect desired by the SEC? In other words, barring the logistics of detection and enforcement, how would insider trading cases fare in non-U.S. courts operating U.S. insider trading laws or variants thereof?

The bulwark of U.S. insider trading regulation is Rule 10b-5, a provision largely nurtured to maturity by the judiciary. In this connection, it has been described as a "judicial oak that has grown from little more than a legislative acorn,"\textsuperscript{198} a description which for Loss and Seligman "falls short, if anything, of describing one of the most dramatic examples in the entire American corpus juris of the growth of law through the interaction of the legislative, administrative, and judicial processes."\textsuperscript{199} Against this background, a major problem with a meaningful and effective exportation of insider trading regulation, is that Rule 10b-5 has largely developed through judicial activism of a sort that is peculiar to the United States and can only be sustained in the context of the country's constitutional framework. This

\textsuperscript{197} Incidentally, the government of Nepal is currently exploring the possibilities of establishing the country as an international financial center. See Harvard Law School, Program Description Brochure, Program on International Financial Systems (1998) (giving details of the Nepalese initiative which is being undertaken with the technical cooperation of the Program). This, in a general sense, makes the prospect of insider trading from such a jurisdiction less remote.


\textsuperscript{199} Loss & Seligman, supra note 6, at 818.
framework has effectively accepted judges as equal participants in the political process, with power to make (and indeed unmake) laws through the judicial process. This feature is appropriately captured by Abram Chayes when he writes that

"[t]he judicial department established by the framers was unique among nations in 1787 and, to a large extent, remains unique today. All modern societies have judges, and an independent judiciary is a hallmark of liberal democracy. In other countries, however, the judicial system is regarded primarily as a service provided by the government, much like education... with the workaday function of resolving the disputes that arise in the ordinary course of social and economic life. The courts in such societies are, of course, essential organs. Unlike the judicial branch brought to life by article III, [of the constitution] however, they are not thought to be, nor are they in fact, engaged in the political process."

Rule 10b-5 in its current configuration is a product of judicial lawmaking—an emanation of judicial participation in the political process. A related factor is the unusually extensive discretionary power wielded by judges, perhaps as a corollary of the U.S. legal system's emphasis on standards rather than bright-line rules. It is this peculiar milieu that has enabled the U.S. judiciary to grow Rule 10b-5 from a little acorn into an oak, and to keep it from becoming stunted, despite occasional trimmings at the edges.

Primary corporate insiders like directors and officers are relatively easy to police since they generally operate in the limelight and the restrictions attaching to their status become readily well defined, from constant exposure to adjudication. The more difficult aspects of insider trading regulation lie in the remote penumbra where tippers, tippees, and a chain of other affiliates descended from them operate. Here, nothing less than the activism of the judiciary in the peculiar American context can achieve the kind of results attained so far. And, it is precisely in these areas that other legal systems will fail the SEC, by not developing at all or developing differently, thereby leading to either non-regulation of this penumbra or regulation that is

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201 Id.
different in scope and effect from that sought by the SEC. The whole corpus of insider trading regulation (as distinct from market manipulation202) is no less an American invention than the common law itself is English in origin. It requires power and passion of a kind lacking in the judiciaries of other jurisdictions, to effectively replicate it in form and effect outside the United States.

Along this line, it is highly unlikely for instance, that the misappropriation theory, which has found favor with many U.S. lower courts, and lately with the Supreme Court,203 would ever receive the imprimatur of non-U.S. courts as a means of extending liability under Rule 10b-5 to capture hitherto uncovered cases of insider trading, as the SEC often would have the courts do. Indeed, all the nuances of insider trading jurisprudence, in key areas like the scienter requirement and fiduciary duty requirement are likely to emanate differently if the prohibition is sought to be vigorously enforced in other jurisdictions. The difficulty here stems to an extent from the fact that insider trading prohibition is not the simple proscription of a single activity, as is piracy for example. Rather, it has come to be a proscription of an open-ended series of transactions, connected mainly by the alleged potential for such transactions to impact the market negatively. There is a gulf between the act complained of in the Carpenter case204 (trading with opinions formed privately, sometimes by using publicly accessible information obtained from corporate insiders) on the one hand, and the act prosecuted in United States v. Chestman205 (a broker trading with publicly inaccessible information whose source was solely and ultimately traceable to a corporate insider).206 This is why its definition is an unappealing proposition to the SEC, as this will confine it to a single offense or definite set of offenses.

