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From Texas Gulf Sulphur to Laudato Si': Mining Equitable Principles from Insider Trading Law

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FROM *TEXAS GULF SULPHUR* TO *LAUDATO SI'*: MINING EQUITABLE PRINCIPLES FROM INSIDER TRADING LAW

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ABSTRACT

In SEC v. Texas Gulf Sulphur, *the Second Circuit declared that all investors trading on impersonal exchanges should have equal access to material information, and therefore anyone who possesses material inside information must either turn it over to the investing public or not trade. The broad reach of that insider trading prohibition sent shock waves throughout the financial markets and encountered significant judicial resistance from the Supreme Court.*

Although the Supreme Court initially rejected the insider trading prohibition announced in Texas Gulf Sulphur, *the fundamental equitable trading principles underlying that decision have endured. This article shows that* TGS *was more than a case about insider trading. It established the fundamental inequity and unfairness of misappropriating resources that are meant to be shared. This article will trace the evolution of those equitable principles from* TGS *to the Supreme Court's current insider trading law. I also suggest that those principles have much in common with both the teachings of Pope Francis in* Laudato Si' *and with the latest research regarding sustainable economic productivity within a robust capitalist system.*

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I. INTRODUCTION

IN *SEC v. Texas Gulf Sulphur* (*TGS*), the Second Circuit declared that all investors trading on impersonal exchanges should have "relatively equal access to material information," and therefore anyone who possesses material inside information must either turn it over to the investing public, or not trade.[1] As predicted by Judge Waterman, who authored the opinion for an en banc court, it was "going to have a hell of an impact on the financial world."[2]

Indeed, before 1968, no securities statute, regulation, or governing precedent appeared to mandate that investors ensure that other investors have equal access to material, non-public information before they could trade on the open market.[3] What *TGS* did was give judicial endorsement to the view that insider trading is inherently inequitable—*no matter who does it*. *TGS* deemed insider trading to be a "constructive fraud" on the market, and thus subject to the securities laws' anti-fraud provisions.[4] Constructive fraud is an equitable concept that enables a court to construe that "a person or entity has gained an unfair advantage over another by deceitful or unfair methods."[5] *TGS* fashioned this rule of equity to address the perceived unfairness of insider trading: that *no one*—no director, officer, fiduciary, or otherwise—may trade on the basis of inside information without disclosing it first, and if that person cannot disclose it, then he or she simply cannot trade.[6]

The magnitude of applying *TGS*'s disclose-or-abstain rule to *all* market traders—not just fiduciaries or those under some traditional common-law obligation—is evident from how quickly the courts, regulators, and commentators tried to retreat from it. Almost immediately, there were reservations about *TGS*'s application to everyone. Did the securities laws really intend to prohibit market trading by *any* person who comes to have material information not yet in the public domain? The Supreme Court quickly said no, and seemed to put to rest *TGS*'s sweeping application of its disclose-or-abstain rule.[7]

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1. *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968) (en banc).
2. Alan M. Weinberger, *Forever Young: Texas Gulf Sulphur Rules at Fifty*, 45 Sec. Reg. L. J. 23 n.2 (Spring 2017).
3. *See* Stephen M. Bainbridge, *Equal Access to Information: The Fraud at the Heart of Texas Gulf Sulphur* 7–13 (UCLA Sch. of Law, Law & Econ. Research Paper Series, Research Paper No. 17-14, 2017), https://ssrn.com/abstract=3014977 [http://perma.cc/5KM6-3AJN].
4. *See Texas Gulf Sulphur*, 401 F.2d at 855.
5. *See Fraud*, Black's Law Dictionary (10th ed. 2014).
6. *See Texas Gulf Sulphur*, 401 F.2d at 848.
7. *See infra* Part III.

But *TGS*'s core principle, that insider trading is inherently inequitable—a constructive fraud on the market no matter who does it—has endured. In fact, the Supreme Court, the federal appellate courts, and the SEC continue to push the limits of insider trading jurisprudence beyond the limits of traditional common law fiduciary duties, getting closer and closer to *TGS*'s sweeping equitable scope.[8]

In this article, I trace the evolution of equitable principles from *TGS* to current insider trading law. Although the Supreme Court appears to have initially limited the reach of *TGS*'s equitable trading principles, the Court actually has built its insider trading doctrine on the foundation of the equitable trading principles established by *TGS*. I also suggest in this article that those equitable trading principles are aligned with both the teachings of Pope Francis in *Laudato Si'* and with the latest research regarding sustainable economic productivity within a robust capitalist system.

II. THE EQUITABLE PRINCIPLES IN *TGS*

A. Texas Gulf Sulphur and the Kidd Creek Mine

Texas Gulf Sulphur's discovery of the ore deposits that would eventually become the Kidd Creek Mine was spectacular. In the late 1950s, Texas Gulf Sulphur (TGS) began exploring the "Canadian Shield," a well-known source of precious mineral deposits in Eastern Canada.[9] After two years of searching, TGS's aerial magnetic imaging detected various anomalies often associated with the presence of ore-bearing rock.[10] For five days in November, 1963, a team of TGS employees drilled a sample from the land.[11] From the sample alone, "the glimmer of metals was visible to crew members as the . . . core containing ore sample was pulled from the ground."[12] In fact, one of the geologists who saw the sample was so excited by the results that he "jeeped 12 miles to a motel . . . where he called his immediate superior . . . at his home at midnight."[13] The next month, TGS sent the sample from Canada to a lab in Utah for a chemical assay. The results of that assay "were so remarkable that neither [TGS's electrical engineer and geophysicist], an experienced geophysicist, nor four other TGS expert witnesses, had ever seen or heard of a comparable

8. *See infra* Part IV.

9. *See Texas Gulf Sulphur*, 401 F.2d at 843. More thorough discussions of the facts in *TGS* can be found elsewhere. Professor Alan Weinberger, for instance, mines not only past U.S. court records, but also the legal proceedings in Canada. His discussion of the background in *TGS* is one of the most extensive and considered discussions to date. *See generally* Weinberger, *supra* note 2.

10. *Texas Gulf Sulphur*, 401 F.2d at 843. *See also* SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262, 282 (S.D.N.Y. 1966) ("[T]he geophysical survey conducted prior to the drilling . . . indicated a 'first class' anomaly over a length of more than 1,000 feet").

11. *See Texas Gulf Sulphur*, 258 F. Supp. at 271.

12. Weinberger, *supra* note 2. *See also Texas Gulf Sulphur*, 258 F. Supp. at 282 ("There is no doubt that the drill core . . . was unusually good and that it excited the interest and speculation of those who knew about it.").

13. Weinberger, *supra* note 2.

initial exploratory drill hole in a base metal deposit."[14] The sample, as described by others, was "one of the most impressive drill holes completed in modern times" and "just beyond your wildest imagination."[15] Experts for TGS, however, would later testify that the sample of the land and the initial assay findings were not necessarily reliable indicators of a significant ore-body that would make up an actual mine.[16]

Nevertheless, with the mere prospect of such a find, TGS employees immediately moved to cover their discovery.[17] The company stopped drilling. TGS's president told the drill team to keep the find "confidential and undisclosed even as to other officers, directors, and employees of TGS."[18] Professor Alan Weinberger captures the full extent of what TGS employees did to disguise the potential mine. TGS employees:

> ordered that the drilling be suspended and the discovery site camouflaged. Tractor tracks were covered by branches. Trees were planted over the original drill hole . . . . To confuse pilots working for competing mining companies who might fly overhead, the drill team set up an identical camp at the opposite end of the township.[19]

And for the next several months, TGS employees negotiated with nearby landowners for ownership or mining rights under strict instructions that they were not to tip off any owner to the potential find.[20] TGS finally bought up all the land it needed by March 1964 and had begun drilling additional samples to confirm its find.[21]

Meanwhile, however, rumors started circulating in nearby mining communities that TGS had hit on a valuable find.[22] Eventually, local papers picked up the rumors which made their way to the *New York Times* and the *New York Herald Tribune*.[23] TGS moved to silence this scuttlebutt, issuing an explicit press release on April 13, 1964: "The drilling done to date has not been conclusive. . . . When we have progressed to the point where reasonable and logical conclusions can be made, TGS will issue a definite statement. . . ."[24] By the time TGS had made this statement, it had drilled five different samples and received the results for one chemical assay confirming the presence of ore bodies and numerous promising

