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ARTICLES

INSIDER TRADING IN A MANNEAN MARKETPLACE

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In 1966, Henry Manne contended that insider trading should be legalized. He argued that permitting insiders to profit from trading on material, nonpublic information would result in faster incorporation of information into securities' prices and, as a result, expedite the movement of capital to its most efficient uses. The government has rejected Manne's argument, choosing instead to make the prosecution of insider trading violations a high priority. This Article posits that the government has, in fact, accepted Manne's position in cases where insider trading occurs in an organized market for material, nonpublic information. The Securities and Exchange Commission has acquiesced in arrangements in which insiders sell material, nonpublic information, disclosed by the seller in violation of a fiduciary duty, to subscribers before it is publicly available. In one such market, as exposed by the New York Attorney General, news wires sold advance access to material, nonpublic corporate announcements to high-speed traders. This Article presents new evidence that nationally recognized statistical rating organizations may have created a similar market for material, nonpublic ratings-related announcements. The Securities and Exchange Commission's policy may reflect the recognition that an elite group of traders will be the first to receive and trade on this information regardless of whether it is obtained in violation of insider trading law. The fact that material, nonpublic information is routinely traded on in violation of insider trading laws calls for a reversal in academics' research agenda. For decades, academics have accepted the appearance of insider trading enforcement as reality.

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They should, instead, give the thriving Mannean marketplace its due and focus on defining its structure, scope, and effects.

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I. INTRODUCTION

In 1966, Henry Manne established himself as an *enfant terrible* of securities regulation by arguing for the legalization of insider trading.[1] He generally contended that permitting insiders to profit from trading on material, nonpublic information would result in faster incorporation of information into securities' prices and, as a result, expedite the movement of capital to its most efficient uses.[2] Although this argument became a standard bearer in the law and

1. *See generally* HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET (1966).

2. *See id.* at 99–103; Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 867–68, 879 (1983) (arguing that permitting insider trading by management would be wealth maximizing); Daniel R. Fischel, *Insider Trading and Investment Analysts: An Economic Analysis of* Dirks v. Securities and Exchange Commission, 13 HOFSTRA L. REV. 127, 133 (1984) (characterizing insider trading as a method for communicating information to markets). For an excellent summary of the economic arguments for and against insider trading prohibition, see John P. Anderson, *Greed, Envy, and the Criminalization of Insider Trading*, 2014 UTAH L. REV. 1. For a summary of the adverse selection argument against insider trading, see Stanislav Dolgopolov, *Insider Trading and the Bid-Ask Spread: A Critical Evaluation of Adverse Selection in Market Making*, 33 CAP. U. L. REV. 83, 103–05 (2004).

economics movement, it has had no recognized effect on insider trading law or enforcement. In fact, insider trading regulation and enforcement has generally expanded since Manne challenged its economic foundation.[3] Congress has repeatedly strengthened insider trading enforcement tools.[4] Frequent, highly publicized insider trading enforcement actions imply a strong public commitment to combatting insider trading.[5]

Yet empirical studies belie the government's claimed opposition to insider trading. A recent study showed "pervasive," "rampant" trading ahead of public announcements of mergers.[6] A substantial part of increases in stock prices in connection with tender offers go to insiders.[7] Insiders routinely trade ahead of corporate earnings announcements,[8] Form 8-K filings,[9] and patent applications.[10]

3. *See* Laura N. Beny & H. Nejat Seyhun, *Has Insider Trading Become More Rampant in the United States? Evidence from Takeovers* 4 (Univ. of Mich. Law. Sch., Law & Econ. Research Paper Series, Paper No. 12-012, 2012), http://ssrn.com/abstract=2103673 (stating that from 1993 to 1999, the likelihood of a convicted inside trader receiving a prison sentence increased tenfold, and median sentences increased from 11.5 to 18 months).

4. *See, e.g.*, Stop Trading on Congressional Knowledge Act of 2012, Pub. L. No. 112-105, 126 Stat. 291 (prohibiting use of nonpublic information by members of Congress and other government employees); Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 746, 124 Stat. 1376, 1737–39 (2010) (codified as amended 7 U.S.C. § 6c(a) (2012)) (prohibiting federal government employees from trading on nonpublic federal agency information and enhancing SEC authority to obtain monetary penalties in insider trading cases); Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 306, 116 Stat. 745, 779–84 (codified at 15 U.S.C. § 7244 (2012)) (prohibiting insiders from trading during pension blackout periods); Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, § 21, 102 Stat. 4677, 4677–80 (authorizing judicial action by the SEC in response to insider trading and setting the maximum allowable penalty); Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (authorizing the Commission to impose civil penalties up to three times the profits made or losses avoided by inside trader).

5. For a discussion of such enforcement actions, see Joanna B. Apolinsky, *The Boundaries of Fraud Under the Insider Trading Rules*, 13 FLA. ST. U. BUS. REV. 1, 4 (2014) (citing *SEC Enforcement Actions: Insider Trading Cases*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/spotlight/insidertrading/cases.shtml (last visited by Apolinsky on June 2, 2014)); Beny & Seyhun, *supra* note 3, at 13–14 (explaining that SEC insider trading enforcement actions rose steadily from twenty in 1980 to fifty-seven in 2011). Prior to the early 1980s, there was little enforcement of insider trading laws, notwithstanding that insider trading was, as now, prevalent. *See* Carlton & Fischel, *supra* note 2, at 859 nn.11–12 (citing studies examining the prevalence of insider trading).

6. Patrick Augustin, Menachem Brenner & Marti G. Subrahmanyam, Informed Options Trading Prior to M&A Announcements: Insider Trading? 1–2 (Oct. 26, 2015) (unpublished working paper), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2441606&download=yes; Jason M. Breslow, *Study: Corporate Mergers Overrun by Insider Trading*, WHYY (June 17, 2014, 4:34 PM), http://www.pbs.org/wgbh/pages/frontline/business-economy-financial-crisis/to-catch-a-trader/study-corporate-mergers-overrun-by-insider-trading/; Susie Poppick, *The Real Reason You Should Care About Insider Trading,* TIME (June 24, 2014), http://time.com/money/2912441/two-reasons-why-you-shouldnt-worry-about-insider-trading-and-one-reason-to-care/ (describing informed trading prior to public announcements of mergers and acquisitions as "startling," "pervasive," and "rampant"); Andrew Ross Sorkin, *Study Asserts Startling Numbers of Insider Trading Rogues*, N.Y. TIMES (June 16, 2014, 8:55 PM), http://dealbook.nytimes.com/2014/06/16/study-asserts-startling-numbers-of-insider-trading-rogues/.

7. *See* Beny & Seyhun, *supra* note 3, at 6 (confirming that increases in stock prices prior to tender offers are consistent with insider trading activity).

8. *See* Bin Ke, Steven Huddart & Kathy Petroni, *What Insiders Know About Future Earnings*

While Rule 10b5-1 purports to reduce insider trading by corporate insiders by creating a safe harbor for those who precommit to a trading plan,[11] trading data show that Rule 10b5-1 actually operates as a mechanism for insulating such insider trading from liability.[12] Systemic insider trading seems to be the norm.

Regulators could identify the individual insiders whose trades have been exposed by these studies. Nonetheless, they have not engaged in any methodical enforcement response to the systemic insider trading that hard data show is pervasive. The leader in insider trading enforcement, the Securities and Exchange Commission ("Commission" or "SEC"), has focused instead on individualized instances of trading that present a more compelling, personal social narrative than the relatively faceless, systemic insider trading that data suggest is far more prevalent. Commission staff has expressly acknowledged the independent importance of "message" and "visibility" in the agency's insider trading enforcement program;[13] compelling stories arguably create a stronger deterrent by sending a louder signal through popular media.[14] No such deterrent appears to exist, however, for the kind of organized, systemic insider trading that empirical analysis has revealed.

This Article makes the novel argument that regulators may have consciously decided to permit insider trading as long as the nonpublic information on which it is based trades in the kind of free market that Manne envisioned. The best example of such a Mannean marketplace was recently provided by the New York Attorney General (NYAG), who revealed that news wires, under a program he notably labeled "Insider Trading 2.0," routinely sold advance access to nonpublic corporate announcements, including earnings surprises, accounting restatements, and other market-moving information.[15] But the NYAG's bark was worse than his bite. He brought no enforcement actions and settled for voluntary, unenforceable agreements with the news wires to suspend the advance access arrangements. The Commission has had no response

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and How They Use It: Evidence from Insider Trades, 35 J. ACCT. & ECON. 315, 316 (2003).

9. *See generally* Alma Cohen, Robert L. Jackson, Jr. & Joshua R. Mitts, *The 8-K Trading Gap* (Columbia Law Sch. Working Paper Series, Paper No. 524, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2657877&download=yes.

10. *See* Ibrahim Bostan, Innovation and Insider Trading 1 (Jan. 9, 2016) (unpublished working paper), http://ssrn.com/abstract=2713118.

11. 17 C.F.R. § 240.10b5-1(c) (2016).

12. See *infra* notes 81–82 and accompanying text explaining that Rule 10b-5 can insulate corporate insiders from liability.

13. *See* U.S. GOV'T ACCOUNTING OFFICE, GAO-02-302, SEC OPERATIONS: INCREASED WORKLOAD CREATES CHALLENGES (2002), http://www.gao.gov/assets/240/233928.html ("According to SEC officials, SEC generally prioritizes the cases in terms of (1) the message delivered to the industry and the public about the reach of SEC's enforcement efforts, . . . and (4) SEC's visibility in certain areas such as insider trading and financial fraud.").

14. *See* Joan MacLeod Heminway, *A Portrait of the Insider Trader as a Woman*, *in* RESEARCH HANDBOOK ON INSIDER TRADING 191, 195 (Stephen M. Bainbridge ed., 2013) (discussing the SEC's insider trading prosecution of Martha Stewart as "enhancing its own perceived value and serving related political aims").

15. See *infra* Part III.A for a discussion of Insider Trading 2.0.

to the NYAG's allegations, which can be explained by a tacit acquiescence to insider trading where nonpublic information is obtained in the kind of open marketplace operated by the news wires.

This Article also presents new evidence that nationally recognized statistical rating organizations (NRSROs), like the news wires, may provide advance access to nonpublic corporate information by selling advance access to ratings-related announcements. Like the news wire arrangements, the scope of NRSRO advance access arrangements—none of which have ever been prosecuted—reveals a well-developed Mannean market in material, nonpublic corporate information that appears to violate insider trading laws. Again, the Commission has never acknowledged, much less brought any enforcement action regarding, such systemic arrangements for the purchase of advance access to material, nonpublic information. Indeed, the Commission has demonstrated indifference to its own contractor's distribution of corporate filings before they are posted on the SEC's website.[16]

The SEC's decision to permit advance access arrangements reflects its pragmatic recognition that, regardless of whether these arrangements are permitted, the same group of elite traders will inevitably receive and be able to trade on corporate and NRSRO announcements before that information is received by the investing public. This is inevitable because a trader, in order to compete to be the first to trade on new information, must make a large investment in human capital and technological infrastructure, in addition to the substantial capital necessary to make the large trades necessary to generate profits. The market for speed therefore is necessarily limited to a small group of traders. New information will virtually never be received by a group large enough to constitute the "investing public"—the test of whether information is no longer nonpublic—before an elite group of high-speed traders has already traded on it. Only a dramatic, politically infeasible regulatory overhaul could level the high-speed playing field.

The inevitability of an exclusive market for nonpublic information may explain why the Commission permits advance access arrangements. Insider trading attaches only if, among other things, the information was obtained in violation of a fiduciary duty. The distribution of information through news wires and NRSRO advance access arrangements violates a fiduciary duty, but the traders receiving the information would be the first to trade on it regardless of whether the advance access arrangements existed. In other words, if an elite group of traders will necessarily be first to trade on *properly* disseminated information, then prohibiting them from being first to trade when the information is *improperly* disseminated regulates the means with absolutely no effect on the ends. Either way, the information is nonpublic when traded on, which means that equal access—the animating principle of insider trading law—cannot be achieved regardless of whether regulators prosecute advance access arrangements. The Mannean goal of speedy incorporation of information into market prices is achieved, while the Commission accomplishes its "message" and

16. See *infra* notes 211–20 and accompanying text for a discussion of the Commission's stance.

"visibility" goals through enforcement actions against discrete, non-market-based insider trading.

While the voluminous literature on insider trading regulation focuses on what lawmakers and regulators purport to accomplish, it is missing the de facto legalization of insider trading under a Mannean, market-based model. Regulators' tolerance for broad-based advance access arrangements reveals a policy decision to permit insider trading occurring in well-developed information markets. Regulators have chosen to allocate new corporation information through Mannean markets (i.e., organized advance access markets), while prosecuting insider trading only when it occurs outside of these markets. This enforcement model satisfies both public policy goals of efficiency and perceived fairness. Academics must reconsider long held assumptions that proponents of a free market in inside information have not won the day. Insider trading regulation is, in reality, far more Mannean than Manichean.

This Article provides a primer on the elements of insider trading liability in Part II.A, with further discussion of (1) what may constitute a violation of a fiduciary duty element of liability in Part II.B, and (2) how that element has been diluted in Part II.C. Readers who are familiar with both topics should skip to Section III, which describes news wire and NRSRO advance access arrangements and explains why they constitute illegal insider trading. Section IV discusses the inevitability of an elite group of traders' ability to trade on material, nonpublic information, as well as further evidence of the SEC's policy of not prosecuting insider trading that is based on information obtained in a Mannean marketplace. Section V concludes.

II. ORIGINS AND ELEMENTS OF INSIDER TRADING LIABILITY

A. *Elements of Insider Trading Liability*

There are multiple sources of insider trading liability under the federal securities laws. Bidders and targets are prohibited from divulging confidential information to persons who are likely to trade on the basis of the information.[17] Section 16(b) of the Securities Exchange Act of 1934 (Exchange Act) imposes strict liability for short-swing profits in company shares on corporate insiders and ten percent owners.[18] Most recently, the STOCK Act prohibits members of Congress and their staffs from trading on nonpublic information, and the Sarbanes-Oxley Act prohibits insiders from trading during specified blackout periods.[19] This Article focuses on insider trading liability under section 10(b) of the Exchange Act.[20]

17. *See* 17 C.F.R. § 240.14e–1 (2016).

18. Section 16(b) of the Securities Exchange Act, codified at 15 U.S.C. § 78p(a)–(b) (2012), contains the strict liability provision.

19. Stop Trading on Congressional Knowledge Act of 2012, Pub. L. No. 112-105, 126 Stat. 291; Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

20. Section 10(b) of the Securities Exchange Act provides that it shall be unlawful

Section 10(b) broadly authorizes the Commission to adopt rules regarding fraudulent conduct in connection with the purchase and sale of a security.[21] In 1942, the Commission adopted Rule 10b-5 under that authority, but the rule does not identify any specific fraudulent conduct. Rather, Rule 10b-5 leaves the task of determining what violates the rule to further rulemaking and adjudication. Insider trading has become the most prominent example of such conduct.

Insider trading implicates two categories of misconduct under Rule 10b-5: (1) misrepresentations and omissions of material facts, and (2) acts that "operate as a "fraud or deceit."[22] As a practical matter, modern insider trading law does not distinguish between these two provisions. Nor does it involve a meaningful number of cases involving misrepresentations. Insider trading law is primarily about material omissions.