So, would a foreign court presented with the same facts and the text of Rule 10b-5 convict the petitioners in the Carpenter case

202 See Loss & Seligman, supra note 6, at 929-31 (noting the distinction between the two concepts and a short history of manipulation).
204 See discussion supra notes 14–15 and accompanying text.
either for insider trading or for aiding and abetting? This would ultimately turn on its conception of the categories of fiduciary relationships, and its opinion on whether it is empowered to stretch the rule to the extent inherent in the misappropriation theory. This is doubtful, given that attaching fiduciary duties to a person is merely to begin inquiries about to whom the duties are owed and the circumstances in which they are owed, questions that may not necessarily be answered by a foreign court in the same way as an American court. Certainly relevant is also the more sedate judicial disposition in most of these jurisdictions, a disposition which does not favor the radical creation or extension of liabilities and judicial concepts generally, as U.S. courts are wont to do.

A look at the EEC (European Union) Insider Dealing Directive\textsuperscript{207} and its operations shows aspects of the foregoing problems. The drafters appear to have appreciated the difficulties of having a rule which is based on fraud, and related fiduciary notions. Article 2(1) of the directive simply prohibited an insider in possession of inside information “from taking advantage of that information with full knowledge of the facts by acquiring or disposing for his own account or for the account of a third party, either directly or indirectly, transferable securities of the issuer or issuers to which that information relates.”\textsuperscript{208} This article also distinguishes between primary insiders and secondary insiders. Article 4 restrains the former from tipping while the latter is not so restrained, though the latter may not trade with the information.\textsuperscript{209} Unlike U.S. law, the rule for secondary insiders under the directive is applicable, irrespective of the legality or otherwise of the means or source by which they obtain information.\textsuperscript{210} Because of this, the whole chain of insiders and tippees is caught, and it is unnecessary to prove where the leak occurred once a person has inside information.\textsuperscript{211} The key concept of inside information is also

\textsuperscript{208} Id.
\textsuperscript{209} Id.
\textsuperscript{210} Id.
\textsuperscript{211} Warren, \textit{supra} note 195, at 1069.
The philosophical underpinning of the directive is the enhancement of the efficiency of the market through eliminating a practice that potentially is corrosive of confidence in its operation, as distinct from the enforcement of fiduciary or other duties owed by management or other market players.

"[T]hrough its prohibitions, the directive is able to circumvent tedious distinctions between insiders and outsiders, inside information and market information, the immoral tipper and the derivative tippee, all based on the fraud and fiduciary duty rubric. . . . By eliminating the forced use of criteria underlying fraud, deception and related fiduciary duty notions, the EC has produced a directive which has a greater potential effectiveness on its face than the evolving insider trading prohibitions in the United States."213

"[B]y focusing on the possession of inside information rather than on a breach of fiduciary duty, these definitions are comprehensive enough to prevent more remote inside traders from slipping through cracks in the system as they often do in the United States."214

212 Coordinating Regulations on Insider Dealing, Council Directive 89/592, art. 1(1), 32 O.J. (L 334/30) (defining inside information as "information which has not been made public of a precise nature relating to one or several issuers of transferable securities or to one or several transferable securities, which, if it were made public, would be likely to have a significant effect on the price of the transferable security or securities in question").