14. *Texas Gulf Sulphur*, 401 F.2d at 843.
15. *Id.* at 850–51.
16. *See* Weinberger, *supra* note 2.
17. *See id.*
18. *Texas Gulf Sulphur*, 401 F.2d at 843.
19. *See* Weinberger, *supra* note 2; *see also* SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262, 271 (S.D.N.Y. 1966) ("[F]ollowing the usual practice in the mining industry, security measures were put into effect. Further drilling on the anomaly was suspended and members of the exploration group were instructed to keep the results of K-55-1 confidential. The drill rig at the site of K-55-1 was moved away and cut saplings were stuck in the ground in the area of the hole to conceal its location. A second drill hole (K-55-2) was drilled off the anomaly in order to produce a barren core.").
20. *Texas Gulf Sulphur*, 401 F.2d at 843.
21. *Id.* at 844.
22. *See Texas Gulf Sulphur*, 258 F. Supp. at 285.
23. *Id.*
24. *Texas Gulf Sulphur*, 401 F.2d at 845.

visual estimates of the core.[25] But on that very same day, TGS invited a reporter from one of the Canadian publications to the Kidd Creek mine, allowed him to speak with various TGS employees, and gave him the drilling records to date.[26] The reporter prepared an article stating that a "major new zinc-copper-silver mine is definitely in the making."[27] TGS held this article for three days.[28]

Then, on April 16, TGS announced that, based on its drilling data, it had struck at least 25 million tons of ore and allowed the Canadian reporter to release his story.[29] Today, that site is home to the world's deepest mine below sea level, contains precious minerals worth $2 billion, and is singlehandedly credited for saving the Canadian town of Timmins.[30]

Before TGS announced its discovery to the investing public, its senior managers and employees who knew about the potential mine began to take advantage.[31] The president of TGS, directors on the board, and senior executives started scooping up TGS stock from the moment the company pulled the first sample from the ground.[32] One of TGS's directors actually left the April 16 press briefing to order more stock.[33] Some TGS geologists and engineers—and their wives—were also buying what they could after the company drilled the initial sample in November 1963—a year before the public announcement.[34] And they tipped off friends and relatives, who in turn touted the stock to others.[35] In all, before TGS drilled the initial sample, the defendants owned 1,135 TGS shares, but by the time TGS announced its find to the public, the defendants owned 8,235 shares and 12,300 calls.[36]

TGS's stock price shot "from about $18 per share at the time the ore body was discovered to more than $31 at the time the discovery was made public."[37] By the end of the next month, the stock was trading at $58 per share.[38] In fact, TGS "was the most actively traded stock on the New York Stock Exchange in 1964."[39]

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25. *See Texas Gulf Sulphur*, 258 F. Supp. at 271–72.
26. *Id.* at 285.
27. *Id.*
28. *Id.*
29. *Texas Gulf Sulphur*, 401 F.2d at 846.
30. *See* Weinberger, *supra* note 2. One of the TGS employees who discovered the orebody that would eventually become the Kidd Creek Mine in the town of Timmins was inducted into the Canadian Mining Hall of Fame, and another TGS employee is considered a local folk hero. *Id.*
31. *See Texas Gulf Sulphur*, 258 F. Supp. at 281–95.
32. *See id.* at 273.
33. *Id.* at 288.
34. *Texas Gulf Sulphur*, 401 F.2d at 891.
35. *Id.* at 841 n.4.
36. *Id.* at 844.
37. Weinberger, *supra* note 2.
38. *Id.*
39. *See id.*

B. *Cady, Roberts* and the SEC *TGS* Prosecution

The attention surrounding TGS and its securities during this time was intense, and almost immediately the SEC zeroed in on the trading in TGS securities.[40] The SEC brought suit against the usual defendants—TGS's president, general counsel, and two directors.[41] But the SEC also went after the lower-level employees who traded as well—the geologists, the scientists, and others who bought up TGS stock.[42] The SEC charged these defendants with violating § 10(b) of the Securities Exchange Act of 1934 (the 1934 Act) and Rule 10b-5.[43] § 10(b) of the 1934 Act makes it unlawful for anyone to engage in any manipulative or deceptive conduct or otherwise employ any "contrivance in contravention" of the rules the SEC prescribes "as necessary or appropriate in the public interest or for the protection of investors" while trading securities.[44] Rule 10b-5 makes it unlawful for anyone to lie, speak half-truths, mislead, defraud, or deceive while trading in securities.[45]

Finding equitable principles underlying the federal securities laws, the SEC contended that insider trading was a "constructive fraud" in violation of Rule 10b-5. The SEC contended that had disclosure been made to the public, other market traders would not have traded, or would have done so at a different price. This framing allowed the SEC to satisfy the statutory prerequisite for Rule 10b-5 liability. But the underpinnings of this theory were soft, and without any inducement of shareholder trading, it was unclear how insider trading could be not just unfair, but actually fraudulent.[46]

When the SEC brought its case, the agency was headed by William L. Cary, who had authored *Cady, Roberts* a few years prior.[47] That decision set forth his view that insider trading—no matter the perpetrator[48]—is

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40. *See Texas Gulf Sulphur*, 401 F.2d at 833.
41. *Id.* at 839.
42. *See id.*
43. *Id.*; *see* 15 U.S.C. § 78j(b) (2012); 17 C.F.R. § 240.10b-5 (2017).
44. 15 U.S.C. § 78j(b) (2012).
45. *See* 17 C.F.R. § 240.10b-5 (2017).
46. Transforming insider trading into some sort of fraud or deception such that it would fit neatly within § 10(b) and Rule 10b-5 required jumping through a series of syllogisms that legal scholars have found less than satisfactory. *See, e.g.*, A.C. Pritchard, United States v. O'Hagan*: Agency Law and Justice Powell's Legacy for the Law of Insider Trading*, 78 B.U. L. Rev. 13, 22–30 (1998); Jill E. Fisch, *Start Making Sense: An Analysis and Proposal for Insider Trading Regulation*, 26 Ga. L. Rev. 179, 189–93 (1991); Donald C. Langevoort, *Insider Trading and the Fiduciary Principle: A Post-*Chiarella *Restatement*, 70 Cal. L. Rev. 1, 8 (1982).
47. *See In re* Cady, Roberts & Co., Exchange Act Release No. 34-6668 (Nov. 8, 1961), 1961 WL 60638, at *1–3. That decision is widely regarded as one of the most important administrative opinions ever issued by the SEC. *See, e.g.*, Walter Werner, *Bill Cary and the SEC*, 83 Colum. Bus. L. Rev. 767, 767 (1983). In *Cady, Roberts*, a broker sold shares in a company following a phone call from a director of that company in which the director told the broker that the company was going to cut its dividend. *Cady, Roberts*, 1961 WL 60638, at *2. The SEC took the position that the broker was obligated to abstain from trading until the information became public. *See id.* at *3.
48. "[A]ny sales by the insider must await disclosure of the information." *Cady, Roberts*, 1961 WL 60638, at *5. *See also* Joel Seligman, *Memories of Bill Cary*, 2013 Colum.

inherently unfair to other market participants, and that existing laws did not adequately reach or remedy this unfairness.[49] *Cady, Roberts* acknowledged the "special obligation[s]. . . required of corporate insiders—officers, directors, and controlling stockholders"—that appeared to limit the reach of the securities laws, but countered that the securities laws' anti-fraud provisions are also phrased in terms of "any person."[50] The SEC made it known that it was concerned not only with trading by those whose relationship gave them "access, directly or indirectly, to information intended to be available only for a corporate purpose" but also with "the plight of the buying public—wholly unprotected from the misuse of special information."[51] Nothing in the securities laws, nor Rule 10b-5, according to *Cady, Roberts*, would require "artificial walls of responsibility" for proper use of inside information.[52]

Cady, Roberts was, and largely is, in line with common perception, because the public generally perceives that insider trading is just plain unfair.[53] The public views insider trading as "unfair," but not necessarily evil or immoral in itself.[54] Rather, the public's irritation with insider trading appears less to do with the insider than with the inability of persons to trade under similar circumstances themselves.[55] Professor Stephen Bainbridge captures this point very well: "Most people want insider trading to remain illegal, but most people . . . are willing to participate if given the chance to do so on the basis of accurate information."[56] In other words, the unfairness underlying insider trading is its inequity. Insider trading prohibitions help to create the perception that all investors who trade on

Bus. L. Rev. 318, 321 (2013) (stating that the SEC under Commissioner Cary "kept as a mission the reduction of opportunities for . . . corporate insiders to take advantage of their positions, as well as a general commitment to raising fiduciary standards").