To make out a case of insider trading, the government must prove that the information traded on was material and nonpublic.[23] Whether an omission or misrepresentation is material depends on a well-settled, if not necessarily predictable, standard.[24] Information is material if, as codified in SEC Rule 405,[25] there is a reasonable likelihood that a reasonable investor would attach importance to it in making an investment decision (or voting shares).[26] An oft-cited alternative to this definition is that information is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[27] As discussed in greater detail *infra*, information is nonpublic until the investing public has access to and an opportunity to act on it.[28] An insider trading defendant also must have acted

> [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (footnote omitted).

21. *Id.*

22. Rule 10b-5 provides that it shall be unlawful

> (a) [t]o employ any device, scheme, or artifice to defraud, (b) [t]o 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) [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Id.

23. Dirks v. SEC, 463 U.S. 646, 654 (1983); Chiarella v. United States, 445 U.S. 222, 230 (1980).

24. *See generally* Joan MacLeod Heminway, *Just Do It! Specific Rulemaking on Materiality Guidance in Insider Trading*, 72 LA. L. REV. 999 (2012).

25. 17 C.F.R. § 230.405 (2016).

26. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

27. *Id.*

28. See *infra* notes 103, 162–65 and accompanying text for definitions of "nonpublic."

with scienter,[29] a standard most courts have found satisfied by recklessness.[30]

The final element of insider trading liability is that the information has been released in violation of a fiduciary duty.[31] As discussed *infra*, early cases under Rule 10b-5 were premised on the simple principle that no investor should be permitted to trade on preferential access to material, nonpublic information.[32] The Supreme Court subsequently narrowed this equal access principle by requiring that the nonpublic disclosure of the information also violate a fiduciary duty.[33] This element is treated separately in the next two sections of this Article because it is the most contentious element of insider trading liability and is particularly relevant to the news wire and NRSRO advance access arrangements.

B. *The Duty to Disclose: From Equal Access to* Chiarella/O'Hagan

Chief Justice Rehnquist once characterized Rule 10b-5 as a "judicial oak which has grown from little more than a legislative acorn,"[34] an aphorism which is exemplified by the development of the fiduciary duty element of insider trading liability. Actually, the acorns that grew into modern insider trading regulation were more judicial than legislative. Insider trading regulation finds its primary origin in the elements of common law fraud established at the beginning of the last century.[35] At that time, liability in connection with a securities

29. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976) (requiring proof of scienter for a Rule 10b-5 violation).

30. *E.g.*, Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1282, 1282 n.18 (11th Cir. 1999) (holding that recklessness is sufficient for establishing scienter).

31. *See* Chiarella v. United States, 445 U.S. 222, 229–30 (1980). See *infra* Part II.B for a discussion of fiduciary duties.

32. See *infra* notes 39–53 and accompanying text for a discussion of the cases preceding *Chiarella*.

33. Insider trading liability may be attached to someone who provided the information but does not trade, if the "tipper" violated a fiduciary duty and received a benefit. *See* Dirks v. SEC, 463 U.S. 646, 667 (1983) (reversing conviction where the tipper, who was motivated by a desire to expose fraud, received no benefit). In this context, the "benefit" need not be pecuniary; a reputational benefit or the kind of social benefit derived from making a gift to a friend qualifies as well. Insider trading may arise for tippees only if they knew or should have known of both the breach of fiduciary duty and the resulting benefit to the tippee. *Id.* at 660. The breadth of benefits that are sufficient to support insider trading liability was recently narrowed by the Second Circuit. *See* United States v. Newman, 773 F.3d 438, 452 (2d Cir. 2014) (holding that the government must prove a "meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature"). However, members of Congress may enact legislation that would eliminate the benefit element. *See* Nate Raymond, *Two Senate Democrats Push Insider Trading Bill After Court Ruling*, REUTERS (Mar. 11, 2015, 2:04 PM), http://www.reuters.com/article/2015/03/11/usa-insidertrading-legislation-idUSL1N0WD1CW20150311 (discussing insider trading bill); Anne Sherry, *Congressional Response to* Newman *Would Make Insider Trading a Standalone Crime*, SEC REGULATION DAILY (Mar. 4, 2015), http://www.dailyreportingsuite.com/securities/news/congressional_response_to_newman_would_make_insider_trading_a_standalone_crime. (discussing the Ban Insider Trading Act of 2015, H.R. 1173, 114th Cong. (2015)).

34. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975).

35. Steven McNamara, *Insider Trading and Evolutionary Psychology: Strong Reciprocity, Cheater Detection, and the Expanding Boundaries of the Law*, 22 VA. J. SOC. POLY & L. 241, 249 (2015) (discussing the common law origins of insider trading law); *see* RESTATEMENT (FIRST) OF TORTS § 525

transaction, as in any commercial transaction, could arise from an overt misrepresentation or fraudulent concealment. Insiders did not otherwise have an affirmative duty to disclose information absent an express assumption of such a duty,[36] which meant that there was generally no clear prohibition against engaging in a securities transaction while in possession of such information. Courts generally found that corporate insiders did not owe a fiduciary duty to shareholders in connection with transactions in the company's shares.[37] As Joel Seligman noted, the standard was essentially caveat emptor.[38]

The seeds of an affirmative duty to disclose were planted in *Oliver v. Oliver*,[39] in which the Supreme Court of Georgia found that corporate directors who obtained inside information in connection with their position were obligated to disclose the information to shareholders before trading with them.[40] The court found that a director "holds the information in trust for the benefit of those who placed him where this knowledge was obtained," which required that the information be disclosed before trading with a shareholder.[41] An insider's "duty to disclose" was born.

The Supreme Court applied a slightly different theory in its 1909 decision, *Strong v. Repide*,[42] where it found that a director's duty to disclose arose in only special circumstances; a general duty to shareholders to disclose did not exist.[43] In that case, the director's concealment of his identity qualified as a special circumstance. The state law duty to disclose continued to evolve under the *Oliver* and *Strong* models, with the pre-nineteenth-century no-duty position slowly yielding ground over the years.[44]

One speed bump was a Supreme Judicial Court of Massachusetts decision in 1933, *Goodwin v. Agassiz*,[45] in which the court held held that a director who purchased shares while in possession of inside information did not owe a duty to sellers on the open market.[46] The court opined that the imposition of a duty to

(AM. LAW INST. 1938) (delineating misrepresentation as element of common law fraud).

36. *See* Bd. of Comm'rs v. Reynolds, 44 Ind. 509, 516 (1873).

37. *See, e.g.*, Laidlaw v. Organ, 15 U.S. 178 (1817) (finding no affirmative duty to disclose material information to counterparty in the context of a commodities sale); *Reynolds*, 44 Ind. at 516 (stating that fiduciary duties to shareholders apply only to management of the business's property or business).

38. Joel Seligman, *The Reformulation of Federal Securities Law Concerning Nonpublic Information*, 73 GEO. L.J. 1083, 1091 (1985) (discussing the history of insider trading law).

39. 45 S.E. 232 (Ga. 1903).

40. *Oliver*, 45 S.E. at 234.

41. *Id.*; *see also* Stewart v. Harris, 77 P. 277, 281 (Kan. 1904) (holding that a bank president purchasing shares while in possession of nonpublic information owed a duty to disclose the information to the selling shareholder).

42. 213 U.S. 419 (1909).

43. *Strong*, 213 U.S. at 420.

44. *See* I. Beverly Lake, *The Use for Personal Profit of Knowledge Gained While a Director*, 9 MISS. L.J. 427, 447–54 (1937).

45. 186 N.E. 659 (Mass. 1933).

46. *Goodwin*, 186 N.E. at 661.

disclose in impersonal market transactions went too far.[47] So insider trading law at the time could be roughly viewed as prohibiting corporate insiders from purchasing shares from shareholders while in possession of material, nonpublic information only in face-to-face transactions.

The Commission rejected *Goodwin*'s position and substantially expanded the duty to disclose with *In re Cady, Roberts*,[48] the first insider trading case brought under Rule 10b-5.[49] In *Cady, Roberts*, a broker received inside information about a company's reduction in its quarterly dividend from a director and sold shares in his clients' accounts before the information was released. In finding the broker liable for insider trading, the Commission transformed insider trading law. It found that a duty to disclose could apply to both impersonal transactions and transactions where the counterparty was not necessarily a shareholder (i.e., sales to nonshareholders). It also found that traders who were not corporate insiders, but received the information from a person who had a duty to disclose, would themselves have a duty to disclose (i.e., tippees receiving information from tippers).

From the combination of these positions sprouted new branches of insider trading regulation that existed independent of state-law-derived fiduciary duties running from corporate insiders to shareholders. *Cady, Roberts* created a federal duty to disclose that generally ran from persons in possession of material, nonpublic information to the entire market. The Commission had effectively adopted a policy of equal access to information among purchasers and sellers of securities.

Seven years after *Cady, Roberts*, the Second Circuit judicially blessed the SEC's equal access position. In *SEC v. Texas Gulf Sulphur Co.*,[50] the Second Circuit found that insiders who purchased shares in the open market on the basis of inside information about a valuable mining discovery were liable for insider trading under Rule 10b-5.[51] The court explained that the disclose or abstain rule

47. *Id.* at 661 ("Purchases and sales of stock dealt in on the stock exchange are commonly impersonal affairs. An honest director would be in a difficult situation if he could neither buy nor sell on the stock exchange shares of stock in his corporation without first seeking out the other actual ultimate party to the transaction and disclosing to him everything which a court or jury might later find that he then knew affecting the real or speculative value of such shares. Business of that nature is a matter to be governed by practical rules. Fiduciary obligations of directors ought not to be made so onerous that men of experience and ability will be deterred from accepting such office. Law in its sanctions is not coextensive with morality. It cannot undertake to put all parties to every contract on an equality as to knowledge, experience, skill and shrewdness. It cannot undertake to relieve against hard bargains made between competent parties without fraud.").

48. Exchange Act Release No. 8-3925, 40 SEC 907 (1961).

49. *Cady, Roberts*, 40 SEC at 907.

50. 401 F.2d 833 (2d. Cir. 1968).

51. *Texas Gulf Sulphur*, 401 F.2d at 848 ("Thus, 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."). In opining on the meaning of "materiality," the court applied a forward-thinking, oft-cited probabilistic standard:

"is based in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively *equal access to material information*."[52] In *Goodwin*, the court opined that a duty to disclose information to the impersonal market before trading was impracticable;[53] *Texas Gulf Sulphur* made such public disclosure mandatory as a precondition of trading.

The Supreme Court substantially pruned the *Cady, Roberts* and *Texas Gulf Sulphur* equal access branches in 1980. In *Chiarella v. United States,*[54] the Court narrowed the equal access rule in finding that the possession of material, inside information could not alone create a duty to disclose or abstain.[55] The defendant, an employee of a printer of tender offer materials, was convicted of trading on the basis of information contained in the materials. The Court reversed his conviction, finding that the duty to disclose must arise from "a fiduciary or other similar relation of trust and confidence."[56] The Court found that the employee had no such relationship with the issuer of the stock he traded, while leaving open the question—not presented in the case by the government—of whether the employee's relationship with his *employer* would be sufficient.[57]

The Court answered that question in the affirmative in 1997. In *United States v. O'Hagan*,[58] it upheld the conviction of a lawyer at a firm that represented a would-be acquiring company who bought options on the stock of the target company on the basis of nonpublic information about the pending tender offer.[59] The Court found that the duty of confidentiality that the lawyer owed to the source of the information, the acquirer, but not to the company whose shares were traded, was sufficient to establish the requisite fiduciary duty to disclose for insider trading liability.[60]

Thus, under insider trading law the duty to disclose arises under two types

> [W]hether facts are material within Rule 10b-5 when the facts relate to a particular event and are undisclosed by those persons who are knowledgeable thereof will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.

Id. at 849.

52. *Id.* at 848 (emphasis added).

53. Goodwin v. Agassiz, 186 N.E. 659, 661 (Mass. 1933).

54. 445 U.S. 222 (1980).

55. *Chiarella*, 445 U.S. at 233, 235 ("We cannot affirm petitioner's conviction without recognizing a general duty between all participants in market transactions to forgo actions based on material, nonpublic 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. . . . We hold that a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information." (citation omitted)).

56. *Id.* at 228 (quoting RESTATEMENT (SECOND) OF TORTS § 551(2)(a) (AM. LAW INST. 1977)).

57. *Id.* at 236 ("We need not decide whether this theory has merit for it was not submitted to the jury.").

58. 521 U.S. 642 (1997).

59. *O'Hagan*, 521 U.S. at 647–49.

60. *Id.* at 652.

of fiduciary duties. A *Chiarella* duty is owed to the shareholders of the corporation whose securities are traded; this is known as the classical theory of insider trading.[61] An *O'Hagan* duty arises from a duty of trust or confidentiality owed not to shareholders of a corporation but to the source of the information; this is known as the misappropriation theory of insider trading. These duties, referred to in this Article as "*Chiarella*/*O'Hagan* duties," began to deteriorate as insider trading regulation entered its second century.

C. *The Return of the Equal Access Doctrine*

Courts have not been particularly respectful of the fiduciary limits of *Chiarella*/*O'Hagan* duties. As catalogued by Professor Donna Nagy, they have expanded *Chiarella*/*O'Hagan* duties to contractual and other relationships that create duties that are not fiduciary in nature.[62] She argues persuasively, and in this author's view correctly, both that Justice Powell's majority opinion in *Chiarella* and Justice Ginsburg's majority opinion in *O'Hagan* were firmly grounded in fiduciary principles *and* that the fiduciary duty requirement they imposed was doctrinally "shaky."[63] To illustrate with an oft-cited example, a *Chiarella*/*O'Hagan* duty would not be violated by a trader who stole information from a company's offices and traded on it because a thief does not owe a fiduciary duty to anyone with respect to the theft.[64] This yields the absurd result that the thief is not liable for insider trading, but the insider who lawfully possesses and trades on the same information is.

Courts have partly solved this analytical problem by diluting *Chiarella*'s and *O'Hagan*'s fiduciary relationship requirement. As Nagy summarizes, "[A] host of lower courts and the SEC have in effect concluded that the offense of insider

61. *Chiarella*, 445 U.S. at 228. Courts, including the *Chiarella* Court, have described this duty as derived from the insider's duty to the company's shareholders. However, this conception does not fit clearly in situations where insiders sell securities to nonshareholders, who have no existing relationship with the company. In this scenario, the duty may be viewed as one owed to the shareholders, under the theory that insiders are obligated to refrain from trading on material, nonpublic information that they "obtained . . . by reason of their position with that corporation." *Id.* The duty therefore is better understood as one owed to the company.

62. *See* Donna M. Nagy, *Insider Trading and the Gradual Demise of Fiduciary Principles*, 94 IOWA L. REV. 1315, 1319–20 (2009) ("These litigated cases and settled proceedings have a common theme: the offense of insider trading involves the wrongful use of material nonpublic information, regardless of whether a fiduciary-like duty is breached.").