213 Warren, supra note 195, at 1056.

214 Standen, supra note 28, at 190–91. An observer may be tempted to ask why the European Union has chosen to implement a general scheme of insider trading regulation, if indeed there is a disappearing consensus or no consensus at all on the undesirability of insider trading as argued earlier in this paper. The answer is that in today’s competitive market every region tries to get as much regulatory leverage as possible in order to enhance its competitiveness. The regions do so even when it involves the deployment of legislative placebos by way of insider trading regulations. Accordingly, the EU’s scheme for insider trading regulation is largely aimed at enhancing the formal credibility of the European market, given that many investors (particularly those from the dominant U.S. market) still distrust markets where insider trading is rife. One commentator noted:

Seen in the best light, the [insider trading] directive establishes a new moral: Insider trading is now, for the first time a European sin and, henceforth, a public wrong for market participants. Seen in the worst light, the directive merely assists the EC in its promotion of a dangerous imagery of regulation; the directive’s denunciation of insider trading conveys the false impression of a comprehensively regulated market place. This image, framing the EC’s regulatory system as a paragon of regulatory virtue, recommends the EC’s
Implicit in the approach adopted by the drafters of this legislation is an acceptance of the limitations of fiduciary based insider trading jurisprudence, as a means of imposing multi-jurisdictional insider trading liability. The fiduciary approach is dispensed with, and a more functional and objective basis is substituted. This is however, not the end of the matter, as several elements of the prohibition have had to be defined in the Directive. What is more, the Directive must be implemented by enabling statutes in each country of the European Union before it can become effective. Divergences certainly exist in the definition of the offense and its constituent elements in each country. Will the SEC be content with a situation in which the same transaction is successfully prosecuted in one country but not in another due to inevitable divergences in the definition of the elements of the offense or due to judicial attitude? Or will it bring pressure to bear in order to achieve a harmonization of definitions, given that the transactions involved affect U.S. interests? What if the different results are a function, not of statutory definition, but of the interpretive approach of a court and the overall judicial culture of a jurisdiction? For some judges, insider trading will for long be something less reprehensible than the legislature intends. Thus, judicial attitude will for long remain a major enforcement problem. But even when judicial attitude in this general sense is altered, such aspects thereof as form part of established marketplace to the international investment community and to regulatory authorities, particularly those in the United States who are under increased political pressure to accord reciprocal treatment to EC firms.

Warren, supra note 195, at 1040. It is instructive that in many EU countries, even after implementation of the Insider Dealing directive through national legislation, there has not been a significant improvement in prosecutions and convictions for insider trading violations. Concerning the situation in several of these countries, see generally, INTERNATIONAL INSIDER DEALING (Mark Stamp & Carson Welsh eds., 1996).

215 In Germany for example, the Second Financial Markets Promotion Act (FMA) was passed in 1994 to give effect to the directive. In clarifying the directive's "precise nature" element of inside information, the FMA distinguishes between insider facts on the one hand, and analyses on the other. "The narrowly construed wording may provide an escape hatch for accused insider traders who can successfully claim their inside information was not factual in nature." Standen, supra note 28, at 203.

interpretive traditions and procedural approaches will stand unchanged. Rule 10b-5 or other statutory enactment of the insider trading prohibition will often be nurtured differently in different jurisdictions, and this will in many cases militate against the attainment of the scope of prohibition necessary to achieve the SEC goal of comprehensively protecting U.S. investors and interests globally.

IV. Recommendations and Conclusion

A predictable conclusion from the foregoing discussion of the problems of regulating international insider trading is that the SEC should discontinue its international crusade against such transactions and take a restrained view of its jurisdiction, thus giving room for other countries' regulators to determine the necessity for, and scope of, insider trading regulation within their domains. As a corollary to this, any concerted efforts to regulate the subject globally should only be in the context of a rigorously negotiated, broad-based, international agreement that seeks to accommodate the interests and objections of other countries. However, it would be naïve, in the context of the entrenched institutional interests and strong passions elicited within the United States by insider trading, to expect that such a radical prescription would find acceptance within the regulatory establishment. It is therefore more realistic to seek a middle course of sorts, that affords U.S. regulators the opportunity of controlling international insider trading in some circumstances, but not in others.