49. *See Cady, Roberts*, 1961 WL 60638, at *1, *3 (acknowledging the decision as one "of signal importance," describing the "purchase and sale of securities" as a "field in special need of regulation for the protection of investors," and stating that the securities laws "generated a wholly new and far-reaching body of Federal corporation law"). *See also* Donald C. Langevoort, *"Fine Distinctions" in the Contemporary Law of Insider Trading*, 2013 Colum. Bus. L. Rev. 429, 430 (2013) ("By all accounts, William Cary, then Chairman of the Securities and Exchange Commission, . . . wanted to promote a wide scope to Rule 10b-5, which would include fiduciary breaches (i.e., constructive fraud), as well as classical common law deceit, and thus help build a federal body of corporate law that would supplement, if not supplant, the meager efforts of state courts and legislatures."); Donald C. Langevoort, *Rereading Cady, Roberts: The Ideology and Practice of Insider Trading Regulation*, 99 Colum. L. Rev. 1319, 1320 (1999) (describing *Cady, Roberts* as a "new corporation law" case); Seligman, *supra* note 49, at 326–27 (describing how SEC Commissioner Cary's *Cady, Roberts* decision "broadly expanded" Rule 10b-5 and restrictions on insider trading).

50. *Cady, Roberts & Co.*, 1961 WL 60638, at *4.

51. *Id.* at *4, *5.

52. *See id.* at *5.

53. *See, e.g.*, Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties Into the Federal Insider Trading Prohibition*, 52 Wash. & Lee L. Rev. 1189, 1241 & n.219 (1995); Langevoort, *supra* note 50, at 1326.

54. *See* Bainbridge, *supra* note 53, at 1242.

55. *See id.*

56. *Id.*

the open market do so on a relatively equal plane.[57]

When someone in a position of trust or power trades on inside information, that sort of insider trading is viewed as not only unfair, but also an abuse of that person's position. Professor Donald Langevoort hints at this dynamic, acknowledging that tales of insider trading involving "the rich and famous like Ivan Boesky and Michael Milliken . . . tap into images of power, greed, and hubris," yet "when [the tales] deal with the smaller traders, they conjure up images of Everyman with luck and far too little self-restraint."[58] Someone already in a position of power or trust taking advantage of inside information is not only unfair, but is an abuse of power. For confirmation, we need look no further than the plaintiff's bar. Plaintiffs' lawyers will look for evidence of insider trading by senior management when evaluating whether to invest in bringing a private securities-fraud class action. Insider trading by corporate executives can be used to turn the jury against those defendants.[59] It is even judicial doctrine that insider trading by senior management can give rise to an inference that management was acting with the intent to get one over on the investing public.[60]

57. *See, e.g.*, Joel Seligman, *The Reformulation of Federal Securities Law Concerning Non-public Information*, 73 GEO. L. J. 1083, 1115 (1985) (contending that "[t]he primary policy reason for proscribing trading while in possession of material, non-public information is to make investors confident that they can trade securities without being subject to informational disadvantages."). Insider trading continues to be a central feature of the SEC's enforcement program. *See, e.g.*, U.S. Sec. & Exch. Comm'n, Division of Enforcement, ANNUAL REPORT: A LOOK BACK AT FISCAL YEAR 2017, 4 (2017) (stating that insider trading will be one of several priorities for the SEC Enforcement Division); Thomas C. Newkirk & Melissa A. Robertson, U.S. Sec. & Exch. Comm'n, Speech by SEC Staff: Insider Trading – A U.S. Perspective (Sept. 19, 1998) ("An essential part of our regulation of the securities market is the vigorous enforcement of our laws against insider trading, an enforcement program, the Chairman noted, that 'resonate[s] especially profoundly' among American investors.").

Whether the securities laws *should* address this unfairness is another matter, and on that, there are conflicting views. *See, e.g.*, Stephen Bainbridge, *The Insider Trading Prohibition: A Legal and Economic Enigma*, 38 U. FLA. L. REV. 35, 42–61 (1986) (summarizing the arguments for "deregulating" insider trading, stating that insider trading would move the price closer to its true value and is an efficient way to compensate managers; conversely, summarizing the arguments for "regulating" insider trading and stating that insider trading is not a cost-effective mechanism for promoting market efficiency or compensating managers, and even still, creates substantial social costs and fairness concerns); George W. Dent, Jr., *Why Legalized Insider Trading Would be A Disaster*, 38 DEL. J. CORP. L. 247, 248 (2013) (contending that legalized insider trading would "muscle out" the investing public, shrink stock markets, and cause managers of public companies to forsake their investors for personal gain); Ian B. Lee, *Fairness and Insider Trading*, 2002 COLUM. BUS. L. REV. 119, 150–91 (2002) (summarizing arguments for and against regulation of insider trading and making a "fairness" case for the regulation of insider trading).

58. Langevoort, *supra* note 49, at 1329.

59. *See* MICHAEL J. KAUFMAN & JOHN M. WUNDERLICH, RULE 10B-5 PRIVATE SECURITIES-FRAUD LITIGATION § 3:2 (2018 ed.) (summarizing factors suggesting a factually strong case for a Rule 10b-5 private plaintiff, including that the "company's senior officers or directors engage in suspicious selling of stock. Insider trading appeals to a jury and may evidence fraudulent intent.").

60. *See, e.g.*, No. 84 Emp'r-Teamster Joint Council Pension Tr. Fund v. Am. W. Holding Corp., 320 F.3d 920, 938–41 (9th Cir. 2003) (holding that the district judge could strongly infer the defendants acted with scienter by virtue of insiders selling nearly all of their stock before the company released bad news about potential government sanctions);

C. THE *TGS* DECISION

The SEC sought to use *TGS* as the vehicle to get judicial endorsement for *Cady, Roberts*. At the district court level, however, the SEC lost.[61] The district judge believed insider trading by those who abuse their positions was something worthy of insider trading laws, but the mere inequity or unfairness of insider trading was not.[62]

On appeal, however, the SEC's view found allies in an en banc panel of Second Circuit judges.[63] In *TGS*, the Second Circuit set out to protect investors from insider trading and to expand the securities laws that regulate the practice.

First, *TGS* endorsed the SEC's view that insider trading is inherently inequitable and unfair, no matter if the trader is in the corporate suite or otherwise, a fiduciary or not.[64] "[I]nequities based upon equal access to knowledge," the court said, "should not be shrugged off as inevitable in our way of life, or, in view of the congressional concern in the area, remain uncorrected."[65] So after *TGS* dismissed the idea that insider trading was simply a perk of inside status—"a normal emolument of corporate office"[66]—the court took aim at the other traders. The court was obviously troubled by trading on such inside information, with no distinction made for who the trader was:

> The insiders here were not trading on an equal footing with the outside investors. They alone were in a position to evaluate the probability and magnitude of what seemed from the outset to be a major ore strike; they alone could invest safely, secure in the expectation that the price of TGS stock would rise substantially in the event such a major strike should materialize, but would decline little, if at all, in the event of failure, for the public, ignorant at the outset

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Fla. State Bd. of Admin. v. Green Tree Fin. Corp., 270 F.3d 645, 656 (8th Cir. 2001) (stating that "trading at a particular time is circumstantial evidence that the insider knew the best time to trade because he or she had inside information not shared by the public" and "kept the information from the public in order to trade on the unfair advantage"); *In re* Apple Computer Secs. Litig., 886 F.2d 1109, 1117 (9th Cir. 1989) ("Insider trading in suspicious amounts or at suspicious times is probative of bad faith and scienter.").