63. *Id.* at 1337. Powell's majority opinion in *Dirks v. SEC* also grounded the duty to disclose in fiduciary principles. 463 U.S. 646, 659 (1983) (finding tippees liable where the tipper realized a personal gain and the tippee had reason to believe the tipper's disclosure violated a duty to disclose). As Powell stated in *Dirks*, "*Chiarella* made it explicitly clear that there is no general duty to forgo market transactions 'based on material, nonpublic information.' Such a duty would 'depar[t] radically from the established doctrine that duty arises from a specific relationship between two parties.'" *Dirks,* 463 U.S. at 666 n.27 (alteration in original) (quoting *Chiarella,* 445 U.S. at 233).

64. *See* John C. Coffee, Jr., *Introduction: Mapping the Future of Insider Trading Law: Of Boundaries, Gaps, and Strategies*, 2013 COLUM. BUS. L. REV. 281, 299–306 (discussing finders' and thieves' insider trading liability); Robert A. Prentice, *The Internet and Its Challenges for the Future of Insider Trading Regulation*, 12 HARV. J.L. & TECH. 263, 293–307 (1999) (discussing theft as a form of misappropriation).

trading focuses on a person's wrongful use of confidential information, regardless of whether a fiduciary-like duty is breached."[65] For example, the Supreme Court has disregarded fiduciary principles by extending insider trading liability to tippees, who do not owe any party a fiduciary duty.[66] Courts have found that theft of information violates a *Chiarella*/*O'Hagan* duty, notwithstanding the absence of a fiduciary duty owed by the thief.[67] The Second Circuit flatly asserted, in a computer hacking case, that neither *Chiarella* nor *O'Hagan* "establish[] a fiduciary-duty requirement as an element of every violation of Section 10(b)."[68]

The Commission has further diluted the *Chiarella*/*O'Hagan* duty requirement. In 2000, it adopted Rule 10b5-2, which codified three categories of *Chiarella*/*O'Hagan* duties. None are fiduciary in nature. First, the rule treats confidential agreements as creating *Chiarella*/*O'Hagan* duties, despite their essentially contractual nature. In 2002, a federal district court implicitly rejected this provision in finding that the breach of a written "confidential commitment" was not fiduciary enough to qualify as a *Chiarella*/*O'Hagan* duty.[69] Second, the rule brings within the ambit of *Chiarella*/*O'Hagan* duties mere understandings between parties based on a "history, pattern, or practice" that create an expectation of confidentiality (but hardly an expectation of fiduciary allegiance).[70] Third, the rule creates a rebuttable presumption that close family members have a relationship of trust and confidence, despite Second Circuit precedent finding, for example, that "marriage does not, without more, create a fiduciary relationship."[71]

By expanding *Chiarella*/*O'Hagan* duties beyond the confines of their namesakes, courts have arguably returned to the equal access doctrine set forth in *Texas Gulf Sulphur*.[72] Courts have removed the limits of *Chiarella* and

65. Nagy, *supra* note 62, at 1337.

66. *Id.* at 1337–39.

67. *See id.* at 1341–44 (discussing problem of thieves' nonfiduciary status).

68. SEC v. Dorozhko, 574 F.3d 42, 48 (2d Cir. 2009); *cf.* Tim Human, *Companies Amp Up Securities Focus Following Leaks*, BUS. INSIDER (Feb. 4, 2011, 5:45 PM), http://www.businessinsider.com.au/companies-amp-up-securities-focus-following-leaks-2011-2 (citing that Microsoft saw its second quarter results published seventy minutes early after a search spider guessed the URL of the company's unpublished earnings release); Kurt Kleiner, *Guessing a Web Address Need Not Make You a Hacker*, NEW SCIENTIST (Nov. 9, 2002), https://www.newscientist.com/article/mg17623680-500-guessing-a-web-address-need-not-make-you-a-hacker/ (noting that a Reuters reporter guessed a URL for a company's then-nonpublic financial news, which the company described as "hacking").

69. *See* United States v. Kim, 184 F. Supp. 2d 1006, 1011–12 (N.D. Cal. 2002); *see also* SEC v. Cuban, 634 F. Supp. 2d 713, 726 (N.D. Tex. 2009) (questioning whether a confidentiality agreement is sufficient to support insider trading liability), *vacated and remanded*, 620 F.3d 551 (5th Cir. 2010). *See generally* Thomas Lee Hazen, *Identifying the Duty Prohibiting Outsider Trading on Material Nonpublic Information*, 61 HASTINGS L.J. 881 (2010) (discussing *Kim* and *Cuban*).

70. 17 C.F.R. § 240.10b5-2(b)(2) (2016).

71. United States v. Chestman, 947 F.2d 551, 568 (2d Cir. 1991) (en banc).

72. The equal access principle has deep roots in federal securities law. *See* Saul Levmore, *Securities and Secrets: Insider Trading and the Law of Contracts*, 68 VA. L. REV. 117, 119 (1982) (stating the purpose of federal securities laws is "to place the buyer on the same plane, so far as available information is concerned, with the seller" (quoting 77 CONG. REC. 2918 (1933) (statement of

O'Hagan by often finding the violation of a *Chiarella*/*O'Hagan* duty to occur in any case where the information has been obtained improperly.[73] The standard adopts, in effect, Chief Justice Burger's argument in his *Chiarella* dissent that the free market principle that "permits a businessman to capitalize on his experience and skill in securing and evaluating relevant information . . . . should give way when an informational advantage is obtained, not by superior experience, foresight, or industry, but by some unlawful means."[74]

Since *Chiarella*'s pruning of the equal access branch that sprouted under *Cady, Roberts* and *Texas Gulf Sulphur*, that branch has grown back into a broad canopy covering, potentially, any scenario in which material, nonpublic information is improperly obtained and traded on. Insider trading law has returned "almost full circle" to the equal access doctrine.[75] And nowhere is the equal access doctrine more obviously violated than in the advance access arrangements discussed immediately below.

III. ADVANCE ACCESS ARRANGEMENTS

Advance access arrangements are pervasive. The examples discussed in this Section cover the vast majority of market-moving announcements by U.S. corporations and NRSROs. These arrangements reflect not only the largest insider trading scheme in history, but also a scheme so pervasive as to call into question whether insider trading is the norm, not the exception. The arrangements reflect a formalization of insider trading that accomplishes the most radical vision of a broad-based market in inside information best articulated, if not unconditionally embraced, by Henry Manne.[76]

Advance arrangements fit nicely into a developing mosaic of arrangements that reflect the virtual institutionalization of insider trading. Studies have long demonstrated that insiders routinely trade ahead of corporate earnings announcements.[77] A substantial part of increases in stock prices in connection with a tender offer go to insiders.[78] A recent study showed pervasive trading ahead of public announcements of mergers.[79] Another recent study showed that the Commission itself may be facilitating advance access arrangements by

Rep. Rayburn))).

73. *See* Nagy, *supra* note 62, at 1340–43.

74. Chiarella v. United States, 445 U.S. 222, 240 (1980) (Burger, C.J., dissenting).

75. Nagy, *supra* note 62, at 1364.

76. *See generally* MANNE, *supra* note 1 (arguing that permitting insiders to profit from trading on material, nonpublic information would result in faster incorporation of information into securities' prices and expedite the movement of capital to its most efficient uses).

77. *E.g.*, Ke et al., *supra* note 8, at 316–17.

78. *See* Beny & Seyhun, *supra* note 3, at 37 (finding that about one-third of an offer price runup occurs prior to announcement); Anup Agrawal & Tareque Nasser, Insider Trading in Takeover Targets 3 (Oct. 12, 2011) (unpublished working paper), ssrn.com/abstract=1517373; *cf.* BEN DUBOW & NUNO MONTEIRO, MEASURING MARKET CLEANLINESS 22 (2006), http://www.fsa.gov.uk/pubs/occpapers/op23.pdf (finding that thirty percent of significant announcements were preceded by informed price movement).

79. *E.g.*, Augustin et al., *supra* note 6, at 2.

permitting an SEC contractor to provide advance access to SEC filings.[80] Empirical evidence reveals that Rule 10b5-1, while intended to reduce the incidence of insider trading by corporate insiders, actually operates as a mechanism for insulating such insider trading from liability.[81] As with Rule 10b5-1, Regulation Fair Disclosure (Regulation FD) operates not as a means of preventing selective disclosure, but as a means of formalizing it,[82] as illustrated in the news wire advance access arrangements discussed immediately below.

The following discussion explains why advance arrangements easily satisfy all elements of insider trading liability. Yet regulators have not brought any enforcement actions in connection with these arrangements or, for that matter, any of the identified specific instances of insider trading documented in studies cited in the preceding paragraph. Section IV, *infra*, contends that regulators' acquiescence reflects a conscious policy of permitting insider trading where material, nonpublic information is distributed in a Mannean marketplace.

The remainder of Section III discusses the news wire and NRSRO advance access arrangements. Parts III.A.1 and III.B.1 describe the arrangements, and Parts III.A.2 and III.B.2 discuss insider trading liability arising from the arrangements.

A. *News Wires and Regulation FD*

1. Advance Access to Corporate Information Released by News Wires

The most remarkable advance access arrangements were recently exposed by NYAG Eric Schneiderman as part of an investigation he named "Insider Trading 2.0."[83] The NYAG extracted verbal agreements from Business Wire and Marketwired (collectively, "news wires") to cease providing market-moving information to "high-frequency traders" milliseconds before it was publicly released ("news wire agreements").[84] The preferred subscribers typically paid

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80. See *infra* notes 211–14 and accompanying text for a discussion of a recent study that showed the SEC may be facilitating advance access arrangements.

81. Alan D. Jagolinzer, *SEC Rule 10b5-1 and Insiders' Strategic Trade*, 55 MGMT. SCI. 224, 224–25 (2009).

82. Dominic Jones, *Why Almost No One Is Complying with Regulation FD*, IR WEB REPORT (Nov. 16, 2008), http://irwebreport.com/20081116/why-almost-no-one-is-complying-with-reg-fd/.

83. *See* Eric T. Schneiderman, N.Y. Att'y Gen., Remarks at the 2013 Bloomberg Markets 50 Summit (Sept. 24, 2013), http://www.ag.ny.gov/press-release/remarks-attorney-general-eric-t-schneiderman-2013-bloomberg-markets-50-summit [hereinafter Bloomberg Remarks]; Eric T. Schneiderman, N.Y. Att'y Gen., Remarks on High-Frequency Trading and Insider Trading 2.0 at the New York Law School Panel on "Insider Trading 2.0—A New Initiative to Crack Down on Predatory Practices" (Mar. 18, 2014), http://www.ag.ny.gov/pdfs/HFT_and_market_structure.pdf ("This is what we call Insider Trading 2.0, and it's one of the greatest threats to public confidence in the markets.").

84. Press Release, N.Y. State Att'y Gen., A.G. Schneiderman Announces Marketwired Agreement to End Sales of News Feeds to High-Frequency Traders (Mar. 19, 2014), http://www.ag.ny.gov/press-release/ag-schneiderman-announces-marketwired-agreement-end-sales-news-feeds-high-frequency [hereinafter NYAG Marketwired Press Release] (stating Marketwired "has agreed to stop selling to high-frequency traders direct feeds of the information that Marketwired distributes on behalf of clients"); Press Release, N.Y. State Att'y Gen., A.G. Schneiderman Applauds Decision by

"thousands of dollars a month" for advance access to the new releases.[85]

The news wire arrangements enabled high-speed traders to trade on the news releases before they were publicly available.[86] To illustrate how the arrangements would provide a trading advantage, on December 5, 2013, the stock of Ulta Salon Cosmetics and Fragrance Inc. experienced rapid trading within fifty milliseconds of Business Wire's release of Ulta's earnings, which missed analysts' forecasts.[87] The release was not sent by the major news wires to

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Business Wire to Prohibit High-Frequency Traders from Purchasing Direct News Feed (Feb. 20, 2014), http://www.ag.ny.gov/press-release/ag-schneiderman-applauds-decision-business-wire-prohibit-high-frequency-traders [hereinafter NYAG Business Wire Press Release] (stating Business Wire "terminated its contracts with all known high-frequency traders"). This Article does not discuss the agreement the NYAG extracted from Reuters to terminate advance access to the Survey of Consumers (Survey) published by the University of Michigan's Survey Research Center. *See* Press Release, N.Y. State Att'y Gen., A.G. Schneiderman Secures Agreement by Thomson Reuters to Stop Offering Early Access to Market-Moving Information (July 8, 2013), http://www.ag.ny.gov/press-release/ag-schneiderman-secures-agreement-thomson-reuters-stop-offering-early-access-market. Some subscribers received the Survey five minutes before it was publicly released ("five-minute subscribers"); others received it two seconds before the five-minute subscribers. Eamon Javers, *Thompson Reuters Is Giving an Elite Group of Clients an Advantage on High-Speed Trades*, BUS. INSIDER (June 12, 2013, 2:50 PM), http://www.businessinsider.com/reuters-gives-speed-traders-an-advantage-2013-6. Reuters paid the university $1 million annually plus a share of its revenues in return for exclusive early access to the data. *Id.* In turn, high-speed traders paid Reuters $6,000 per month for two-second advance access. *See* John Maxfield, *Legal Insider Trading for $6,000 a Month*, MOTLEY FOOL (July 16, 2013), http://www.fool.com/investing/general/2013/07/16/legal-insider-trading-for-6000-a-month.aspx. Matt Taibbi has reported on evidence that traders have traded on the early release of the Survey. Matt Taibbi, *16 Major Firms May Have Received Early Data from Thomson Reuters*, ROLLING STONE (Sept. 5, 2013), http://www.rollingstone.com/politics/blogs/taibblog/16-major-firms-may-have-received-early-data-from-thomson-reuters-20130905. A Reuters employee reportedly informed the FBI that "Thomson Reuters had violated insider-trading laws by the early release" of the Survey. *Thomson Reuters and Ex-Employee Agree to Settle Lawsuit*, REUTERS (May 12, 2014, 4:47 PM), http://www.reuters.com/article/2014/05/12/thomsonreuters-lawsuit-idUSL1N0NY1HB20140512. Reuters terminated the employee, who then sued Reuters for wrongful termination. *See* Rosenblum v. Thomson Reuters (Mrkts.) LLC, 984 F. Supp. 2d 141, 143 (S.D.N.Y. 2013). As a general rule, the creator of material, nonpublic information owes no duty to withhold information from traders until its public release. However, in view of steady expansion of *Chiarella*/*O'Hagan* duties beyond traditional fiduciary relationships, a duty of confidentiality may have been violated in connection with the Reuters arrangements, including duties found in tort law, contract law, internal codes of conduct or ethics, grant terms, nonprofit law, and honest services law. This topic is beyond the scope of this Article.

85. Scott Patterson, *Speed Traders Get an Edge: Paying for Direct Access to News Releases Can Give a Lucrative Time Advantage*, WALL ST. J. (Feb. 6, 2014, 8:49 PM), http://online.wsj.com/news/articles/SB10001424052702304450904579367050946606562?mg=reno64wsj&url=http%3A%2F%2Fonline.wsj.com%2Farticle%2FSB10001424052702304450904579367050946606562.html [hereinafter Patterson, *Speed Traders Get an Edge*].