In a 1995 piece, a professor and former SEC commissioner notes the dilemma that globalized markets pose for the SEC: "how to accommodate its mandate of investor protection and [i] the growing interest of U.S. investors in diversifying across the globe, and [ii] the interest of the U.S. financial community in having foreign issuers use the U.S. capital markets."\(^{217}\) He reaches conclusions generally consistent with the need for the SEC to regulate less in the international context, especially through experimentation with international reciprocity.\(^{218}\) However, he nevertheless finds the extra-territorial application of U.S.

\(^{217}\) Longstreth, \textit{supra} note 29, at 320.

\(^{218}\) \textit{Id.}
securities laws excusable, where foreign activities harm U.S. investors.\footnote{Id. at 336.} This sort of instinctive inclination towards extraterritoriality on account of the “interest of U.S. investors” lies at the center of the regulatory problems with insider trading discussed in this paper. The fact that in this instance, the statement issues from an ex-regulator who is otherwise amenable to reduced extra-territoriality is indicative of the addictive qualities of this cliché and the psychological disposition that fuels it. From constant usage, this cliché has acquired the character of a mathematical constant, becoming a veritable starting point in analysis rather than the conclusion that it should ordinarily be. Yet, in today’s constantly evolving world, fast-paced change is the norm, with little room for fossilized clichés.

In light of the foregoing, there is a need to analyze the content of “interests of U.S. investors” in the context of the international regulation of insider trading. What exactly is the content of that phrase or idea for purposes of insider trading in the globalized financial markets? Given the likelihood of a multiplicity of contents, how best can the several aspects of the “interests of U.S. investors” be satisfied? Is it even remotely possible that such interests are better served in the long-term through a redefinition to make it capable of accommodating the interests of non-U.S. investors and regulators? Even if not redefined, can it in its current configuration, be administered in such a way as to accommodate other interests? Several other similarly relevant questions can be posed. However, exploring the last question, by seeking ways of administering U.S. investors’ interests in a manner accommodating of other interests, seems the least onerous of the possible approaches. Moreover, it holds a good prospect of establishing that middle course of sorts, first mentioned above, that affords U.S. regulators the opportunity of controlling international insider trading in some circumstances, but not in others. It potentially aligns the competing interests, without going through the sensitive task of redefining U.S. investors’ interests or questioning the assumptions underlying their current shape, a task that is likely to be very political in nature. With this in mind at least two approaches commend themselves for consideration in relation to international insider trading, and international securities
regulation more generally.

A. Nationality of Issuer

This involves an arrangement whereby each country applies "its insider trading regime to transactions in shares of issuers of its nationality" only.\(^{220}\) In effect, even if the insider trading transaction occurred on a particular country's stock exchange and involved its citizens, the transaction will not be regulated by that country if the issuer of the securities involved does not have that country as its nationality. This is an approach canvassed by Professor Merrit B. Fox.\(^{221}\)

For this purpose, nationality is not treated as the place of an issuer's incorporation. Rather, drawing on the continental European "real seat" doctrine, an issuer is considered a national of a country when "the largest portion of its shares is held by residents of that country, and the largest portion of its operations is conducted there."\(^{222}\) This test or approach leads to situations which on the surface appear skewed. The United States would find that a purchase on the New York Stock Exchange of the shares of Mercedes Benz AG by an insider with material, non-public information was not a violation of U.S. insider trading laws, even if the seller and purchaser were U.S. residents or nationals. German insider trading laws would apply, Germany being the country whose residents hold the largest portion of Mercedes Benz shares, and the place where the company conducts a greater portion of its operations. Along the same lines, the United States would find that an insider's purchase on the Frankfurt stock exchange of General Motors stock was a violation of U.S. insider trading laws, even if both parties to the transaction were German nationals or residents.

These results seem skewed, since the application of German law instead of U.S. law in the first case runs contrary to the established "investor protection" tradition of U.S. securities regulation, while application of U.S. law to the second transaction on the Frankfurt stock exchange appears very intrusive. However, by focusing on corporate law (rather than securities per se), and by

\(^{220}\) Fox, supra note 122, at 302.

\(^{221}\) Id. at 294–95.