61. *See* SEC v. Texas Gulf Sulpher Co., 258 F. Supp. 262 (S.D.N.Y. 1966).

62. *Id.* at 284 (quoting Spector Motor Service, Inc. v. Walsh, 139 F.3d 809, 823 (2d Cir. 1944) (Hand, J., dissenting)) ("It may be that the 'fairness' overtones of *Cady, Roberts* indicate a trend toward the elimination of all insider purchasing. But even were the Court to accept the proposition that all insider trading is unfair, a proposition of doubtful validity at best, it would be deterred by the admonition of Judge Learned Hand that it is not 'desirable for a lower court to embrace the exhilarating opportunity of anticipating a doctrine which may be in the womb of time, but whose birth is distant.'").

63. In fact, as Professor Langevoort recounts, by the time *TGS* came around, the Second Circuit had already set the SEC's position in motion, holding, just a few years earlier "that insiders had [an] obligation of affirmative disclosure when engaged in face-to-face securities transactions. Donald C. Langevoort, From *Texas Gulf Sulphur* to *Chiarella*: A Tale of Two Duties 5 (2017) (unpublished manuscript) (on file with Georgetown University Law Center).

64. *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 852 (2d Cir. 1968) (en banc).

65. *Id.*

66. *In re* Cady, Roberts & Co., Exchange Act Release No. 34-6668 (Nov. 8, 1961), 1961 WL 60638, at *4 n.15.

of the favorable probabilities would likewise be unaware of the unproductive exploration and additional exploration costs would not significantly affect TGS market prices.[67]

Second, to ensnare insider trading under the net of liability laid by Rule 10b-5, *TGS*, like *Cady, Roberts*, deemed insider trading a constructive fraud.[68] In so doing, *TGS* deliberately expanded what it perceived as "the limited protection afforded outside investors" under existing law, and then used this expansion to level the playing field for investors.[69] "The core of Rule 10b-5," the court said, "is the implementation of the Congressional purpose that *all* investors should have equal access to the rewards of participation in securities transactions."[70] In particular, to effectuate Congress's purpose of protecting the investing public and insuring the "maintenance of fair and honest markets," *TGS* modified the common law standard of deceptive conduct so that negligent insider conduct would also be unlawful.[71] And *TGS* found that the securities laws contained obligations that exceeded common law duties and prohibitions. At common law, the failure to disclose material, non-public information generally does not gives rise to an action for fraud in the absence of a duty to disclose. But that common law duty to disclose usually arises only when there is a pre-existing fiduciary duty among the parties. *TGS*, however, concluded that § 10b and Rule 10b-5 were designed to expand common law protections.[72]

Ultimately, *TGS* declared that

> anyone in possession of material inside information must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed.[73]

TGS's rule "was probably the broadest possible formulation of a prohibition against insider trading."[74]

At the time, it made sense for the Second Circuit to take up the mantle on expanding the securities laws; in the 1960s, the Second Circuit was the steward of the securities laws.[75] The Supreme Court was not as involved

67. *Texas Gulf Sulphur*, 401 F.2d at 852.
68. *See id.* at 855.
69. *Id.* at 851.
70. *Id.* at 851–52 (emphasis added). *See also id.* at 852 ("It was the intent of Congress that all members of the investing public should be subject to identical market risks—which market risks include, of course, the risk that one's evaluative capacity or one's capital available to put at risk may exceed another's capacity or capital.").
71. *Texas Gulf Sulphur*, 401 F.2d at 855.
72. *Id.* at 851. *See, e.g.*, Herman & MacLean v. Huddleston, 459 U.S. 375, 389 (1983) (stating that Congress enacted the federal securities laws "to rectify perceived deficiencies in the available common law protections").
73. *Texas Gulf Sulphur*, 401 F.2d at 848.
74. Charles W. Murdock, Insider Trading, in 8 ILL. PRAC. SERIES, BUSINESS ORGANIZATIONS § 15:11 (2d ed. 2017).
75. *See, e.g.*, Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting) (deeming the Second Circuit the "Mother Court" for securities juris-

in developing securities jurisprudence as it is today.[76] But the Second Circuit's decision in *TGS* was not just typical tending to the field; the decision was a fundamental pronouncement on how persons could trade in the market. As Professor Donald Langevoort writes, at the time of the decision, the judiciary generally was at its zenith in "pursuing a broad, expansive common law style of securities law jurisprudence" such that "courts were entitled and expected to add onto statutory obligations based on purely purposive reasoning."[77] Many scholars of the day viewed *TGS* as a remarkable expansion of (and for some, an alarming departure from) established SEC and judicial precedent at the time.[78] Under *TGS*, fiduciaries were not the only ones liable for insider trading.[79] The insider trading prohibition may have operated differently for non-fiduciary insiders, but it operated nonetheless. As summarized by Professor Stephen Bainbridge:

> [U]nder *TGS* and its progeny, virtually anyone that possessed material, non-public information was required either to disclose it to the investment public before trading or abstain from trading in the affected company's securities. If the would-be trader's fiduciary duties precluded him from disclosing the information prior to trading, abstention was the only option.[80]

In *TGS*, this meant that not just the company's Vice President, President, and directors were on the hook for their trading, but even the geologist was liable as well.[81]

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prudence); Karen Patton Seymour, *Securities and Financial Regulation in the Second Circuit*, 85 FORDHAM L. REV. 225, 225 (2016) ("From 1961 to 1978, the Second Circuit produced nearly five times as many securities law opinions as the average federal appellate court; the Second Circuit was responsible for one-third of all securities opinions issued by appellate courts.").

76. *See* A.C. Pritchard, *Securities Laws in the Roberts Court: Agenda or Indifference*, 37 J. CORP. L. 105, 106–07 (2011).

77. Langevoort, *supra* note 63, at 4.

78. *See, e.g.*, Bainbridge, *supra* note 57, at 37–39; Platt W. Davis III, *Rule 10b-5 Is Violated Whenever an Insider Purchases Stock Without Disclosing Information That Would Affect the Judgment of a Reasonable Investor*, 47 TEXAS L. REV. 509, 514 (1969) (stating *TGS* "may have inhibited severely the legitimate activities of imaginative and aggressive insiders."); Arthur Fleischer, Jr. et. al., *An Initial Inquiry into the Responsibility to Disclose Market Information*, 121 U. PA. L. REV. 798, 816 (1973) (stating that *TGS* "embodies a dramatic stretching of present doctrine" beyond just fiduciaries); Roberta S. Karmel, *Outsider Trading on Confidential Information – A Breach in Search of a Duty*, 20 CARDOZO L. REV. 83, 89 (1998) (stating that the "parity of information" theory upon which *Cady, Roberts* and *TGS* rest "ha[d] not been accepted by the Supreme Court or the SEC itself"); Roberta S. Karmel, *The Law on Insider Trading Lacks Needed Definition*, 68 SMU L. REV. 757, 760 (2015) (noting that parity of information "was not fully accepted by all SEC Commissioners and was later rejected by the Supreme Court"); Langevoort, *supra* note 63, at 2 (describing *Texas Gulf Sulphur* as a "blockbuster ruling[ ] at the time").

79. *See* SEC v. Texas Gulf Sulpher Co., 401 F.2d 833, 848 (2d Cir. 1968) (en banc).

80. Bainbridge, *supra* note 53, at 1194 (footnotes omitted).

81. *See Texas Gulf Sulphur*, 401 F.2d at 852.