86. *Compare* Press Release, Business Wire, Statement from Business Wire Regarding News Delivery to High Speed Trading Firms (Feb. 20, 2014, 4:31 PM), http://newsroom.businesswire.com/press-release/statement-business-wire-regarding-news-delivery-high-speed-trading-firms, *with* Patterson, *Speed Traders Get an Edge*, *supra* note 85.

87. Patterson, *Speed Traders Get an Edge*, *supra* note 85*; see also* Scott Patterson, *Behind One Second of Trading Mayhem*, WALL ST. J. (Feb. 7, 2014, 8:59 PM), http://blogs.wsj.com/moneybeat/2014/02/07/behind-one-second-of-trading-mayhem/. A millisecond is one-thousandth of a second. The high-speed traders have the ability to execute trades in millionths of a second (microseconds) and

public subscribers until forty-two milliseconds after trading began. The high-speed traders' head start gave them a valuable trading advantage because they were able to act on Ulta's inevitable stock drop before other traders. Within a 550-millisecond period, Ulta's stock price dropped from $122 per share to $118 per share.[88]

The NYAG has not prosecuted any participants in connection with the news wire arrangements, although he appears to have obtained the news wire agreements under threat of litigation. The NYAG implied that he would have sued the news wires under New York's Martin Act for insider trading had they not complied with his requests.[89] However, the news wires asserted that their arrangements were legally permissible and strongly implied that they would resume the arrangements in the future.[90]

The NYAG does not appear to have obtained any written commitments or binding representations. The news wire agreements appear to be nothing more

possibly billionths of a second (nanoseconds). Pavitra Kumar, Michael Goldstein, Frank Graves & Lynda Borucki, *Trading at the Speed of Light: The Impact of High-Frequency Trading on Market Performance, Regulatory Oversight, and Securities Litigation*, FINANCE (The Brattle Grp), 2011, at 4, http://www.brattle.com/system/publications/pdfs/000/004/355/original/Finance_Newsletter_2011_2_-_High-Frequency_Trading.pdf?1378772100 (citing a system that can complete a trade in sixteen microseconds).

88. Patterson, *Speed Traders Get an Edge*, *supra* note 85; *cf.* Information, United States v. Lucarelli, 14 MAG 1878 (S.D.N.Y. Aug. 26, 2014), http://www.justice.gov/usao/nys/pressreleases/September14/LucarelliPleaPR/Lucarelli,%20Michael%20Information.pdf (charging investor relations firm executive with trading on advance access to press releases in breach of duty to employer).

89. This Article does not discuss the NYAG's similar agreement with PR Newswire, because its status as an insider trading tippee is not as clear as that of Marketwired or Business Wire. *See* Press Release, N.Y. State Att'y Gen., A.G. Schneiderman Announces Unprecedented Steps by News Distribution Firm to Curb Preferential Access for High-Frequency Traders (Apr. 30, 2014), http://www.ag.ny.gov/press-release/ag-schneiderman-announces-unprecedented-steps-news-distribution-firm-curb-preferential. PR Newswire claims that it denied high-speed traders access to its direct feed and provided the information to clients with the "understanding" that they would not use it to trade. Patterson, *Speed Traders Get an Edge*, *supra* note 85. It also represented that it had not been compensated for providing advance access and that it did not know the identity of its subscribers. Nonetheless, PR Newswire may have been paid to be included in Reuters' "ultra-low latency" direct news feed, another potential source of advance access. *See Data Direct Feed*, THOMSON REUTERS, http://thomsonreuters.com/en/products-services/financial/market-data/data-feed-direct.html#tab-1 (last visited Feb. 1, 2016).

90. Eamon Javers, *NY AG's Early Data Probe Goes Beyond Reuters*, CNBC (July 8, 2013, 2:15 PM), http://www.cnbc.com/id/100870690 ("The firm also defended the practice of early data release as journalism, rather than market activity. 'Thomson Reuters strongly believes that news and information companies can legally distribute non-governmental data and exclusive news through services provided to fee-paying subscribers.'" (quoting Thomson Reuters)). Reuters announced that it was suspending a so-called "tiered release" of market moving data to elite clients. *Id.* The term "suspending" suggests that the program may be reinstated in the future. *But see* Letter from Michael Becker, Vice Pres., Bus. Wire, to Robert Pozen, Chairman, SEC Advisory Comm. on Improvements to Fin. Reporting 1 (Feb. 4, 2008), https://www.sec.gov/comments/265-24/26524-36.pdf ("Given the proliferation of program trading, which has underscored the importance of milli-seconds in trading decisions, the need for all investors to have simultaneous access to market-moving data is clearly paramount. Full, fair and simultaneous disclosure remains the conceptual bedrock of our financial markets; technological advances have definitely improved the process, but they have failed to supplant a proven disclosure platform that guarantees a level playing field for all market participants.").

than unenforceable promises that will quickly lose any purchase as the NYAG's attention shifts elsewhere.[91] In addition, the terms of the news wire agreements applied to only the release of information to "high-speed traders" or the "knowing" release to such traders, which suggests careful wording by defense counsel to allow for continued preferred distribution as long as the identity of the recipients is not known.[92] The NYAG's actions are arguably most noteworthy for not only allowing a massive insider trading scheme that dwarfed all precedents to go unprosecuted, but also permitting the perpetrators to publicly assert their innocence.

Nor has the Commission brought any enforcement actions that are related to the news wire arrangements. Indeed, this author has been unable to find *any* references by any SEC Commissioner or official to the NYAG's investigation or the news wire agreements.[93] While this Article hypothesizes that the Commission has consciously refrained for policy reasons from commenting on the news wire advance access arrangements or taking any public action, the SEC's response may also have been prompted by longstanding tension between the NYAG and the Commission, and the SEC staff's resentment of the NYAG's history of upstaging the federal regulator.[94]

2. Insider Trading Liability for News Wire Arrangements

The NYAG's irresolute new wire agreements seem underwhelming in light of the strong insider trading case that he could have made. The information provided under the advance access arrangements would have included, for example, earnings and tender offer announcements, that were often undoubtedly material.[95] The information was nonpublic because news wires are often the vehicle through which public companies first disseminate corporate information. Indeed, what the preferred subscribers bargained for was precisely the receipt of

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91. *But see* Press Release, N.Y. State Att'y Gen., A.G. Schneiderman Announces Fraud Charges Against Barclays in Connection with Marketing and Operation of Its Dark Pool (June 25, 2014), http://www.ag.ny.gov/press-release/ag-schneiderman-announces-fraud-charges-against-barclays-connection-marketing-and [hereinafter NYAG Barclays Press Release] (explaining that through the NYAG's Insider 2.0 initiative, the Attorney General has "worked to end the distribution of corporate earnings releases directly to high-frequency traders ahead of the investing public").

92. See *supra* notes 83–84 and accompanying text for information about the terms of the news wire agreements.

93. See *infra* note 197 and accompanying text for a list of SEC speeches and testimony, none of which mention the Insider Trading 2.0 investigation.

94. *See* OFFICE OF THE INSPECTOR GEN., U.S. SEC. & EXCH. COMM'N, INVESTIGATION OF THE CIRCUMSTANCES SURROUNDING THE SEC'S PROPOSED SETTLEMENTS WITH BANK OF AMERICA, INCLUDING A REVIEW OF THE COURT'S REJECTION OF THE SEC'S FIRST PROPOSED SETTLEMENT AND AN ANALYSIS OF THE IMPACT OF BANK OF AMERICA'S STATUS AS A TARP RECIPIENT 12 (2010), http://www.sec.gov/foia/docs/oig-522.pdf ("[T]here has historically been tension in the relationship between the SEC and the NYAG. . . . SEC attorneys expressed that the NYAG has had a history of undermining the SEC in order to upstage them . . . .").

95. *See* NYAG Barclays Press Release, *supra* note 91 (the news wire arrangements entailed "the distribution of corporate earnings releases directly to high-frequency traders ahead of the investing public").

the information before it was made available to the news wires' general subscribers.[96] The news wires certainly knew that the recipients of advance access would trade on the information.[97] And the payments to the news wires constituted an undeniable benefit.[98]

The only element of tipper liability that is not self-evident is the violation of a *Chiarella/O'Hagan* duty. Nonetheless, that element appears to be just as provable as the rest. The news wire arrangements violated a *Chiarella/O'Hagan* duty to the corporate sources of the information not to provide advance access in violation of Regulation FD.[99]

Regulation FD, adopted in 2000, mandates that, when public companies intentionally release market-moving information, they do so publicly so as to ensure that the market participants receive the information simultaneously.[100] Issuers' public release obligations can be satisfied by filing the information with the Commission on Form 8-K or by "disseminat[ing] the information through another method (or combination of methods) of disclosure that is reasonably designed to provide broad, non-exclusionary distribution of the information to the public."[101]

The Commission has provided extensive guidance regarding disclosures that would qualify as a "broad, non-exclusionary distribution of the information to the public."[102] In proposing Regulation FD, it discussed nonpublic information in *Faberge Inc.*, which requires that the information be "disseminated . . . through recognized channels of distribution, [whereby] public investors [are] afforded a reasonable waiting period to react to the information."[103] The news wires' distribution of nonpublic corporate information to preferred subscribers would not qualify as "recognized channels of distribution"; much less would investors who relied on the news wires' regular distribution have been "afforded a reasonable waiting period to react to the information."[104]

Although Regulation FD applies directly to issuers, and not to news wires,

96. *See* NYAG Business Wire Press Release, *supra* note 84.

97. *See* Patterson, *Speed Traders Get an Edge*, *supra* note 85 ("Business Wire's clients include Chicago's Chopper Trading LLC and Spano Trading LLC, a Miami Beach, Fla., high-speed trader.").

98. See *supra* note 33 for a discussion of *United States v. Newman*, which narrowed the scope of the term "benefit" for purposes of insider trading liability.

99. *See* 17 C.F.R. §§ 243.100–243.103 (2016).

100. *Id.* § 243.100(a)(1) (requiring issuer to "make public disclosure" of information "[s]imultaneously, in the case of an intentional disclosure"); *id.* § 243.101(b) (defining issuer as public company). In the case of an unintentional disclosure, the information must be made public "[p]romptly." *Id.* § 243.100(a)(2). The rule proscribes disclosure to "holder[s]" of an issuer's securities. *Id.* § 243.100(b)(1)(iv). At least some of the high-speed traders are likely to be holders of the issuer's securities and therefore members of the class of persons to whom selective disclosure is forbidden.

101. *Id.* § 243.101(e)(2).

102. *Id.*

103. Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72, 595 (proposed Dec. 28, 1999) (codified at 17 C.F.R. pts. 230, 240, 243, 249) [hereinafter Proposing Release] (quoting Faberge, Inc., Exchange Act Release No. 10174, 45 SEC 249, 1973 WL 149283, at *6 (May 25, 1973)). See also *infra* notes 162–65 for a discussion of how the SEC has defined "nonpublic information."

104. *Faberge Inc.*, 1973 WL 149283, at *6.

the news wires assume obligations in connection with their Regulation FD services that easily qualify as *Chiarella*/*O'Hagan* duties. For example, Marketwired promises to provide clients with "a service that enables them to comply with their Reg[ulation] FD and associated regulations, which require full and fair simultaneous disclosure of information."[105] Business Wire describes itself as a "trusted, recognized disclosure vehicle" that, as specifically emphasized in its marketing materials, "ensures **simultaneous disclosure of your material news** to all market participants."[106]

The news wires' advance access arrangements violated a *Chiarella*/*O'Hagan* duty because the arrangements violated their relationship of trust and confidence with issuers. Under the terms of Regulation FD, the news wires acted as agents of the issuers and therefore owed the issuers the fiduciary duties owned by an agent to its principal. Regulation FD requires issuers to make simultaneous public disclosure when the issuer "or [any] person acting on its behalf" releases material, nonpublic information.[107] The Commission interprets the phrase "any person acting on its behalf" to include any "agent of an issuer

105. Patterson, *Speed Traders Get an Edge*, *supra* note 85 (quoting Marketwired); *see* MARKETWIRED, INVESTOR RELATIONS SOLUTIONS 1 (2013), http://www.marketwired.com/get attachment/Solutions/InvestorRelations/Marketwired_Brochure_IR.pdf (indicating that Marketwired can assist in "[u]ncover[ing] new opportunities while safely meeting regulatory compliance"); *Investor Relations*, MARKETWIRED, http://www.marketwired.com/Solutions/Investor-Relations (last visited Feb. 1, 2016) ("Marketwired's turnkey solutions for regulatory disclosure and filing . . . help to streamline and integrate your processes. . . . [Marketwired allows you to] [d]istribute time-sensitive, market-moving news with ease with simultaneous delivery to print and broadcast media, news agencies and regulatory authorities, social media and websites around the world."); *Disclosure and Regulatory Filing*, MARKETWIRED, http://www.marketwired.com/Products/Distribute/Disclosure-Regulatory-Filing (last visited Feb. 1, 2016) ("[Marketwired . . . . will[] [c]ombine your 8-K filings with your material press releases to meet SEC requirements, including both Regulation FD and the newer Sarbanes-Oxley regulations."); *see also Filing, Printing, Disclosure and Engagement Services*, PR NEWSWIRE, http://www.prnewswire.co.in/products-services/ir/ (last visited Feb. 1, 2016) ("PR Newswire makes it simple for public companies to comply with disclosure regulations . . . . [and] [s]atisfy SEC mandates.").

106. *Reach Capital Markets*, BUS. WIRE, http://www.businesswire.com/portal/site/home/press-release-disclosure/ (last visited Feb. 1, 2016); *see also Delivering Your Market-Moving News*, BUS. WIRE, http://www.businesswire.com/portal/site/home/financial-disclosure/ (last visited Feb. 1, 2016) ("Hundreds of public companies worldwide rely on Business Wire to deliver their material news and fulfill their regulatory disclosure requirements."); *Distribution Options,* GLOBENEWSWIRE, https://globenewswire.com/Home/Send-Press-Release/Distribution-Options (last visited Feb. 1, 2016) ("Publicly traded companies can receive disclosure media services that simultaneously distribute to [major, national media outlets], as well as the reporting company's local media outlets . . . ."); *Filing, Printing, Disclosure and Engagement Services*, *supra* note 105 ("PR Newswire makes it simple for public companies to comply with disclosure regulations . . . . [and] [s]atisfy SEC mandates."). News wires also offer to file corporate documents with the Commission, which raises the possibility that these filings may be provided early to preferred subscribers as well. *See, e.g.*, *Disclosure and Regulatory Filing*, *supra* note 105 ("Marketwired helps you . . . . [c]ombine your 8-K filings with your material press releases to meet SEC requirements, including both Regulation FD and the newer Sarbanes-Oxley regulations.").