\(^{222}\) Id. at 275 n.26.
exploring the transactions through the prism of the interests served by insider trading rules of each jurisdiction, we see that the results are far from being skewed. It is a fact that the purchase of real estate with insider information is not penalized by the law in the same way as the purchase of securities, even though the same type of information is involved. From this, it can be surmised that the policy behind the law's prohibition of insider trading in securities is a reinforcement of the general strictures against self-interested behavior by corporate insiders, rather than reinforcement of any general notion of fairness in the circumstances. This justifies the reach of U.S. and German insider trading laws in the above examples. The underlying policy being the restraint of self-dealing by insiders and the resultant negative effects on the corporation, it is quite normal for this to be regulated by German law for Mercedes Benz, and U.S. law for General Motors. Beyond the fact of corporate governance issues being ordinarily within the purview of these jurisdictions for the respective companies, there is also the very important point that the country of a company's nationality will often be best positioned to reach the respective insiders and prosecute them. Thus, their jurisdiction is effective, which "is an important value in and of itself because it reinforces the legitimacy of a regulatory regime."²²³ The approach effectively entrusts to the government of the country of a company's nationality the task of regulating insider trading affecting the company's insiders, as an adjunct of its corporate regulatory jurisdiction.

The chief attraction of this approach for purposes of this paper is that, "by the transactions it assigns to each government, [it] concentrates the effects of the regime that the government chooses—whether those effects turn out to be good or bad—on the residents of the country the government represents."²²⁴ In essence, it potentially internalizes any tendencies of the country's regulator to be unduly aggressive or high-handed. Also related to this is its likelihood to minimize conflict between countries because only one country will be entitled to regulate a cross-border insider trading transaction.

There are, however, some potential setbacks to the approach.

²²³ Id. at 300.
²²⁴ Id. at 299.
First is the fact that it assumes that even when there is a multiplicity of countries with potentially conflicting claims to an interest in regulating a particular insider trading transaction, one of them will always emerge clearly as the nationality of the issuer. This is not always the case, especially when dealing with true multinationals whose operations are evenly laid out in several countries. Professor Fox’s solution is that there are relatively few such companies today, and that for these the place of incorporation or simply the seat of their governance (headquarters) should be used as a default rule.\(^2\) He concedes however that in the long run, increases in transnational portfolio investments and transnational direct investments “could render the recommended approach unworkable,” as a large proportion of the world’s production becomes undertaken by firms whose operations are so structured that “no clear national center of gravity” will be discernible.\(^2\)\(^6\) “Arrival at this point . . . rather than indicating the need for a new principle to determine the reach of national regulation, will signal that the entire system of national-level regulation of corporate law and insider trading will have become obsolete.”\(^2\)\(^7\)

Another possible point concerning the approach is that it would require a great deal of cooperation between regulators. Inability to garner such cooperation will be its undoing. However, cooperation is an absolute necessity for any form of effective global regulation of insider trading. It is a common denominator. Even the SEC in its current largely unilateral approach to international insider trading regulation needs to elicit the cooperation of other regulators, sometimes by coercion, in order to achieve its aim. This therefore does not diminish the appeal of the approach, as a possible way for a reasoned reciprocal restraint on extra-territorial extension of insider trading regimes.

**B. Portable Reciprocity**

The theory of portable reciprocity was developed by Professors S. Choi and T. Guzman in a recent piece.\(^2\)\(^8\) While

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\(^{225}\) *Id.* at 299 n.73.

\(^{226}\) *Id.*

\(^{227}\) *Id.* at 302.

\(^{228}\) Choi & Guzman, *supra* note 48.
developed with the general field of securities regulation in mind, the specific needs of insider trading regulation in a global market place also received attention.

The piece notes the assumption of the current U.S. securities regulatory regime that Americans are unable to discount for the loss of the protection provided by U.S. securities laws, and that U.S. regulation indeed acts as a valuable form of protection. These assumptions are the standard justifications for extending the reach of the U.S. regime extraterritorially, to transactions taking place in other jurisdictions and having some effect on U.S. markets and investors. Rule 10b-5 is an aspect of the U.S. regime that is sometimes extended in this way. It notes in particular that the extra-territorial application of Rule 10b-5 to deal with the increasing internationalization of the securities markets are "misguided" for several reasons, including the fact that it potentially leads to a policy subjecting any securities transaction in the world to U.S. law. Choi and Guzman also note the existence of normal reciprocity as exemplified in the Multijurisdictional Disclosure System (MJDS) between Canada and the United States, and propose portable reciprocity as a means of taking this much further.