III. LIMITING INSIDER TRADING PROHIBITIONS UNDER *CHIARELLA*

In *Chiarella v. United States*, the Supreme Court held that the insider trading prohibitions of the securities laws did not apply to *everyone* who has material, non-public information, but only to traditional common law *fiduciaries*.[82] The Court seemed to reject *TGS*'s result and reasoning, concluding that only traditional common law fiduciaries—i.e., those in positions of trust and confidence vis-à-vis the information—would be prohibited from trading on material, non-public information.[83] In the *Chiarella* Court's view, the securities laws do not espouse a principle of fairness and informational parity, as set forth in *TGS*.[84] Rather, one's trading obligations run with status, not mere possession of material, non-public information.[85] *Chiarella* seems to put to rest *TGS*'s equality-of-information principle:

> We cannot affirm petitioner's conviction without recognizing a general duty between all participants in market transactions to forgo actions based on material, non-public information. Formulation of such a broad duty, which departs radically from the established doctrine that duty arises from a specific relationship between two parties . . . should not be undertaken absent some explicit evidence of congressional intent.[86]

But then, using the "constructive fraud" concept set out by *TGS*, the Court said that under the common law silence can indeed constitute fraud, *but only* in the face an affirmative common law duty to disclose. Further, § 10(b) and Rule 10b-5 themselves do not create disclosure obligations not already present at common law. For those with material, non-public information, unless they have a special fiduciary status or some other common law obligation to disclose, their trading without disclosure is not fraudulent—constructive or otherwise—and thus beyond the reach of Rule 10b-5.[87]

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82. Chiarella v. United States, 445 U.S. 222, 233 (1980).

83. *See id.* On this issue, Professor Langevoort makes the case that even if *TGS* planted "some seeds of egalitarianism," even before *Chiarella*, "they bore surprisingly little fruit." Langevoort, *supra* note 63, at 10, 15 (surveying post-*TGS* decisions and enforcement actions and concluding that duty was "clearly becoming status-based, not possession-based" and noting that "the egalitarianism expressed in *TGS* was long gone by the time Justice Powell wrote the Court's opinion in *Chiarella*.").

84. *See Chiarella*, 445 U.S. at 232 ("[N]ot every instance of financial unfairness constitutes fraudulent activity under § 10(b).").

85. *See id.* at 235.

86. *Id.* at 233.

87. For the trader in *Chiarella*, this was dispositive. *See id.* at 224–25. While working for a financial printer, Mr. Chiarella gleaned from data contained in tender-offer materials the identities of five target companies. *Id.* Over the course of 15 months, he bought stock in targets before five different tender offer materials had been published, and sold the stock after the announcements of the offers drove the price up. *Id.* He was not a corporate insider. He wasn't wealthy or well connected. He set typeface and page layouts for various printer jobs. He was charged criminally, and the Second Circuit upheld his jury conviction, reasoning that Rule 10b-5 renders unlawful the mere receipt of material, non-public information where the recipient fails to disclose the information. *Id.* at 231. But the Supreme

IV. THE EVOLUTION OF *TGS*'S EQUITABLE PRINCIPLES AFTER *CHIARELLA*

While *TGS* did not immediately erect principles of equitable trading, its lasting contribution is that it gave life to the idea that insider trading is unfair—a "constructive fraud."[88] Since *Chiarella*, the SEC and the federal courts have stretched the concept of "insider" and "fiduciary," and have attempted other expansions that harken back to the equitable trading principles articulated in *TGS*. As Professor Donna M. Nagy writes, insider trading law has returned "almost full circle to the years preceding *Chiarella*."[89]

In *Dirks v. SEC*,[90] the Court appears to reaffirm *Chiarella*'s premise that § 10(b) and Rule 10b-5 do not contain any requirement of fairness, parity, or equal access to material information. *Dirks* also reiterated that

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Court reversed. *Id.* at 235. No common law duty arose from his relationship with the sellers of the securities because he "had no prior dealings with them. He was not their agent, he was not a fiduciary, he was not a person in whom the sellers had placed their trust and confidence. He was, in fact, a complete stranger who dealt with the sellers only through impersonal market transactions." *Id.* at 232–33.

88. *See, e.g.*, Sung Hui Kim, *Insider Trading as Private Corruption*, 61 UCLA L. Rev. 928, 945 (2014):

> The closer one looks at insider trading law, the messier it appears. In what seemed like a reasonable strategy, the Supreme Court initially adopted an insider trading as common law fraud approach. But as the Court sought to punish different sorts of trading misbehavior, it initiated doctrinal extensions and mutations, stretched even further in unexpected ways by lower courts, which now seem to threaten insider trading law's basic stability and internal coherence. Indeed, we now have reason to question the centrality of breach of fiduciary duty and even fraud.

Langevoort, *supra* note 63, at 15–16 (stating that "the spirit of *TGS* did return to push against the newly narrowed insider trading prohibition, and the nearly four decades since *Chiarella* have shown much more expansion than limitation in insider trading doctrine").

After *Chiarella*, the SEC itself sought to revive the rule of law on insider trading as set out in *TGS* and move the prohibition on insider trading beyond mere fiduciaries. *See, e.g.*, Marc I. Steinberg, *From the Editor-In-Chief*, 45 Sec. Reg. L. J. 1 (Spring 2017) (Professor Steinberg, who was an SEC attorney post-*Chiarella*, stating "the SEC . . . was displeased with the Court's narrow interpretation of the insider trading prohibition" in *Chiarella* and thus, "shortly after . . . opted to adopt an expansive insider trading prohibition within the confines of tender offer regulation"). The SEC adopted § 14(e), which adopted an expansive insider trading prohibition within the confines of tender-offer regulation. Rule 14e-3 prohibits any person from trading or tipping on material, non-public information if that person knows or has reason to know that such information was received directly or indirectly from an inside source. *See* 17 C.F.R. § 230.14e-3 (2017). There is no logical justification for treating insider trading in the context of a tender offer different than insider trading otherwise. *See, e.g.*, Steinberg, *supra* note 88 ("[D]isparate treatment in the tender offer setting as compared to other contexts signifies that a subject person's legality of trading and tipping is dependent on the form of the transaction. Hence, if the subject transaction is a merger, only § 10(b) applies with respect to insider trades. Yet if the transaction is structured as a tender offer, then Rule 14e-3 becomes applicable as well, thereby casting a wide liability net. It makes no sense that one can legally buy a luxurious penthouse or go to the slammer based on engaging in identical conduct—with the only differentiation that, for unrelated reasons, the 'deal' was structured as a merger or tender offer."). And yet, in the tender-offer context, *TGS* lives; outside it, *TGS* just haunts.

89. Donna M. Nagy, *Insider Trading and the Gradual Demise of Fiduciary Principles*, 94 Iowa L. Rev. 1315, 1320 (2009).

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

Rule 10b-5 would not reach insider trading absent some fiduciary or common law requirement to disclose: "there can be no duty to disclose where the person who has traded on inside information 'was not [the corporation's] agent, . . . was not a fiduciary, [or] was not a person in whom the sellers [of the securities] had placed their trust and confidence.'"[91]

As *Dirks* built on *Chiarella*, however, it also expanded its framework for liability in two ways, albeit still hewing closely to the idea that some fiduciary or common law relationship must exist before insider trading would be impermissible under the securities laws.[92] First, *Dirks* set up a framework by which persons could become constructive fiduciaries.[93] Under *Dirks*, someone is a constructive fiduciary when: (1) that person enters into a special confidential relationship in the conduct of the business of the enterprise, (2) is given access to information solely for corporate purposes, and (3) the corporation expects that the information will remain confidential.[94] Second, *Dirks* pushed the bounds of liability for insider trading further still to one who lacks a fiduciary duty to shareholders altogether.[95] According to *Dirks*, one could violate Rule 10b-5 if that person tips off another trader to material, non-public information that he came by "improperly."[96] Information is leaked "improperly" if the insider has breached a fiduciary duty to the corporate shareholders by disclosing the information to the tippee.[97] The tippee assumes or inherits the insider's fiduciary duty when that tippee knows or should know that there has been a breach.[98]

Still, there must be a link between the tippee's breach and the tippee's knowing or reckless use of the tipped information. That link is supplied when the insider benefits personally from the disclosure.[99] *Dirks* established the common law fiduciary duty and personal-benefit framework "in a case brought under the classical theory of insider-trading liability, which applies 'when a corporate insider' or his tippee 'trades in the securities of [the tipper's] corporation on the basis of material, non-public information.'"[100] "In such a case, the defendant breaches a duty to, and takes advantage of, the shareholders of his corporation."[101]

In *Salman*, the Supreme Court settled that a jury can infer a personal benefit where the tipper receives something of value in exchange for the tip or makes a gift of confidential information to a trading relative or