107. Selective Disclosure and Insider Trading, Securities Act Release No. 7881, Exchange Act Release No. 43,154, Investment Company Act Release No. 24,599, 65 Fed. Reg. 51,716, 51,721 (Aug. 24, 2000) [hereinafter Adopting Release].

who regularly communicates with . . . the issuer's securities holders."[108] The news wires' selective disclosure to high-speed traders are "regular" communications, and the high-speed traders would often be "holders" of the issuer's securities,[109] which makes the wires "agents" under the definition of "person[s] acting on [this issuer's] behalf."[110]

Moreover, under well-established common law, agents such as the news wires owe fiduciary duties to their principals. An agent may not engage in self-dealing or otherwise unduly enrich itself at the expense of the principal.[111] The news wires violated their agency duties by selectively disclosing nonpublic information. The prevention of selective disclosure is the primary responsibility that the news wires were hired to assume and promised to fulfill. Their selling of advance access breached their fiduciary duty to the issuers, which falls squarely within insiders' duties under *Chiarella* and closely fits the classical theory of insider trading. Their profiting from providing selective disclosure created the benefit necessary for tippee liability.

Other provisions of Regulation FD present an arguably stronger basis to establish *Chiarella*/*O'Hagan* duties. Issuers are permitted to disclose material, nonpublic information to agents such as the news wires in reliance on two relevant exemptions. They may disclose to a "person who owes a duty of trust or confidence to the issuer" and/or "expressly agrees to maintain the disclosed information in confidence."[112] The news wires would have assumed a *Chiarella*/*O'Hagan* duty under both exemptions.

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108. *Id.*

109. The Commission has not clarified whether "holders" refers to persons who trade in the issuer's stock or only persons who are "holders" at the moment of disclosure. Under the latter understanding, high-speed traders may be infrequently considered "holders." A common characteristic of high-speed traders is that they do not take long positions, and if they do, their positions last only milliseconds. One would expect high-speed traders to exploit advance access arrangements not by being holders at the time they received the information, but by buying or short selling the issuer's stock when they receive it. However, it is likely that the Commission would view trading on negative information by shorting an issuer's stock as acting as a "holder" for purposes of the rule, in view of its overarching insider trading concerns. In addition, as long as a single high-speed trader held the issuer's securities at the moment the disclosure was made, the news wires would satisfy a literal interpretation of "holders."

110. Regulation FD presents a twist to this analysis by excluding such "agents" from the category of "person[s] acting on [this issuer's] behalf" if the person discloses the information "in breach of a duty of trust or confidence to the issuer." 17 C.F.R. § 243.101(c) (2016). That is exactly what the news wires were doing in providing selective disclosure. Nonetheless, that provision does not exclude the news wires from being *agents*, but rather only from being agents who are acting on behalf of their principals—the issuers.

111. *See* RESTATEMENT (SECOND) OF AGENCY § 388 (AM. LAW INST. 1958).

112. 17 C.F.R. § 243.100(b)(2)(i)–(ii). A third exemption applies to filings made in connection with securities offerings. *See id.* § 243.100(b)(2)(iii); *see also* Proposing Release, *supra* note 103, at 72,595 ("Such a confidentiality agreement would also include an agreement not to trade on the nonpublic information."). On their face, the exemptions protect issuers even if they know that a person is selectively disclosing the information, although one might argue that the exemptions are impliedly conditioned on reasonable reliance on the duty of trust and confidence and/or a confidentiality agreement.

The news wires relationships with issuers also would independently establish *Chiarella/O'Hagan* duties under Rule 10b5-2.[113] Under paragraph (b)(2) of the rule, when a person communicating material, nonpublic information has a "history, pattern, or practice of sharing confidences with the recipient," then the recipient owes the person a "duty of trust or confidence." The news wires' relationships with issuers reflect such a "history, pattern, or practice of sharing confidences." Alternatively, to the extent that an issuer relied on the Regulation FD safe harbor for communications to a recipient who "expressly agrees to maintain the disclosed information in confidence,"[114] the recipient would be one who, under Rule 10b5-2(b)(1), "agrees to maintain information in confidence," which would also render the relationship one of "trust or confidence."

The case for a *Chiarella/O'Hagan* duty is particularly compelling here because the duty is, unlike many *Chiarella/O'Hagan* duties,[115] specifically intended to prevent insider trading. In proposing Regulation FD, the Commission characterized each of the exemptions discussed immediately above as "refer[ring] to several types of persons whose misuse of the information *would subject them to insider trading liability under Rule 10b-5*."[116] The Commission doubled down in the adopting release, where it stated that the "misuse of the information for trading [by the persons under these two exemptions] would . . . be covered either under the 'temporary insider' or 'misappropriation' theory" of insider trading.[117]

In summary, there are multiple grounds for finding that the news wires' advance access arrangements violate a *Chiarella/O'Hagan* duty. The news wires are common law agents and agents under Regulation FD that owe a duty to issuers to ensure that their material, nonpublic information is not selectively disclosed. The news wires independently owe *Chiarella/O'Hagan* duties under Rule 10b5-2. Indeed, it is difficult to imagine a *Chiarella/O'Hagan* duty violation that would provide a stronger justification for imposing insider trading liability than the news wires' selective disclosure of corporate announcements. The Commission has expressly characterized persons who are provided pre-public access to Regulation FD information as persons whose trading on the information would constitute illegal insider trading. Every element of insider trading is patently provable, and the advance access arrangements are open and notorious, yet the Commission has not acknowledged their existence, much less instituted any enforcement activity. The news wires are likely tippers because they know how their preferred subscribers use the information, and the news

113. *See* 17 C.F.R. § 240.10b5-2.

114. *Id.* § 243.100(b)(2)(ii).

115. *See, e.g.*, United States v. Willis, 737 F. Supp. 269 (S.D.N.Y. 1990) (holding that a psychiatrist who traded on confidential information learned from a patient committed insider trading); United States v. Reed, 601 F. Supp. 685 (S.D.N.Y. 1985) (holding that a son breached a duty of confidence to his father by trading on confidential information received from his father), *rev'd on other grounds*, 773 F.2d 477 (2nd. Cir. 1985).

116. Proposing Release, *supra* note 103, at 72,595 (emphasis added).

117. *Id.*

wires benefit by selling it. The preferred subscribers are likely tippees because they know about the news wires' violation of *Chiarella*/*O'Hagan* duties and trade anyway. All elements of tipper and tippee insider trading liability are present.

B. Rating Agencies and Readily Accessible Means

1. Advance Access to Ratings Information

While the news wire arrangements have been well publicized, what appear to be similar arrangements involving NRSROs have received little attention. Both Fitch and Standard & Poor's (S&P), two of the three largest NRSROs,[118] participate in arrangements through which preferred subscribers obtain ratings information from high-speed electronic feeds ("NRSRO arrangements").[119] These feeds belong to a category of "low latency" information services that claim to deliver data and information with the smallest delay (latency) between their release by the source and their receipt by the subscriber. For text-based information, the feeds are often provided in machine-readable format, which enables immediate response by algorithms that are programmed to decipher and act on market-moving announcements in fractions of a second.

Through an "exclusive" arrangement, the Deutsche Börse offers access to Fitch corporate ratings announcements that appears to enable subscribers to trade on the announcements before they are publicly available. The Börse boasts that its AlphaFlash ratings feed "provides the fastest available access to machine-readable Fitch rating[s]."[120] A Börse executive made the purpose of the feed quite clear in stating that, "[b]y adding Fitch ratings data, we are enabling AlphaFlash clients to instantly react to rating changes, which can have a huge market impact."[121] The explicit purpose of AlphaFlash is to enable high-speed

118. The third is Moody's. Aaron Luchetti & Jeannette Neumann, *Kroll Gets a License to Shoot (Bonds)*, WALL ST. J. (Aug. 30, 2010, 12:01 AM), http://www.wsj.com/articles/SB100014240527 48704323704575462040422537232 ("[Moody's, Fitch, and S&P] issued 97% of all outstanding ratings . . . ."). As of September 2012, there were nine NRSROs. U.S. SEC. & EXCH. COMM'N, REPORT TO CONGRESS: CREDIT RATING STANDARDIZATION STUDY 7 (2012), http://www.sec.gov/news/studies/2012/939h_credit_rating_standardization.pdf.

119. The news wires may provide similar feeds, but this information has not been disclosed in reports about their advance access arrangements.

120. DEUTSCHE BÖRSE MARKET DATA, ALPHAFLASH® FITCH RATINGS (2013), https://web.archive.org/web/20130323025337/http://alphaflash.com/sites/alphaflash.com/files/downloads/AlphaFlash_Fitch%20Ratings_2013%2002_e.pdf ("The feed provides the fastest available access to machine-readable Fitch rating announcements[.]"); *see also* Geoffrey Rogow, *High-Frequency Traders Once Again Flat Out Buying Data Ahead of You*, WALL ST. J. (Sept. 12, 2012, 1:03 PM), http://blogs.wsj.com/marketbeat/2012/09/12/high-frequency-traders-once-again-flat-out-buying-data-ahead-of-you/ ("Clients of Deutsche Boerse with superfast computers, algorithmic-trading software and access to the exchange company's data centers around the world will now be first to trade on nearly every ratings decision from Fitch."); Phil Schwarzmann, *Deutsche Börse Helps Traders Find Alpha on Equini,* EQUINIX BLOG (Aug. 20, 2013), http://blog.equinix.com/2013/08/deutsche-borse-helps-traders-find-alpha-on-equinix/ ("AlphaFlash's Fitch ratings feed provides the fastest, and only, access to machine-readable Fitch ratings.").

121. Rogow, *supra* note 120 (quoting Georg Gross, head of Front Office Data and Analytics, Deutsche Börse). Deutsche Börse also offers a service whereby subscribers are alerted to pending

traders to trade on information before it becomes publicly available.

S&P provides advance access to its ratings announcements through multiple information feeds.[122] For example, S&P provides its credit ratings through "RatingsXpress," which provides "intra-day and real-time access to Standard & Poor's Ratings' credit ratings" via a "real-time digital feed."[123] S&P also owns a subsidiary, S&P Capital IQ, that provides an "ultra-low latency" market data feed that may carry S&P ratings announcements that are received by subscribers even before subscribers to its Internet-based RatingsXpress receive them.[124]

The earliest advance access to S&P ratings information appears to be provided through an arrangement with Selerity Inc.,[125] which has an "agreement with [S&P] to deliver low-latency credit rating announcements in a machine-readable format."[126] Selerity is "a low latency, real-time fact aggregation and event data company that caters to sophisticated investment firms including hedge funds, banks and proprietary trading firms."[127] Selerity's S&P service provides "ratings on public companies" that are "straight from the source" and include "Upgrades and Downgrades, [and] Changes in Outlook and Credit Watch Status (Positive/Negative) for Corporates"[128] A Selerity executive has described notice of ratings downgrades as "pre-market intelligence," which is consistent with its service providing advance access.[129]

Selerity's data and information feeds are co-located with national securities

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releases of information, including Fitch ratings. *Id.*

122. *See* S&P CAPITAL IQ, 2013 INVESTOR FACT BOOK 27 (2013), http://media.corporate-ir.net/media_files/IROL/96/96562/mhfi-factbook-20135/html/pdfs/MHFI%202013%20Investor%20 Fact%20Book-S&P%20Capital%20IQ.pdf. The SEC has inquired into the validity of such methods. Peter J. Henning, *Was There Insider Trading on S.&P.'s Downgrade?*, N.Y. TIMES (Aug. 15, 2011, 2:49 PM), http://dealbook.nytimes.com/2011/08/15/was-there-insider-trading-on-s-psdowngrade/?_php=true &_type=blogs&_r=0 ("T]he Securities and Exchange Commission has started a preliminary inquiry into whether Standard & Poor's employees selectively leaked information about the impending downgrade of the United States' debt rating to AA+ from AAA."); Kara Scannell, *SEC Makes S&P Downgrade Inquiries*, CNBC (Aug. 12, 2011, 4:09 AM), http://www.cnbc.com/id/44099845 (discussing SEC inquiry into whether S&P's downgrade of U.S. debt was selectively leaked to traders by S&P employees).

123. S&P CAPITAL IQ, *supra* note 122, at 27.

124. *Id.* at 18; *see also Data*, S&P CAPITAL IQ, http://www.spcapitaliq.com/client-solutions/data (last visited Feb. 1, 2016) ("Driving all our analysis, tools and insights is S&P Capital IQ's rich and abundant well of data. We reach far, wide and deep to compile quality data and deliver it in milliseconds through our tools and analytics, enterprise feeds and desktops . . . .").

125. *Selerity Signs Agreement with Standard & Poor's to Offer Low-Latency, Machine-Readable Credit Rating Announcements,* BUS. WIRE (May 16, 2011, 10:24 AM), http://www.businesswire.com/ news/home/20110516006390/en/Selerity-Signs-Agreement-Standard-Poor%E2%80%99s-Offer-Low-Latency.

126. *Id*.

127. *Id*.

128. *Id.* (quoting Ryan Terpstra, Founder and CEO of Selerity).

129. Tracy Alloway, *Machine-Readable Sovereign Downgrades Are Here*, FT ALPHAVILLE (May 16, 2011, 2:21 PM), http://ftalphaville.ft.com/2011/05/16/568791/machine-readable-sovereign-downgrades-are-here/.

exchanges' matching engines.[130] Co-location entails the placement of traders' servers, in which trading algorithms have been preloaded, in close physical proximity to the services of securities exchanges, which hold the exchanges' order-matching software. Co-location can reduce transmission speeds to less than one microsecond and are widely available for an extraordinary variety of market-moving information.[131]

The delivery of S&P's ratings data through Selerity's co-location service suggests that this feed is specifically tailored to provide traders with the first opportunity to trade on S&P ratings announcements. S&P developed "specific low-latency machine-readable technology" for use in the Selerity feed,[132] which provides even greater assurance that co-located traders will be first to trade on ratings announcements. Selerity has been described as "promising to deliver data feeds deliberately created for [high-speed traders], electronic market makers and algorithmic trading firms,"[133] just as the news wire arrangements were tailored for high-speed traders.

Federal law requires that NRSROs publicly disclose how they make their information available to the public,[134] yet Fitch does not appear to provide any

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130. Press Release, Equinix, Selerity Selects Equinix Frankfurt Datacenter for European Expansion (Sept. 12, 2011), http://www.equinix.com/company/news-and-events/press-releases/selerity-selects-equinix-frankfurt/ (discussing Selerity's co-location points).

131. *See* Kumar et al., *supra* note 87 (discussing co-location); James Angel, Lawrence Harris & Chester S. Spratt, *Equity Trading in the 21st Century* 38 (Marshall Research Working Paper Series, Working Paper No. FBE 09-10, 2010) ("To speed their communications, high frequency traders co-locate their servers as close as possible to the exchange servers that produce market information and collect orders."); Douglas Cumming, Feng Zhan & Michael Aitken, High Frequency Trading and End-Of-Day Price Dislocation 30 (Oct. 28, 2013) (unpublished working paper), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2145565 ("[C]o-location involves an exchange renting a space to the trading firm next to the trading facility, which provides added speed for the flow of time-sensitive information."); Charles M. Jones, What Do We Know About High-Frequency Trading? 10, 26–27 (Mar. 20, 2013) (unpublished manuscript), https://securitytraders.org/wp-content/uploads/2013/04/HFT0324.pdf (discussing how high-speed traders use co-location); Steven R. McNamara, The Law and Ethics of High-Frequency Trading 22–25 (unpublished manuscript) (Feb. 16, 2015), http://ssrn.com/abstract=2565707 (discussing co-location); Phil Albinus, *Hedge Funds Leveraging Colocation to Take on Larger Firms*, WALLSTREET & TECH. (Sept. 27, 2011, 4:45 PM), http://www.wallstreetandtech.com/trading-technology/hedge-funds-leveraging-colocation-to-take-on-larger-firms/d/d-id/1265289?; Geoffrey Rogow, *Colocation: The Root of All High-Frequency Trading Evil?*, WALL ST. J. (Sept. 20, 2012, 1:57 PM), http://blogs.wsj.com/marketbeat/2012/09/20/collocation-the-root-of-all-high-frequency-trading-evil/. *See generally* Shengwei Ding, John Hanna & Terrence Hendershott, *How Slow Is the NBBO? A Comparison with Direct Exchange Feeds*, 49 FIN. REV. 313 (2014) (providing an empirical analysis of the speed advantages of co-location). Co-location provides market participants with "reduced latency," which refers to the faster receipt of information. *See Co-Location (Co-Lo)*, NASDAQ, http://www.nasdaqtrader.com/Trader.aspx?id=colo (last visited Feb. 1, 2016).