Portable reciprocity involves an arrangement between a group of countries, whereby an issuer may select the laws of any of the participating countries to govern a particular transaction, such as a stock issue. The law chosen need not be the law of the place of the transaction or the law of the company's nationality (by whatever criteria this is defined). This approach effectively delinks the choice of a capital market from the choice of a regulatory regime. Thus, choosing to use the U.S. capital markets would not necessarily mean a choice of U.S. securities law. Furthermore, an issuer's sale of securities under the regime of a particular country does not preclude a subsequent issue under the regime of another country. Each issue is so designated and

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229 Id. at 905 n.9, 911.
230 Id. at 915.
231 Id. at 907.
232 Id. at 937.
233 Id.
234 Id.
marked that the regime under which it is issued is apparent. The regime under which an issue was effected becomes a sort of personal law attaching to the securities in that issue, and regulating subsequent transactions therein, including insider trading.

In the context of this paper, the chief advantage of portable reciprocity stems from the fact that it effectively “rejects territorial notions of jurisdiction and allows securities market participants to choose the most appropriate regulatory regime for themselves. By rejecting territorial-based jurisdiction, portable reciprocity essentially allows securities market participants to determine the jurisdictional reach of different countries’ regimes” through the choice they make to use it or ignore it.\textsuperscript{235} The costs and problems of the SEC’s present approach to global insider trading regulation will be considerably attenuated by portable reciprocity through the SEC’s recognition of transactions under less stringent rules of other jurisdictions, which transactions would hitherto have been the subject of SEC enforcement action if American investors’ interests are implicated. Portable reciprocity has other advantages such as increased investor choice stemming from the potential availability of a greater variety of securities.\textsuperscript{236}

A major source of apprehension, however, is the possibility that portable reciprocity will lead to a race to the bottom between securities regulators. This is not necessarily so, as Choi and Guzman show, since each regime should have its own attractions, and the most lax regime need not necessarily attract the most patronage.\textsuperscript{237} The U.S. regime for instance would be seen as a quality regime for high quality issues, so that securities to which such image is essential would naturally seek to be regulated under that regime. They will not only enjoy a premium on price, but also the positive signal to the market concerning the quality of the issue and issuer generally. Those securities and issuers operating under less strict regimes will have to suffer a discount on their prices, in order to compensate for their lower quality.\textsuperscript{238}

Portable reciprocity additionally has advantages over the nationality approach. It is in particular a long-term approach

\textsuperscript{235} Id. at 921.
\textsuperscript{236} Id. at 922.
\textsuperscript{237} Id. at 923–24.
\textsuperscript{238} Id. at 922–24.
Unlike the nationality approach, which is admittedly mid-term, and would need to be dropped when the present pattern of global investment changes to a level where it is difficult to locate a clear national center of gravity. Therefore, portable reciprocity is the regulatory approach of the near and far future.

Each of the two approaches described above, even if fully accepted and implemented, is still but a half-way house, a compromise that imposes substantial but not complete restraints on extraterritorial application of insider trading laws. They do not address fully or eliminate some of the enforcement problems raised in this paper. Portable reciprocity for instance, even if adopted, does not define or constrain the enforcement actions and procedures that may be adopted by the SEC when a Swiss trader in Switzerland trades with inside information on securities whose issuer has voluntarily chosen U.S. law.\textsuperscript{239} Will the SEC take the Constitution off like a coat in the process of investigating and punishing such a trader, thus putting fundamental rights in jeopardy?\textsuperscript{240} A sense of restraint and global responsibility is

\textsuperscript{239} One approach might be for the SEC to ask the Swiss authorities to take enforcement action on its behalf. The chance of this happening is remote, however, given the SEC's current mindset on enforcement.