91. *Id.* at 654.
92. *See id.* at 654–55 (stating that a "duty must arise from a specific relationship between two parties").
93. *See id.*
94. *See id.* at 655 n.14.
95. *See id.* at 660.
96. *Id.*
97. *Id.* at 659.
98. *Id. See also* Kim, *supra* note 88, at 941 (describing how *Dirks* mutates the features of and ultimately departs from the fiduciary duty requirement to "reach the result that it wanted, namely, to proscribe tipping.").
99. *Dirks*, 463 U.S. at 662.
100. Salman v. United States, 137 S. Ct. 420, 425 n.2 (2016).
101. *Id.*

friend.[102] There, the Court reaffirmed that "§ 10(b) of the Securities Exchange Act of 1934 and the Securities and Exchange Commission's Rule 10b-5 prohibit undisclosed trading on inside corporate information by individuals who are under a duty of trust and confidence that prohibits them from secretly using such information for their personal advantage."[103]

In *Salman*, an investment banker employed at Citigroup repeatedly gave tips to his brother on pending mergers and acquisitions, knowing that the brother was using the information to trade.[104] That brother also passed those tips to a relative, Bassam Salman, who was later convicted of securities fraud.[105] Providing the tip to a relative was by itself sufficient to confer a personal benefit. As the Court reasoned: "Making a gift of inside information to a relative . . . is little different from trading on the information, obtaining the profits, and doling them out to the trading relative. The tipper benefits either way."[106] According to the Court,

> "when an insider makes a gift of confidential information to a trading relative or friend . . . [t]he tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient." In these situations, the tipper personally benefits because giving a gift of trading information to a trading relative is the same thing as trading by the tipper followed by a gift of the proceeds. Here, by disclosing confidential information as a gift to his brother with the expectation that he would trade on it, Maher breached his duty of trust and confidence to Citigroup and its clients—a duty acquired and breached by Salman when he traded on the information with full knowledge that it had been improperly disclosed.[107]

The Supreme Court further expanded insider trading beyond corporate insiders to not just fiduciaries, actual or constructive, but to those who "misappropriate" non-public information.[108] Under this theory, adopted in *United States v. O'Hagan*, one who misappropriates material, non-public information is in breach of a duty owed, and when he trades on the basis of that information, he is then breaking the prohibition on insider trading and committing a constructive fraud in violation of Rule 10b-5.[109]

In that case, James O'Hagan, a former law firm partner, learned that a firm client was planning a hostile takeover of another company.[110] Needing money to cover stealing from client trust accounts, he bought shares

102. *See id.* at 428.
103. *Id.* at 423.
104. *See id.* at 423–25.
105. *Id.*
106. *Id.* at 428.
107. *Id.* at 422 (quoting *Dirks*, 463 U.S. at 664) (citation omitted).
108. United States v. O'Hagan, 521 U.S. 642, 653 (1997). Federal appellate courts began embracing the misappropriation theory before the Supreme Court's decision in *O'Hagan*. *See, e.g.*, United States v. Chestman, 947 F.2d 551, 553 (2d Cir. 1991) (en banc); SEC v. Cherif, 933 F.2d 403, 408–09 (7th Cir. 1991); SEC v. Clark, 915 F.2d 439, 443–44 (9th Cir. 1990).
109. *See O'Hagan*, 521 U.S. at 653.
110. *Id.* at 647–48.

and call options for the target company's stock.[111] O'Hagan's investments reaped about $4.3 million when he sold.[112] The SEC charged him, but the Eighth Circuit overturned.[113] The Supreme Court reversed, holding that O'Hagan committed fraud in connection with a securities transaction because, by misappropriating confidential information, he breached a duty he owed to the source of the information.[114]

Notably, the Court called back to the days of *TGS* when the prohibition on insider trading would ensure a level playing field.[115] The Court said that

> [a]lthough informational disparity is inevitable in the securities markets, investors likely would hesitate to venture their capital in a market where trading based on misappropriated non-public information is unchecked by law. An investor's informational disadvantage vis-á-vis a misappropriator with material, non-public information stems from contrivance, not luck; it is a disadvantage that cannot be overcome with research or skill.[116]

With *O'Hagan*, one can see how elastic the "fiduciary" requirement becomes. Under the "classical" theory endorsed in *Chiarella* (and stretched in *Dirks*), the trader has some relationship to the company selling the securities. But under a misappropriation theory, the trader need not have had *any* relationship to the company selling securities; rather, the trader uses material, non-public information that was entrusted to him while he had a duty of trust or confidence to the source of the information.[117]

Next, under the guise of the misappropriation theory, the SEC and the appellate courts expanded the misrepresentation theory even in the complete absence of any fiduciary or fiduciary-like relationship. Some cases are examples of ignoring precedent outright. Professor Nagy examined insider trading decisions after *O'Hagan* and found a growing number of courts and SEC enforcement actions that simply disregarded the tradi-

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111. *Id.*
112. *Id.*
113. *Id.* at 648–49.
114. *Id.* at 652. The doctrinal underpinnings of *O'Hagan* are hard to reconcile, suggesting the Court was dabbling in legal fiction to get the result it wanted. "The most perplexing aspect of the misappropriation theory is the way it transforms a breach of duty to an employer or client under state law into a fraud under the federal securities laws." Karmel, *Outsider Trading on Confidential Information*, *supra* note 78, at 109. *See also* Kim, *supra* note 88, at 943 ("[C]onsider what the Court did in *O'Hagan*. By adopting the misappropriation theory, the Court switched its focus from what the defendant did to the counterparties of the trade to what the defendant, as an agent, did to his principal. Accordingly, the Court relied not on the common law of fraud and deceit that undergirded *Chiarella*, but the common law of agency, citing extensively to the Restatement (Second) of Agency relating to an 'agent's disclosure obligation regarding use of confidential information.'").
115. *See O'Hagan*, 521 U.S. at 658–59.
116. *Id.*
117. The SEC would later decree that, in its view, for purposes of the misappropriation theory, a duty of trust or confidence would exist whenever a person agreed to maintain information in confidence. *See* 17 C.F.R. § 240.10b5-2(b)(1) (2017).

tional common law fiduciary status dictate when it foreclosed liability.[118]

But there have been doctrinal adjustments by the lower courts that have reinforced the equitable trading principles of *TGS* and treated insider trading as a constructive fraud. *SEC v. Dorozhko* is a prominent example.[119] In *Dorozhko*, the SEC pursued a trader who had no relationship whatsoever to the source of information.[120] The trader was not employed by the issuer, did not contract with the issuer, was not an agent for the issuer, and, as far as we know, had no contact or communications with the issuer or anyone affiliated with the issuer.[121] Rather, Oleksandr Dorozhko hacked into Thomson Financial's servers and accessed confidential quarterly earnings reports on a company called IMS Health. With that information, he bought about $40,000 of IMS put options.[122] At the close of trading, IMS announced its earnings were 28% below what Wall Street expected. When Dorozhko sold his options the next day, he realized a profit of nearly $287,000.[123]

There's no question Dorozhko was engaged in wrongdoing—he hacked into Thomson Financial's systems and stole information.[124] But was he engaged in insider trading? He was not an insider and he owed no fiduciary duty to IMS or Thomson Financial.[125] But the Second Circuit held Dorozhko could be liable anyway; remarkably, the Second Circuit said that the prohibition on insider trading wasn't necessarily limited to fiduciaries.[126] The Second Circuit stated that when insider trading liability is premised on an affirmative misrepresentation, the person trading does not have to be an actual or even constructive fiduciary, a tipper or tippee, or stand in a position of trust to the source of information.[127]

Even under the "misappropriation" theory, this outcome was extremely hard to square with existing boundaries on insider trading.[128] To bring Dorozhko's case within the ambit of the misappropriation theory,