132. Alloway, *supra* note 129.

133. James Armstrong, *Machine-Readable News Feeds Look Beyond HFTs*, TRADERS MAG. (July 2011), www.tradersmagazine.com/issues/24_325/catering_to_hfts.php.

134. Rule 17g-1(g) requires that NRSROs make their Form NRSRO publicly available on their website "or through another comparable, readily accessible means." 17 C.F.R. § 240.17g-1(i) (2016). Form NRSRO requires that, if a fee is charged to obtain a rating, then the NRSRO must "provide a fee schedule or describe the price(s) charged." Nationally Recognized Statistical Rating

disclosure about the AlphaFlash service, much less claim that it qualifies as public disclosure. Fitch's website includes no references to the AlphaFlash service. Regarding the timing of its release of ratings, its website states only that, "[d]ue to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers."[135] This statement could be read to imply that the information is made public through "electronic publishing and distribution," but this does address the potential for *preferential* electronic access.

As with Fitch, S&P does not provide much information regarding how it publicly discloses ratings information, but none of its advance electronic feeds would constitute public disclosure. Its SEC filings, for example, state that it is paid for subscriptions to receive or access its ratings, but the filings do not disclose the timing, terms, or associated fees.[136] As to the fees charged for access to its ratings, S&P discloses that ratings are available on its website and RatingsDirect, a delivery service that appears to be slower than its RatingsXpress, ultra-low latency, and Selerity feeds, none of which are mentioned in its Form NRSRO.[137]

2. Insider Trading Liability for NRSRO Arrangements

As with the news wire arrangements, most elements of insider trading liability seem self-evidently satisfied in connection with the NRSRO arrangements. Many of the ratings announcements are undeniably material;[138] the value of their special access to corporate information has increased since the adoption of Regulation FD.[139] In meetings with an issuer's managers, credit analysts routinely obtain confidential information "such as profit breakdowns by

Organizations, Exchange Act Release No. 72936, 2014 WL 4538057, at *361 (Aug. 27, 2014). Exhibit 6 of Form NRSRO requires identification of conflicts of interest, including where "[t]he Applicant/NRSRO is paid by persons for subscriptions to receive or access the credit ratings of the Applicant." *Id.* at *370.

135. *Terms of Use*, FITCH RATINGS, https://www.fitchratings.com/web/en/dynamic/terms-of-use.jsp (last visited Feb. 1, 2016).

136. STANDARD & POOR'S, APPLICATION FOR REGISTRATION AS A NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO) ¶ 6 (expires Nov. 30, 2017), http://www.standardandpoors.com/en_US/delegate/getPDF?articleId=1498006&type=COMMENTS&subType=REGULATORY.

137. *Id.* ¶ 7.B. ("Public ratings and ratings actions are made available at no charge at www.standardandpoors.com/ (except for ratings of Standard & Poor's Maalot, which are made available at no charge at www.maalot.co.il), through release to wire services and for a fee through various subscription-based products, such as RatingsDirect.").

138. *See* Ilia D. Dichev & J. D. Piotroski, *The Long-Run Stock Returns Following Bond Ratings Changes*, 56 J. FIN. 173, 173 (2001) (demonstrating that rating downgrades and upgrades cause abnormal returns); Robert W. Holthausen & Richard W. Leftwich, *The Effect of Bond Rating Changes on Common Stock Prices*, 17 J. FIN. ECON. 57, 57 (1986) (same); Phillipe Jorion, Zhu Liu & Charles Shi, *Informational Effects of Regulation FD: Evidence from Rating Agencies*, 76 J. FIN. ECON. 309, 312 (2005).

139. Jorion et al., *supra* note 138, at 313 (stating that NRSROs have become the "main conduits of selective disclosures after Reg FD" and demonstrating that after Regulation FD, the effect of rating upgrades on stock prices becomes statistically significant).

products, new product plans, financial projections, capital spending plans, and minutes of board meetings."[140] There is no doubt that the information, while still in possession of the NRSRO, is nonpublic. The NRSROs arrangements with Reuters and Selerity appear to have been designed for the very purpose of providing the information to high-speed traders before it is publicly available. The NRSROs would know or be reckless in not knowing that high-speed traders use the information to trade. Although no public information is available regarding payments to the NRSROs, subscribers pay for their direct feeds, and it is likely that part of these payments finds its way to Fitch and S&P. In any case, the high-speed traders' use of NRSRO announcements as the basis for trading would provide reputational benefits under *Dirks* by reinforcing the credibility of their ratings, which are likely to make them more attractive to issuers. The violation of a *Chiarella/O'Hagan* duty is the only element of tipper liability that is not obvious.

a. Chiarella/O'Hagan *Duties Under Rule 17g-4*

Like the selective disclosure of issuer information under Regulation FD, the selective disclosure of NRSRO ratings announcements is prohibited. Under the Credit Rating Agency Reform Act of 2006 (CRAR Act), credit ratings organizations attain NRSRO status by applying to the Commission for approval as credit rating agencies.[141] The CRAR Act defines a "credit rating agency" as an entity that publishes its ratings "on the Internet or through another readily accessible means, for free or for a reasonable fee."[142] Pursuant to this definition, the Commission adopted Rule 17g-4, which requires credit rating agencies to adopt procedures to prevent the "inappropriate dissemination of . . . pending credit rating[s] . . . before issuing the credit rating on the Internet or through another readily accessible means."[143]

The Commission takes the position that "inappropriate" disclosure occurs when credit rating actions are disclosed selectively before they are "widely disseminated to the market."[144] S&P has acknowledged that "the selective disclosure to investors of rating actions based on material non-public information" would constitute "inappropriate dissemination" under Rule

140. *Id.* at 315.

141. Credit Card Agency and Reporting Act of 2006, Pub. L. No. 109-291, § 4, 120 Stat. 1327, 1329 (codified at 15 U.S.C. § 78o(f)(2) (2012)).

142. 15 U.S.C. § 78c(a)(61). Rating agencies must disclose on Form NRSRO how they publish their ratings. See *supra* note 134 for a sample disclosure.

143. 17 C.F.R. § 240.17g-4(a)(3) (2016).

144. Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 55231, 2007 WL 325688, at *41 (Feb. 2, 2007); s*ee also* Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organization, Exchange Act Release No. 55857, 90 SEC Docket 2032, 2007 WL 1624609, at *58 (June 5, 2007) ("[A]n NRSRO must have policies designed to ensure that its pending credit rating actions are not selectively disclosed before the credit rating is issued on the Internet or through another readily accessible means.").

17g-4.[145] The NRSRO arrangements therefore would violate the CRAR Act because the advance access arrangements would constitute the "inappropriate" dissemination of ratings announcements in violation of the requirement that the ratings be published via the Internet or other readily accessible means (i.e., widely disseminated to the public).

The NRSRO arrangements also would violate Rule 17g-4. Rule 17g-4 requires that NRSROs' compliance procedures be reasonably designed to prevent inappropriate dissemination. Although "the rule, by itself, does not expressly prohibit any types of disclosures,"[146] because it only requires reasonably designed procedures, the NRSROs' procedures could not have been *reasonably designed* if they allowed for the systematic selective disclosure described *supra*. As noted, S&P itself developed technology specifically for the Selerity feed. Its arrangement was reported in the press. Fitch's arrangement is publicly advertised in AlphaFlash materials. Such open and notorious arrangements could not be reconciled with a finding that an NRSRO's procedures were reasonably designed to prevent selective disclosure.

One might argue that the act of disclosure *itself* does not violate Rule 17g-4—only a procedure's failure can—and that a requirement to have a reasonably designed procedure does not create a *Chiarella*/*O'Hagan* duty of trust or confidence. There is a reasonable likelihood that a court would overlook this distinction as excessively semantic. The violation of Rule 17g-4, which is intended to prevent selective disclosure, should alone be sufficient to provide the breach of a *Chiarella*/*O'Hagan* duty necessary for tipper liability.

To the extent that an NRSRO's procedures prohibit selective disclosure, the NRSRO arrangements would violate its internal procedures and thereby violate a *Chiarella*/*O'Hagan* nondisclosure duty. For example, Fitch's internal policies

145. In a comment letter to the SEC, S&P criticized the Regulation FD exemption for NRSROs as follows:

> For example, under the amendment as proposed, a corporate issuer would be permitted to disclose material non-public information to an NRSRO (such as information about an undisclosed business combination transaction, or a likely credit agreement default), and the NRSRO could then use that information as a basis for downgrading the rating assigned to the issuer's securities. The NRSRO would then be free to communicate that downgrade to its paying clients, giving those clients a clear information advantage over other investors who have no knowledge of either the material non-public information, or the downgrade. It is difficult to imagine a rule that would have a more pernicious impact on investor confidence in the fairness of our markets. . . . [T]he proposed amendment to rule 100 of Regulation FD would appear to sanction the selective disclosure to investors of rating actions based on material non-public information, and such investors would not be restricted from trading on this information. We believe this would likely constitute "inappropriate dissemination" of material non-public information within the meaning of rule 17g-4, and "misuse" of that information within the meaning of Exchange Act § 15E(g) . . . .

Vickie A. Tillman, Exec. Vice Pres., Standard & Poor's Ratings Servs., Comment Letter on Re-Proposed Rule for Nationally Recognized Statistical Rating Organizations (Mar. 27, 2009), 2009 WL 931205.

146. *See* 90 SEC Docket 2032, 2007 WL 1624609, at *57; *see also* Matt Phillips & Jean Eaglesham, *S&P Met with Bond Firms*, WALL ST. J., Sept. 7, 2011, at C1 (describing S&P meetings with bond investors prior to downgrading U.S. debt).

generally prohibit the disclosure of nonpublic ratings information outside of the firm. Fitch's Global Confidential Policy states that Fitch and its employees shall not disclose ratings information to anyone other than the issuer "prior to the publication of the rating or rating action and its related commentary."[147]

b. Chiarella/O'Hagan *Duties Under Regulation FD*

The *Chiarella*/*O'Hagan* duties of NRSROs under Regulation FD are far more indirect than for news wires. Issuers make material, nonpublic information available to NRSROs in order for the NRSROs to develop ratings, but the NRSROs are not agents of issuers under Regulation FD. The news wires are retained for the purpose of disseminating material, nonpublic information, whereas the NRSROs are provided with the information to enable them to develop credit ratings. Thus, providing information to NRSROs does not appear to implicate Regulation FD by reason of their acting as agents of issuers.

If NRSROs are not Regulation FD agents, then issuers' selective disclosure to them would trigger Regulation FD only if NRSROs were among the regulation's list of prohibited recipients of selective disclosure. This group generally includes holders of the issuer's securities, investment funds, broker-dealers, and investment advisers.[148] None of the first three applies to NRSROs solely by reason of their credit rating activities, and this analysis assumes that any NRSRO affiliates that were prohibited recipients would not be viewed as receiving the information unless actually provided to them by the NRSRO. Historically, NRSROs fell into the investment adviser category of holders because they were included in the definition of investment adviser under the Investment Advisers Act,[149] but Congress excluded them from that definition in the CRAR Act.[150] Issuers' selective disclosure to NRSROs therefore does not implicate Regulation FD.

Finally, the NRSRO arrangements involve the disclosure of issuer *ratings*, not issuer *information*. Even if selective disclosure to NRSROs were subject to Regulation FD, NRSROs' advance access arrangements do not necessarily

147. FITCHRATINGS, GLOBAL CONFIDENTIALITY POLICY 4 (2014), https://www.fitchratings.com/web_content/credit_policy/global-confidentiality-policy.pdf. The confidentiality policy for S&P prohibits the release of confidential information outside of S&P. STANDARD & POOR'S, CONFIDENTIALITY, CONFLICTS AND FIREWALL 1–2 (2012), http://www.standardandpoors.com/en_EU/delegate/getPDF?articleId=1498354&type=COMMENTS&subType=REGULATORY. Moody's policy prohibits the disclosure of confidential information to any person other than the issuer. MOODY'S, CODE OF PROFESSIONAL CONDUCT 6 (2015), https://www.moodys.com/uploadpage/Mco%20Documents/Documents_professional_conduct.pdf. The term "confidential information" in both the S&P and Moody's policies includes unpublished ratings information.

148. 17 C.F.R. § 243.100(b)(1)(i–iv) (2016).

149. Investment Company Act of 1940, Pub. L. No 76-768, 54 Stat. 789 (codified at 15 USC § 80a-1 *et seq.*).

150. Winston & Strawn LLP, *Securities and Exchange Commission Issues Rule Proposals to Implement Dodd-Frank Act for Investment Advisers, Advisers to Private Funds, Venture Capital Funds, and Foreign Private Advisers*, LEXOLOGY (Dec. 2, 2010) ("Congress amended the Advisers Act to exclude NRSROs from the definition of investment adviser and provided for a separate regulatory regime for NRSROs under the Securities Exchange Act of 1934 . . . .").

involve disclosure of *issuers'* material, nonpublic information. One might contend that issuing ratings indirectly discloses issuer information, but there is no precedent in support of this position.

Nonetheless, Regulation FD may create an indirect source of a *Chiarella/O'Hagan* duty for NRSROs because issuers *believe* that it applies. One reason for this belief is that in 2010 Congress ordered the Commission to delete a Regulation FD exemption that applied specifically to NRSROs.[151] The deletion of this exemption logically implied that, going forward, selective disclosure to NRSROs would be subject to Regulation FD. In fact, the exemption had never been necessary because, after NRSROs were excluded from the definition of investment adviser in 2006, Regulation FD did not apply to disclosures to NRSROs in the first place.

Whether out of an abundance of caution or a misunderstanding of the law, issuers have entered into confidentiality agreements with NRSROs in order to remove any doubt as to issuers' liability risk under Regulation FD.[152] Those agreements, while not legally necessary, would still establish a *Chiarella/O'Hagan* duty because they would be confidentiality agreements for purposes of Rule 10b5-2(b)(1).[153] Where these agreements are in place, an NRSRO that provides advance access to ratings information about the issuer would violate a *Chiarella/O'Hagan* duty. One could also argue that the requirements of the CRAR Act and Rule 17g-4 establish, under Rule 10b5-2(b)(2), a "history, pattern, or practice of sharing confidences."[154] In both cases, a *Chiarella/O'Hagan* expectation of confidentiality would exist under the rule.