\textsuperscript{240} Cf. Ron Chepesiuk, Hard Target: The United States War Against International Drug Trafficking 78 (1999). Professor Andreas Lowenfeld, criticized the U.S. invasion of Panama in 1989 and the removal of its ruler, Manuel Noriega, to the United States on drug charges. He noted that the “DEA and the FBI take off the [U.S.] Constitution like a coat when they cross the border . . .” leading to much abuse of fundamental liberties. \textit{Id.} It is indeed possible to take much further, a comparison of the international drug law enforcement activities of the Drug Enforcement Administration (DEA) and Federal Bureau of Investigation (FBI) with the international insider trading initiatives of the SEC. First, narcotics, like insider trading, is a disproportionately American problem. America has six percent of the world's population, but consumes fifty percent of its mind-altering substances. \textit{Symposium: Towards a Compassionate and Cost-Effective Drug Policy: A Forum on the Impact of Drug Policy on the Justice System and Human Rights}, 24 FORDHAM URB. L. J. 315, 323 (1997) [hereinafter \textit{Symposium}].

Similarly, insider trading is a disproportionately American problem. The fervor with which American jurisprudence abhors insider trading and the expressive language with which it is described is unsurpassed. This is evidenced for instance by the following statement made in 1984 by Senator D'Amato (R-NY): “I concur wholeheartedly with John Fedders, the Director of the SEC's Division of enforcement, that insider traders are thieves.” \textit{Hearing Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs}, 98th Cong. 1 (1984) (statement of Sen. D'Amato, Chairman, Senate Subcomm. on Securities). See Amir Licht, Securities Regulation in a World of Interacting Securities Markets, Ch. 4, 4–61 (1998)
perhaps ultimately the only constraint on such excesses.

While the foregoing approaches are certainly not complete solutions, they do indicate that with an open mind better solutions can be found to global insider trading than the current unilateral inward-looking approach of the SEC. As globalization proceeds apace, the concept of a national economy and its regulation will gradually become empty and frustrating attempts at closing ever-widening gaps in the national systems. A broader perspective becomes necessary in defining national interests in a manageable way, in seeking novel approaches to the management of such interests, and indeed, in knowing when such interests should be abandoned or restructured in the context of new realities. The SEC will have to engage in this process more readily than it hitherto has done.

(Unpublished SJD dissertation, Harvard Law School) (on file with Harvard Law Library). The common result is that when the SEC or the DEA goes after offenders in foreign lands, or takes other action having extraterritorial effect, such moves are supported by the feeling within the United States that no sacrifice is too great to stem these vices. This is, however, counterbalanced by a feeling in foreign lands that this is a case of the United States putting the burden of its problems on other countries. This is more true in relation to insider trading, given its apparently weaker normative foundation. Even more revealing than the foregoing is agency resistance to change that results largely from the encrustation of secondary objectives and vested interests as a burden and hindrance on the primary statutory mandates of both the SEC and the DEA. As already noted, supra notes 139–43 and accompanying text, both the SEC itself and other constituencies, especially market professionals and securities lawyers, possess vested interests in continued regulation, leading to a displacement of the public's own interests. This appears to be even more so in relation to the regulation of narcotics. There, the vested interests are gargantuan. Drug law enforcement has become a business and a profession. Worse than the professionals at the SEC, the DEA professionals are mono-service professionals. If drugs were to suddenly become legalized, they would likely be displaced professionally, unless substantially retrained and reabsorbed. (The SEC's professionals on the other hand could still continue with other aspects of securities regulation, even if insider trading were to be de-proscribed.) The thinking in some quarters is that the drug enforcement business is so entrenched that getting rid of it is a major obstacle on the path of fresh and more effective thinking on the narcotics problem. The major components of what has been referred to as the prison-industrial complex include unions of prison guards and correction officers as well as private enterprises involved in the business of imprisonment, some of the latter having enough financial prospects to merit listings on the stock exchange. See generally, Symposium, supra note 240.