118. Nagy, *supra* note 89, at 1340–48.
119. SEC v. Dorozhko, 574 F.3d 42 (2d Cir. 2009).
120. *Id.* at 43–45.
121. *Id.*
122. *Id.* at 44. This amount of trading was unlikely to go unnoticed. In fact, Dorozhko's put purchases accounted for about 90% of all put purchases for IMS stock for an entire six-week period. Dorozhko's brokerage service noticed the activity and referred it to the SEC. *See id.*
123. *Id.*
124. *See id.* The district court rightly noted that Dorozhko could have been charged with violating the Computer Fraud and Abuse Act, 18 U.S.C. § 1030(a)(4), the mail fraud statute, 18 U.S.C. § 1341 et seq., and the wire fraud statute, 18 U.S.C. § 1341, and the U.S. Attorney could have seized Dorozhko's trading proceeds under 18 U.S.C. § 981(b). *See* SEC v. Dorozhko, 606 F. Supp. 2d 321, 324 (S.D.N.Y. 2008).
125. *Dorozhko*, 574 F.3d at 44.
126. *Id.* at 48–49 ("In our view, none of the Supreme Court opinions . . . establishes a fiduciary-duty requirement as an element of every violation of § 10(b)," and "*Chiarella*, *O'Hagan*, and *Zandford* all stand for the proposition that nondisclosure in breach of a fiduciary duty satisfies § 10(b)'s requirement . . . of a deceptive device or contrivance") (citations omitted).
127. *Id.* at 49.
128. *See, e.g.*, Kenneth R. Davis, *Insider Trading Flaw: Toward a Fraud-on-the-Market Theory and Beyond*, 66 AM. U. L. REV. 51, 76 (2016) (describing *Dorozhko* as "analytical

the Second Circuit had to say that stealing was the same as lying: "[D]efendant affirmatively misrepresented himself in order to gain access to material, non-public information, which he then used to trade."[129] No one whose home was robbed would think they had just been duped or lied to; stealing isn't the same as deceiving. "At most, the hacker 'lies' to a computer network, not a person."[130] Yet this was enough for the Second Circuit: "In our view, misrepresenting one's identity in order to gain access to information that is otherwise off limits, and then stealing that information is plainly 'deceptive' within the ordinary meaning of the word."[131] But, as pointed out by the district court in *Dorozhko*, serious scholars of insider trading jurisprudence understood that insider trading laws *would not* ensnare someone who trades off information stolen from illegal hacking, even if there may be good policy reasons for doing so.[132] For the entire existence of the securities laws up to *Dorozhko*, no federal court had ever held that those who steal material, non-public information and then traded on it violated the securities laws' prohibition on insider trading.[133] How insider trading after stealing is an "affirmative misrepresentation" under Rule 10b-5 (such that no fiduciary status is needed), but insider trading after some other conduct is not (such that fiduciary status is needed), is unclear. And *Dorozhko* is just one example. Professor Nagy points to other similar computer-hack cases brought by the SEC (which defendants later settled) and other instances where federal courts stretched (if not broke) the rules to permit prosecution of persons whose trading was within legal bounds but still offensive to our notions of

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bootstrapping"); Michael D. Wheatley, *Apologia For the Second Circuit's Opinion in* SEC v. Dorozhko, 7 J. L. ECON. & POL'Y 25, 37, 42 (2010).

129. *Dorozhko*, 574 F.3d at 49.

130. *See* Stephen Bainbridge, *The Second Circuit's Egregious Decision in* SEC v. Dorozhko, STEPHEN BAINBRIDGE'S J. L. RELIGION POL. & CULTURE (July 29, 2009), http://www.professorbainbridge.com/professorbainbridgecom/2009/07/the-second-circuits-recent-decision-in-sec-v-dorozhko-available-here-dealt-with-one-of-the-questions-left-open-by-the.html [https://perma.cc/M5G2-GR5L].

131. *Dorozhko*, 574 F.3d at 51. The Second Circuit tried to finesse this further, saying that the outcome, in some cases, may hinge on the *type* of hack. *See id.* For instance, the Second Circuit said, if the hacker merely exploited "a weakness in an electronic code to gain unauthorized access," that might be "mere theft." *Id.*

132. SEC v. Dorozhko, 606 F. Supp. 2d 321, 341–42 (S.D.N.Y. 2008) (citing Kathleen Coles, *The Dilemma of the Remote Tippee*, 41 GONZ. L. REV. 181, 221 (2005–2006); Donna M. Nagy, *Reframing the Misappropriation Theory of Insider Trading Liability: A Post-*O'Hagan *Suggestion*, 59 OHIO ST. L. J. 1223, 1249–57 (1998); Robert A. Prentice, *The Internet and Its Challenges for the Future of Insider Trading Regulation*, 12 HARV. J. L. & TECH. 263, 296–307 (1999)). Even the government, when it argued *O'Hagan*, acknowledged that the misappropriation theory would not extend to securities trading by a stranger who stole confidential information. *See* Nagy, *supra* note 89, at 1334.

133. *See Dorozhko*, 606 F. Supp. 2d at 339 ("Although a coherent system of insider trading regulation could cover 'stealing and trading' or 'hacking and trading,' as far as this Court is aware, no federal court has *ever* held that those who steal material, non-public information and then trade on it violate § 10(b). Even by itself, this lack of any case law supporting the SEC position is noteworthy. The Exchange Act was enacted over seventy-four years ago, and parallel situations have no doubt arisen in that time span. While the SEC attempts to paint hacking as a new challenge for the securities laws, traditional theft (*e.g.* breaking into an investment bank and stealing documents) is hardly a new phenomenon, and involves similar elements for purposes of our analysis here.").

fairness.[134]

In the wake of *Dirks*, *O'Hagan*, and *Salman*, liability for insider trading extends to persons who trade on material, non-public information in breach of a duty to disclose running to the trading counterpart or to the source of the information; to tippers who disclose material, non-public information to another trader in breach of their fiduciary duty not to do so; and to tippees who trade on material, non-public information knowing that they received the information from a tipper who breached a duty to disclose in return for a personal, familial or financial benefit. Liability now extends well beyond common law fraud to encompass anyone who inequitably benefits from professional or familial relationships. The principles of equitable access to information which form the bedrock of *TGS* have not only survived, they provide the foundation for contemporary insider trading law.

V. FROM *TGS* TO *LAUDATO SI'*

A. *TGS*'s Equitable Trading Principle are Consistent with the Teachings of Pope Francis

In *Laudato Si'* and other teachings, Pope Francis decries our inequitable economic system, which has produced a "throwaway culture"[135] that has "rupture[d] . . . the bonds of integration and social cohesion."[136] The Pope recognizes "how environmental deterioration and human and ethical degradation are closely linked."[137] An economic system that idolizes the maximization of profits, including profits reaped unjustly from the misappropriation of material, non-public information, diminishes human dignity and degrades the natural environment. The Pope declares that "we should be particularly indignant at the enormous inequalities in our midst, whereby we continue to tolerate some considering themselves more worthy than others."[138]

Like the court in *TGS*, the Pope would seek a legal structure that encourages equitable trading rather than insider trading. *TGS* tried to erect just such a structure, and as demonstrated in this article, was ultimately fairly successful in doing so. *TGS* discourages unequal access to information. As the Pope teaches, and as *TGS* placed into law, information is a valuable resource that should be shared equitably.[139] Insider trading involves the inequitable misappropriation of informational resources for personal gain. It is unjust because it diminishes our common wealth and devalues our shared humanity.

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134. Nagy, *supra* note 89, at 1340–48.

135. Pope Francis, Encyclical Letter, *Laudato Si': On Care for Our Common Home*, The Holy See para. 43 (2015) [hereinafter *Laudato Si'*], http://w2.vatican.va/content/dam/francesco/pdf/encyclicals/documents/papa-francesco_20150524_enciclica-laudato-si_en.pdf [https://perma.cc/8NPY-GY5P].

136. *Id.* para. 46.

137. *Id.* para. 56

138. *Id.* para. 90.

139. *See id.* para. 104.

The principle of equity that understands that information is a valuable resource to be shared has its roots in the concept of the universal destination of material goods. As the Pope writes, "[t]he principle of the subordination of private property to the universal destination of goods, and thus the right of everyone to their use, is a golden rule of social conduct. . . ."[140] This principle does not devalue private property. To the contrary, the appropriation of natural resources by individuals is an instrument of the universal destination of goods. By appropriating only those material goods that are needed for human flourishing, individuals can freely exchange material goods to others who need them most. Equitable appropriation of resources increases the common wealth; by contrast, the *misappropriation* of resources like information degrades resources and decreases individual and collective well-being.