Thus, the NRSRO advance access arrangements appear to violate multiple *Chiarella/O'Hagan* duties. Like the news wires, NRSROs are what the Commission has called "types of persons whose misuse of the information *would*

151. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 938B, 124 Stat. 1376, 1885 (2010). The exemption applied to information provided to "an entity whose primary business is the issuance of credit ratings, provided the information is disclosed solely for the purpose of developing a credit rating and the entity's ratings are publicly available." Selective Disclosure and Insider Trading, Exchange Act Release No. 7881, 2000 WL 1201556, at *8 (Aug. 15, 2000); *see also* Removal from Regulation FD of the Exemption for Credit Rating Agencies, Exchange Act Release No. 9146, 2010 WL 3791922 (Sept. 29, 2010) (removing the rating agency exemption from Regulation FD).

152. For example, Fitch has indicated that it enters into such agreements for the express purpose of providing comfort to issuers under Regulation FD. *See* Steve Quinlivan, *Dealing with Rating Agencies After Regulation FD Change*, DODD-FRANK.COM (Oct. 10, 2010), http://dodd-frank.com/dealing-with-rating-agencies-after-regulation-fd-change/ (quoting Fitch CEO: "[I]n the event that issuers feel it necessary to have in place with Fitch a confidentiality agreement pursuant to that provision of Regulation FD (Rule 100(b)(2)(ii)), which permits selective disclosure to a person who expressly agrees to maintain the disclosed information in confidence, Fitch has received confirmation from [its outside counsel] that its standard form confidentiality agreement would suffice for this purpose." (second alteration in original)); *see also* Eric S. Robinson, David A. Katz & Andrew J. Nussbaum, *SEC's Amendment of Reg FD to Remove Exemption for Rating Agencies Less than it Seems*, 45 BANK & CORP. GOVERNANCE L. REP. 490, 490 (2010), http://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.18068.10.pdf.

153. 17 C.F.R. § 240.10b5-2.

154. *Id.* § 240.10b5-2(b)(2).

subject them to insider trading liability under Rule 10b-5."[155] The NRSROs' advance arrangements would violate *Chiarella/O'Hagan* duties by violating the CRAR Act, Rule 17g-4, and, as applicable, confidentiality agreements with issuers. As with duties under Regulation FD, these duties were created to prevent precisely the insider trading that the NRSRO arrangements would enable. The case that NRSRO advance access arrangements would satisfy all elements of tipper liability is very strong.

IV. THE MANNEAN MARKET IN MATERIAL, NONPUBLIC INFORMATION

The existence of the news wires' and NRSROs' advance access arrangements raises the question of why regulators, particularly the Commission, have not responded in any meaningful way. The advance access arrangements described above are pervasive, and the new wires' arrangements have been well publicized. The NYAG's agreements count for little. They are unenforceable, and the news wires view the agreements as temporary and the advance access arrangements as legal.[156] The Commission has said nothing about these open and notorious deals, much less brought any enforcement actions.

Such open, notorious, and pervasive insider trading activities should be prime enforcement targets. The Regulation FD issues raised by the advance access arrangements are fairly obvious, yet these issues have gone virtually unnoticed, with only a passing reference by the NYAG[157] and, to this author's knowledge, no comments from the Commission or any other state regulator. Their acquiescence has the effect of converting Regulation FD, which is intended to prevent insider trading, into a formalized structure through which insider trading can be carried out unimpeded. As with Rule 10b5-1,[158] another anti-insider trading rule, Regulation FD has the effect of insulating the very practices it purports to mitigate. The Commission itself has allowed Electronic Data Gathering and Retrieval system (EDGAR) filings to be publicly disseminated by the same news wires.[159]

Insider trading is so prevalent in the securities markets,[160] and regulators so seemingly indifferent, it is hard to be impressed when new forms of insider trading emerge. But the news wire and NRSRO arrangements should raise an eyebrow. Between the news wires' advance disclosure of issuers' announcements and the NRSROs' advance disclosure of ratings information, advance access

155. Proposing Release, *supra* note 103, at 72,595 (emphasis added).

156. See *supra* notes 83–84 and accompanying text for views on the NYAG's news wire agreements.

157. *See* NYAG Business Wire Press Release, *supra* note 84 (noting that public companies rely on Business Wire for compliance with rules such as Regulation FD "that require market-moving information to be released to all market participants at the same time").

158. See *infra* notes 211–14 and accompanying text for a discussion of the SEC's position on advance access arrangements and lack of prosecution under Rule 10b-5.

159. See *infra* notes 215–220 and accompanying text for a discussion of advance notice of SEC filings.

160. See *supra* notes 76–82 and accompanying text for a discussion of the expansion and effects of insider trading in the United States.

arrangements cover a sizeable swath of the total universe of material, nonpublic information about U.S. public companies. It is fair to ask whether new information about such companies is ever first traded on when it becomes public.

This Article contends that regulators' acquiescence in advance access arrangements may reflect a conscious policy to permit insider trading that occurs in a broad-based free market. Regulators recognize that, as a practical matter, an elite group of investors will always be able to trade on corporate and NRSRO announcements while they are still nonpublic. Regulators cannot, as a practical matter, prevent such trading. This will be true, and those who trade first will be the same group of traders, regardless of whether the information is disclosed in violation of a *Chiarella/O'Hagan* duty. Either way, the same group of traders will be the first to access and trade on material, nonpublic information.

Regulators have concluded that, if it is inevitable that the same group of traders will buy material, nonpublic information in a free market before it is available to the investing public, then there is no real fairness-related reason to prosecute such trading when the information has been obtained in violation of a *Chiarella/O'Hagan* duty. With or without a *Chiarella/O'Hagan* duty violation, equal access is not practicably achievable. Nonpublic information will always have been traded on before the public receives it, and the same traders will always capture the profits from advance access to the information. Elite traders who obtain information in violation of a *Chiarella/O'Hagan* duty may gain an advantage over other elite traders, but in no event will the public have equal access to corporate or NRSRO announcements. Prosecuting participants in Mannean marketplaces when only a *Chiarella/O'Hagan* duty has been violated would simply increase enforcement costs while impeding efficiency in the market of material, nonpublic information. Regulators have privately embraced Henry Manne's imagining of a free market in inside information.[161]

A. The Inevitability of Trading on Nonpublic Information

Elite investors will always be able to trade on corporate and NRSRO announcements before they are received by the public for two primary reasons. First, for purposes of insider trading law, information is "nonpublic" until the investing public has received and had the opportunity to act on the information. Second, the nature of the electronic delivery of information makes it impossible for such a large group of investors—the investing public—to receive information before an elite group of traders has received and traded on it. In reality, the nonpublic element of insider trading liability is a myth because there is no possibility of trading on public information in the sense of trading before the information has been substantially incorporated into a security's price.

As noted above,[162] insider trading liability attaches only if the information traded on was not public at the time of the trade. In Justice Powell's words, the

161. *See generally* MANNE, *supra* note 1 (arguing that insider trading produces beneficial effects for the economy).

162. See *supra* notes 23–30 for a description of what constitutes nonpublic information.

nonpublic element of insider trading liability reflects "the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure."[163]

It is not just equal access to information that makes it public. Public investors must also be able to act on it; otherwise, equal access to information would have no value. As the Commission explained in *Faberge, Inc.*:

> [P]ublic investors must be afforded a reasonable waiting period to react to the information. . . . [W]hat constitutes a reasonable waiting period must be dictated by such surrounding circumstances as the form of dissemination and the complexity of information, *i.e.*, whether it is "readily translatable into investment action."[164]

The Commission requires that, before trading, insiders afford public investors an opportunity ("reasonable waiting period") to trade on ("react to") the information. The phrase "readily translatable into investment action," originally iterated by the *Texas Gulf Sulphur* court, refers to the ability to convert the information into informed trades ("investment action").[165] The longer this conversion would take, the longer an insider must wait before trading.[166]

Under this conception of when information is public, corporate and NRSRO announcements will never become public before an elite group of high-speed traders has already traded on it. Neither posting information on a company website, nor electronically sending it to a large number of subscribers, nor filing it with the Commission will provide equal access to the investing public. These information dissemination approaches do nothing to provide the investing public with equal access to and the ability to trade on information because an elite group of traders will inevitably receive and trade on it first.

The time at which electronic information is received and trades can be entered generally depends on speed, location, and format.[167] When the

163. Chiarella v. United States, 445 U.S. 222, 227 (1980).

164. Faberge, Inc., Exchange Act Release No. 10174, 1 SEC Docket 21, 1973 WL 149283, at *6 (May 25, 1973) (quoting SEC v. Texas Gulf Sulphur, Co., 401 F.2d 833, 854 (2d. Cir. 1967)); *see* Commission Guidance on the Use of Company Web Sites, Exchange Act Release No. 58288, 2008 WL 4068202, at *6 (Aug. 1, 2000) ("[I]n evaluating whether information is public for purposes of our guidance, companies must consider whether and when: (1) a company web site is a recognized channel of distribution, (2) posting of information on a company web site disseminates the information in a manner making it available to the securities marketplace in general, and (3) there has been a reasonable waiting period for investors and the market to react to the posted information."); *see also* SEC v. Mayhew, 121 F.3d 44, 50 (2d Cir. 1997) ("Information becomes public when disclosed 'to achieve a broad dissemination to the investing public generally and without favoring any special person or group . . . .'" (quoting Dirks v. SEC, 463 U.S. 646, 653 n.12 (1983))).

165. *Texas Gulf Sulphur*, 401 F.2d at 854.

166. The insider must wait until *after* the information has been incorporated into the security's price. *See Mayhew*, 121 F.3d at 50 ("Information becomes public when . . . although known only by a few persons, their trading on it 'has caused the information to be fully impounded into the price of the particular stock.'" (quoting United States v. Libera, 989 F.2d 596, 601 (2d Cir. 1993))).

167. *See* Carol L. Clark, Controlling Risk in a Lightning-Speed Trading Environment, Chicago Fed Letter, no. 272, Mar. 2010, at 2, https://www.chicagofed.org/publications/chicago-fed-letter/2010/march-272 ("Latency is measured in microseconds (millionths of a second) and has various

transmission is received will depend on the speed of the line on which it is carried. Subscribers to whom information is sent over faster cables will receive it before those with slower cables. Subscribers with servers in close physical proximity to the transmitting server ("co-located") will receive the information before those who are further away.[168] If the transmitter sends the information using different transmission protocols, then traders who receive the information formatted in the faster protocol will receive it before those who use the slower protocol.[169] If the transmitter formats information to be machine readable, then traders whose software can automatically interpret the information will understand it before others.[170] Such interpretive algorithms are also instrumental in enabling traders to enter and execute orders immediately upon receipt of market-moving information.[171]

To illustrate, assume that corporate and NRSRO information is disseminated electronically from Point A. Traders that place servers in close physical proximity to Point A will receive that information in a few microseconds. The traders' algorithms, which reside on the same servers, can interpret the information, send an order, and execute a trade, also within microseconds. These steps will have been completed long before a retail investor's PC receiving information over a standard commercial Internet connection has fully loaded either a corporate website's page, a message from a news wire, or an RSS feed from the SEC's electronic database. The trader with co-located, algorithm-preloaded servers connected through high-speed cables will be able to complete trades before the information is even displayed on the retail investor's computer screen.

In a free market, these speed advantages will necessarily be possessed by a small group of elite traders. The potential profit from advance access trading is finite, and the commitment capital required to be among the first to trade is

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components, including speed at which market data and signals from the marketplace are processed - and geographical distance and response time from the exchange matching engine (a computer or - computers where the trade is matched and executed).").

168. See *supra* notes 130–33 for a discussion of the effects of having co-located servers.

169. For example, data sent via the Transmission Control Protocol will be received after data sent via the User Datagram Protocol. *See OpenVPN over TCP Vs. UDP: What Is the Difference, and Which Should I Choose?*, BEST VPN (Aug. 23, 2013), https://www.bestvpn.com/blog/7359/openvpn-tcp-vs-udp-difference-choose/.

170. See *supra* notes 132–33 and accompanying text for an example of the deliberate tailoring of information for readability.

171. *See* Terrence Hendershott, Charles M. Jones & Albert J. Menkveld, *Does Algorithmic Trading Improve Liquidity?*, 66 J. FIN. 1, 1 (2011) (stating that trading algorithms "make certain trading decisions, submit orders, and manage those orders after submission"); Charles R. Korsmo, *High-Frequency Trading: A Regulatory Strategy*, 48 U. RICH. L. REV. 523, 538–40 (2014) (discussing algorithmic trading); *see also* Jeff Cox, *Here's the HFT Paper that Has Wall St Freaking Out*, CNBC (Dec. 2, 2014, 2:02 PM), http://www.cnbc.com/2014/12/02/heres-the-hft-paper-that-has-wall-st-freaking-out.html ("It's a competitive advantage, and this is just the 21st century way of trading . . . . Just a few decades ago, if you wanted a job on Wall Street you studied finance, you studied economics. That's how you learned to trade. Now it's a matter of, Can you write code? Are you able to input code that's going to give you a competitive advantage in trading?" (quoting Todd Schoenberger, head of LandColt Capital)).

substantial.[172] Traders that have made this capital investment will begin capturing the profits from buying shares from or selling shares to uninformed sellers before the price rises or falls to reflect the incorporation of the new information. Only a small number of high-speed traders will capture a large portion, if not all of the profit from corporate and NRSRO announcements because the market for high-speed access to information, like any market, will be regulated by the forces of supply and demand.[173] Thus, trading on the "public" release of information will always begin while the information is still nonpublic and the investing public is still in the dark.[174]

B. Can Access Be Equal?

In theory, the Commission could craft a regulatory regime under which the investing public has an equal opportunity to trade on corporate and NRSRO announcements. For example, the release of electronic information could be staged based on the time it takes to travel to each investor's IP address to ensure that every investor receives it simultaneously. This kind of synchronization of receipt would eliminate co-location and line-speed advantages. The requirement that NRSROs provide ratings information for free or for a reasonable fee implies that Congress intended to create this result.[175] A reasonable fee would presumably be low enough such that the entire investing public could afford the cost of receiving information simultaneously.

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172. *See* David Glovin & Christine Harper, *Goldman Trading-Code Investment Put at Risk by Theft (Update3)*, BLOOMBERG (July 6, 2009), http://www.proinvestor.com/boards/15179/Goldman-Trading-Code-Investment-Put-at-Risk-by-Theft- (quoting Larry Tabb, Founder of Tabb Group, discussing charges against a Goldman Sachs employee who allegedly stole proprietary trading code worth millions of dollars: "The more sophisticated market makers—and Goldman is one of them—spend significant amounts of money developing software that's extremely fast and can analyze different execution strategies so they can be the first one to make a decision.").