B. *TGS*'s Equal Access Principle are Consistent with a Robust Capitalist Economy

In *Laudato Si'*, the Pope declares that "[t]he principle of the maximization of profits, frequently isolated from other considerations, reflects a misunderstanding of the very concept of the economy."[141] A wealth of empirical evidence supports the Pope's declaration. In *Lawless Capitalism: The Subprime Crisis and the Case for an Economic Rule of Law*,[142] for example, Steven Ramirez documents the inefficiencies of unrestrained capitalism and demonstrates how "excessive economic inequality breeds too much elite privilege," which in turn leads to the "irrational underdevelopment of human potential."[143] In fact, countries with relatively low economic inequality experience sustained economic growth.[144]

Moreover, sustained economic growth is not adversely impacted by the redistribution of resources to achieve economic equality.[145] Professor Ramirez argues that the founders of our capitalist economic system, including Adam Smith, actually espoused a much more nuanced understanding of human and market behavior—one that establishes the value of mutually beneficial transactions, rather than the advantage of one side at the expense of the other.[146]

In language entirely consistent with the Pope's understanding that mutually beneficial transactions maximize our human potential and common wealth, Adam Smith in *The Theory of Moral Sentiments*, declared:

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140. *Id.* para. 93.

141. *Id.* para. 195.

142. Steven Ramirez, Lawless Capitalism: The Subprime Crisis and the Case for an Economic Rule of Law (2012).

143. *Id.* at 132.

144. *See* Andrew G. Berg & Jonathan D. Ostry, *Inequality and Unsustainable Growth: Two Sides of the Same Coin?*, Int'l Monetary Fund 9 (Apr. 8, 2011), https://www.imf.org/external/pubs/ft/sdn/2011/sdn1108.pdf [https://perma.cc/RW76-EFDW].

145. *See* Jonathan D. Ostry et al., *Redistribution, Inequality and Growth*, Int'l Monetary Fund 24 (Apr. 2014), https://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf [https://perma.cc/HX6N-67SS].

146. *See* Ramirez, *supra* note 142, at 17.

> We can never survey our own sentiments and motives, we can never form any judgment concerning them, unless we remove ourselves, as it were, from our own natural station, and endeavor to view them as at a certain distance from us. But we can do this in no other way than by endeavoring to view them with the eyes of other people, or as other people are likely to view them.[147]

Thus, the foundations of capitalism do not justify the unfettered acquisition and consumption of resources, including informational resources. Rather, as Professor Ramirez demonstrates, it is the Pope's message and the equitable trading principles announced in *TGS* that are "fully consistent with the most robust systems of capitalism."[148]

In fact, there is an emerging body of evidence that indicates that rigorous prohibitions on insider trading lead to greater investment and innovation. In *Insider Trading and Innovation*, the authors demonstrate "that enforcing insider trading laws spurs investment and innovation—as measured by patent intensity, scope, impact, generality, and originality."[149] Laws that permit insider trading, by contrast, slow innovation and investment by impeding the reliable valuation of innovative activities.[150] Equity issuances also rise much more in industries after a country starts enforcing its rigorous insider trading laws.[151]

The Supreme Court recognized the power of this evidence in *O'Hagan*. In language that fully supports the guiding principles of *TGS* and *Laudato Si'*, the Court there decried an "investor's informational disadvantage" as the product of a constructive fraud, and recognized that "[a]lthough informational disparity is inevitable in the securities markets, investors likely would hesitate to venture their capital in a market where trading based on misappropriated non-public information is unchecked by law."[152] As the Supreme Court affirms, empirical evidence indicates that the principles of equitable trading espoused in *TGS* and *Laudato Si'* are more conducive to economic growth than are legal structures that enable insiders to unfairly profit by misappropriating material, non-public information.

C. The Anomaly in *Texas Gulf Sulphur*

A closer look at the equitable trading principles espoused in both *TGS* and the Pope's teachings reveals an anomaly however. The court in *TGS* erected the equal access principle for information, but disregarded that same principle for natural resources. TGS purchased land near Timmins,

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147. *See* Adam Smith, The Theory of Moral Sentiments 161 (1759).

148. Steven A. Ramirez, *Social Justice and Capitalism: An Assessment of the Teachings of Pope Francis from a Law and Macroeconomics Perspective*, 40 Seattle U. L. Rev. 1229, 1234 (2017).

149. *See* Ross Levine et al., *Insider Trading and Innovation* (Nat'l Bureau of Econ. Research, Working Paper No. 21634, 2015).

150. *Id.*

151. *Id.*

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

Ontario, based on its non-public assessment of the potential value of the land and as a drilling site.[153] The Kidd 55 site was only one of several thousand anomalies (areas where there is unusual variation in the electrical conductivity of rocks) that TGS detected in its aerial exploration of the Canadian Shield.[154] Several hundred of these were considered worthy of further study and options on the land around them were acquired.[155] In fact, the district court in *TGS* found that "TGS had previously drilled 65 equally promising anomalies, but most of them had revealed either barren pyrite or graphite, while a few had shown marginal mineral deposits in insufficient quantities to be commercially mined."[156]

The *TGS* court implicitly defends the defendants' intentional and sustained misappropriation of these natural resources, even as it condemns those defendants for their misappropriation of information. In *Mining in Ontario—A Deeper Look*, Rike Burkhardt, Peter Rosenbluth, and Julee Boan show that "[w]hile the life of a mine can last a few years, the footprint it leaves in the land can be permanent."[157] Although TGS unquestionably brought employment and economic opportunity to Timmons, its unrestrained mine exploration and development has had devastating long-term effects on the environment, including acid mine drainage, fuel and hydronic fluid contamination, trenching erosion, and water and soil poisoning.[158]

The actual development of the mine exacerbates these hazards and also brings contamination of surface and groundwater, increased erosion of lakes and streams, acid generation from waste rock, wildlife and fishery loss, waste rock piles, and tailings disposal areas.[159] The crushed rock and chemicals left after the extraction process are called tailings. The tailings are the nonvaluable portions that remain after the valuable portions of minerals are taken out. As a rule, at least 95% percent of the material extracted from the process becomes tailings waste.[160]

The Timmons Kidd Site, for example, stores more than 100 million tons of base metal sulphide tailings in a pile that is 1.2 kilometers wide and 25 meters high.[161] The waste site is surrounded by tributaries of the Porcupine River. The extraction process required the use of poisonous chemicals such as sodium cyanide and sulphuric acid.[162] The potential that these tailings sites will leak into the water supply causing serious environmental hazards is significant. These tailings sites have in fact failed, spill-

153. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 843–44 (2d Cir. 1968).
154. *Id.* at 843.
155. *Id.* at 843–44.
156. SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262, 271 (S.D.N.Y. 1966).
157. Rike Burkhardt et al., *Mining in Ontario—A Deeper Look*, ONTARIO NATURE, http://ontarionature.org/wp-content/uploads/2017/10/mining-in-ontario-web.pdf [https://perma.cc/MCA9-PHNH] (last visited Apr. 3, 2018).
158. *Id.* at 7.
159. *Id.* at 8.
160. *Id.* at 9.
161. *Id.*
162. *Id.*

ing toxic chemicals into the Ontario water supply.[163]

Accordingly, the defendants in the *TGS* case not only misappropriated material, non-public information for personal gain, they also misappropriated natural resources for personal gain. The issue raised in the case, of course, was not about environmental law; it was only about securities law. The court had no occasion to address any of the environmental law issues raised by the fact pattern. But a consistent application of the principles of equitable access to resources and the universal destination of goods would have required a more serious reflection on the economic and social harm of the misappropriation of both information and the environment.

VI. CONCLUSION

TGS was more than a case about insider trading. It established the fundamental inequity and unfairness of misappropriating resources that are meant to be shared. Although the Supreme Court initially recoiled from the extension of equitable principles into the prohibitions of § 10(b), it slowly but surely incorporated those principles into its evolving insider trading law. Those principles have much in common with the Pope's teachings, particularly his support for the concept of the universal destination of goods, which recognizes the economic and human benefit of equal access to valuable resources like information.

163. *Id.*