173. Prices may continue to rise after insider trading has taken place. *See, e.g.*, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 847 (2d Cir. 1968) (defendants' trading left much of the stock price's rise to post-announcement trading); *see also* James Cox, *Insider Trading and Contracting: A Critical Response to the 'Chicago School*,' 1986 DUKE L.J. 628, 647 n.65 ("Contrary to Professor Manne's assertions, price changes do follow corporate announcements and this suggests that insider trading is not an efficient signal of nonpublic information."). Traders will pay for information that suggests the returns of a security will be high. *See* Sanford J. Grossman & Joseph E. Stiglitz, *On the Impossibility of Informationally Efficient Markets*, 70 AM. ECON. REV. 393, 393 (1980).

174. Some academics have suggested that an "always disclose" rule, which would mandate continuous disclosure of all material information, might come closest to achieving fairness goals. *E.g.*, Levmore, *supra* note 72, at 126–28. As a practical matter, however, no such system could avoid an elite group of traders having the first opportunity to trade, as Manne opined almost five decades ago. MANNE, *supra* note 1, at 159–69; *see* Christopher Paul Saari, Note*, The Efficient Capital Market Hypothesis, Economic Theory and the Regulation of the Securities Industry*, 29 STAN. L. REV. 1031, 1052–53 (1977) (citing studies finding insiders' outperformance); *see also* Levmore*, supra* note 72*,* at 127 n.34 (contending that quick actors may compete away available profits, but "if the information is disclosed in a way that enables only a select few outsiders to act on it quickly and without much cost, those outsiders will profit from this informational advantage in a way that neither other outsiders nor insiders who are forced to wait can").

175. See *supra* note 142 and accompanying text for a description of the CRAR Act's fee requirement.

However, ensuring materially simultaneous receipt of information would require an enormous capital investment and regulatory overhaul, while still leaving unresolved the problem that, once the investing public has received the information, it must also have an equal opportunity to translate the information into action.[176] Synchronizing the speed with which investors interpret and act on simultaneously received information would be practicably untenable. High-speed traders interpret electronic information with algorithms that are constantly becoming more efficient and accurate. These algorithms are highly individualized and they reside on private servers. The investing public would have to be given the same tools in order to act on information as quickly as high-speed traders.

The government could distribute a common interpretive algorithm to the investing public that is as fast as the fastest high-speed trader algorithm (a "regulatory algorithm"), but even if the government could compete with private programmers at that level, it would not be enough to level the playing field. Investors would still need the technology to convert whatever interpretation was generated by the regulatory algorithm (e.g., "buy" or "sell") to an order and execute it as quickly as a high-speed trader. No system can provide equal access unless there is no point at which private investment in speed or coding talent can obtain an advantage.

Thus, the only technically feasible way to ensure equal access would be for the government to control the entire process—information interpretation, order entry, and order execution.[177] Under this approach, the investing public would provide standing instructions to a government order entry and execution system regarding how information interpreted as a "buy" or "sell" signal for a company should be translated into an order. This system would be politically, if not technically, infeasible. Government-issued decisions on whether to buy or sell stocks based on corporate and NRSRO announcements would create an unacceptable level of governmental intrusion into the securities markets.[178] Moreover, interpreting even the most transparent market information involves some degree of subjectivity. A company's surprisingly high earnings announcement may necessarily cause a stock's price to rise relative to the market, but how much it will rise will depend on highly subjective factors.

Such an Orwellian model could never be implemented; even if it were, it *still* would not ensure that the investing public had equal access and opportunity to trade on announcements because the question of the execution priority

176. See *supra* notes 165–66 and accompanying text for a description of the process investors go through before trading is possible.

177. *See generally* Luke Dormehl, *Algorithms Are Great and All, but They Can Also Ruin Lives*, WIRED (Nov. 19, 2014, 6:00 AM), http://www.wired.com/2014/11/algorithms-great-can-also-ruin-lives/?mbid=synd_slate (explaining potential negative effects and limitations of computer algorithms).

178. The risks of government-directed investment in companies have been frequently debated. *See, e.g.*, *Oversight Hearing on Social Security Investments in the Securities Markets Before the Subcomm. on Secs., S. Banking, Housing and Urban Affairs Comm.*, 105th Cong. (1997) (prepared testimony of Roger Mehle, Exec. Dir., Fed. Retirement Thrift Inv. Bd.) (discussing the risks of government-directed investment pursuant to privatization of Social Security).

assigned to orders would still be unresolved. While it is theoretically possible for information to be received and translated into action simultaneously, orders cannot be executed at the same time. Orders must be prioritized. Exchanges often give first priority, after price, to time of receipt,[179] but an equal access system, indeed, would be *designed* to ensure simultaneous receipt. This problem could be solved by applying neutral tiebreakers for simultaneously received orders, such as size and price.[180] Or priority could be randomized. Thus, through a complex, expensive, cumbersome, politically infeasible process, the government could conceivably turn corporate and NRSRO announcements into a kind of public utility by implementing a *Faberge, Inc.* model for ensuring that the investing public had the opportunity to trade on corporate and NRSRO announcements.[181]

A more realistic solution might be to create equal access through the single step of bundling orders received during very short time intervals. Under a bundling model, a company or NRSRO announcement that was released at exactly 12:00 p.m., for example, would automatically trigger a suspension of trading in the (rated) company's shares. During the trading suspension, orders received would be collected but not executed.[182] Only after sufficient time had passed for the investing public to receive and interpret the announcement and submit an order, the bundle of orders would be executed without regard to the time of receipt. High-speed traders would gain little or no advantage from their faster infrastructure or software.[183]

Academics have previously proposed bundling for the purpose of

179. *See* James J. Angel & Daniel G. Weaver, Priority Rules! 12 (Nov. 1998) (unpublished working paper), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=169274.

180. *Id*. (discussing tie breakers).

181. The difficulties of developing such a system are illustrated in Professor Nagy and Professor Painter's model for a fairer system under which government officials would release material, nonpublic governmental information. Donna M. Nagy & Richard W. Painter, *Selective Disclosure by Federal Officials and the Case for an FGD (Fairer Government Disclosure) Regime*, 2012 WIS. L. REV. 1285, 1355–64. The public utility model brings to mind various proposals for regulating intellectual property rights. For example, the issuers of corporate and NRSRO announcements could be paid based on how frequently the announcements were downloaded, similar to how some have proposed that music artists be compensated. *See* Steve Knopper, *The New Economics of the Music Industry*, ROLLING STONE (Oct. 25, 2011), http://www.rollingstone.com/music/news/the-new-economics-of-the-music-industry-20111025 (discussing how subscription services pay musicians).

182. Bundling at some time interval is always employed. If an exchange's clocks can measure only milliseconds, orders received throughout a single millisecond would be treated as having been received simultaneously (i.e., they would be bundled until the end of that millisecond). They would be assigned the same time of receipt and prioritized based on other factors.

183. A speed advantage cannot be entirely eliminated by bundling alone because informational advantages arising at the end of a bundling period would still exist. To illustrate, assume that orders are bundled each millisecond. A high-speed trader generally would not gain an advantage by submitting an order one microsecond before another trader, if both orders were received during the same millisecond bundling interval. However, an order received one-half microsecond before the end of the millisecond bundling interval would be executed *before* an order received one-half microsecond *after* the interval. In such situations, a one-microsecond speed advantage would result in earlier execution.

eliminating wasteful spending on speed.[184] While they accept the Mannean argument that the speed with which information is incorporated into stock prices can make capital formation more efficient, they assert that subsecond speed differences generally provide no such capital formation benefit.[185] High-speed traders therefore create no net social wealth by making large capital investments in order to achieve subsecond trading advantages. Proponents of bundling argue that it would eliminate the dead weight social cost of such investments in subsecond speed advantages by ignoring subsecond advantages when prioritizing orders.[186]

In a way, bundling for the purpose of creating equal access to information reflects the inverse of the bundling academics' economic analysis. Bundling would facilitate equal access by allowing the investing public to trade on information at very low cost—the inverse of eliminating the benefit of high dollar investments in speed advantages. As long as the bundling time interval exceeded the time it took for a group large enough to constitute the investing public to enter an order, bundling would provide de facto equal access to corporate and NRSRO announcements.[187]

However, bundling would require a major regulatory overhaul that has already generated intense opposition.[188] Exchanges generally have a great deal of leeway in designing their order handling procedures and would be a formidable opponent in any attempt to reduce their discretion and profitability. Determining the length of bundling intervals also would be empirically challenging. The Commission would still be left with a difficult enforcement task as traders sought means of circumventing bundling by obtaining corporate and NRSRO announcements before their official release.

In summary, the current market structure ensures that an elite group of traders will be able to trade on corporate and NRSRO announcements before that information becomes public. The Commission could institute reforms that provide the investing public equal access to this information, such as bundling trades, but it has taken no steps to do so. Instead, it has acquiesced in free markets in nonpublic information.

The SEC's position on nonpublic information markets is understandable. Ensuring bona fide equal access to information, if even technically possible, would require major changes in the way that information is incorporated into

184. *See generally* Eric Budish, Peter Cramton & John Shim, *The High-Frequency Trading Arms Race: Frequent Batch Auctions as a Market Design Response*, 130 Q.J. ECON. 1547, 1548 (2015) (proposing batch auctions as a means of mitigating wasteful spending on speed advantages).

185. *See id.* at 1592.

186. *E.g.*, *id.*

187. Bundling could be viewed as a subsecond version of the "disclose-or-suspend" rule, once suggested by Saul Levmore, under which a corporation would be required to disclose material information or suspend all trading until it does so. Levmore, *supra* note 72, at 128–29.

188. *See, e.g.*, D. Keith Ross, *Synchronized Frequent Batch Auctions: A Rebuttal*, TABBFORUM (Nov. 18, 2014), http://tabbforum.com/opinions/synchronized-frequent-batch-auctions-a-rebuttal?utm_source=TabbFORUM+Alerts&utm_campaign=b023c375d3-UA-12160392-1&utm_medium=email&utm_term=0_29f4b8f8f1-b023c375d3-275571493.

stock prices. These changes would be complex and politically unpopular. The Commission therefore has little incentive to change the status quo. Moreover, as discussed immediately below, the Commission may believe that acquiescing in trading on material, nonpublic information is good policy. The same traders will be the first to trade regardless of whether information obtained in that market has been disclosed in violation of a *Chiarella/O'Hagan* duty, so prosecuting such arrangements would have no effect on the investing public's equal access to material information,[189] but would impose additional enforcement costs and potentially disrupt the efficient operation of markets in nonpublic information.

C. The Mannean Marketplace and Nonpublic Information

The SEC's acquiescence in trading on material, nonpublic information may reflect a conscious policy decision. Under current law and regulatory practice, high-speed traders will be the first to receive and trade on corporate and NRSRO announcements. It makes no difference whether the information market in which they compete entails the purchase of nonpublic information in violation of a *Chiarella/O'Hagan* duty. Either way, an elite group of high-speed traders will trade on nonpublic information, the investing public will not have equal access or opportunity, and only a revolution in market regulations could change this situation.

In addition, the continued vitality of the *Chiarella/O'Hagan* element of insider trading has faded, while *Texas Gulf Sulphur*'s equal access principle has been substantially restored as the animating core of insider trading policy. Recent case law has validated Judge Luttig's prescient statement in 1995 that the fiduciary duty element of insider trading liability was a mere incantation.[190] A focus on equal access rather than *Chiarella/O'Hagan* duties would be consistent with the SEC's preference for the equal access doctrine as evidenced by both its positions in *Cady, Roberts* and *Texas Gulf Sulphur*, and its efforts to dilute the *Chiarella/O'Hagan* duty element.[191]

Thus, Judge Luttig's complaint that the fiduciary fig leaf renders investors "the targets of *ad hoc* decisionmaking or pawns in an overall litigation strategy

189. Although advance access arrangements do not fit within the *Dirks* exception because the tippers are compensated, the SEC's position echoes Justice Powell's observation that "as market values fluctuate and investors act on inevitably incomplete or incorrect information, there always are winners and losers; but those who have 'lost' have not necessarily been defrauded." Dirks v. SEC, 463 U.S. 646, 666–67 n.27 (1983).

190. *See, e.g.*, United States v. Bryan, 58 F.3d 933, 951 (4th Cir. 1995) ("[W]hile the courts adopting the misappropriation theory incant that the breach of a fiduciary relationship is a necessary element of the offense, in principle, if not in reality, these courts would be obliged to find liability in the case of simple theft by an employee, even where no fiduciary duty has been breached, for the *raison d'etre* of the misappropriation theory in fact is concern over 'the unfairness inherent in trading on [stolen] information.'" (citing Chiarella v. United States, 445 U.S. 222, 241 (1980) (Burger, C.J., dissenting))), *abrogated by* United States v. O'Hagan, 521 U.S. 642 (1997).

191. *See* Nagy, *supra* note 62, at 1320 ("[L]ower courts, encouraged by the SEC, have been willing to allow *O'Hagan*'s policy justifications for the federal insider trading proscription to trump the fiduciary-based doctrine actually endorsed by the Court.").

known only to the SEC"[192] is overstated. The SEC's policy is not entirely ad hoc. Rather, it is consistent with a conscious decision to permit insider trading on nonpublic information that is available in a free market, while prosecuting insider trading on nonpublic information that is not.

The SEC's insider trading policy precisely mirrors the view that insider trading should be permitted as long as it occurs in a Mannean marketplace. Its enforcement actions, including cases involving precisely the same nonpublic information that news wires sell to high-speed traders, reflect a policy of prosecuting a kind of black market in which a handful of traders "cheat" the Mannean marketplace by entering into side deals with discrete information providers. Traders who respect this unspoken policy by obtaining their information in a Mannean marketplace, *Chiarella*/*O'Hagan* duty violating or otherwise, are left undisturbed.

Consider the news wire cases that the Commission has brought and the news wire advance access arrangements it has ignored. The Commission has sued traders who traded on advance access to *exactly* the same nonpublic news wire releases that were the subject of the NYAG news wire agreements. For example, in 2005 the Commission settled claims against traders who had become subscribers to Business Wire's releases in order to insert software (a "spider") into Business Wire's secure website that extracted corporate information before it became public.[193] The spider achieved the same advance access obtained in the news wire arrangements discussed *supra*, but that access was different in that it was not widely available in an information market.

In 2008, the Commission similarly sued an employee of an investor relations firm who traded on the firm's clients' announcements before they were released to the public.[194] An SEC official pointedly characterized the case as follows:

> [Defendant] Lucarelli knew full well that he was prohibited from trading on information contained in draft press releases that had not yet been made public, but he brazenly gave himself a head start on the rest of the investors by trading based on the nonpublic details and exiting his holdings after the news came out . . . .[195]

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192. *Bryan*, 58 F.3d at 951.

193. *See* Complaint at 2, SEC v. Lohmus Haavel & Viisemann, 05 CV 9259 (S.D.N.Y. Nov. 1, 2005), http://www.sec.gov/litigation/complaints/comp19450.pdf.

194. Complaint, SEC v. Lucarelli (S.D.N.Y. Aug. 26, 2014) (No. 14-Civ. 6933), http://www.sec.gov/litigation/complaints/2014/comp-pr2014-175.pdf. The employee was also charged criminally and sentenced to two and one-half years in prison. Kevin Dugan, *'I Couldn't Perform My Sexual Duties': Ex-Wall Street Exec at Sentencing*, N.Y. POST (Jan. 21, 2015, 2:49 PM), http://nypost.com/2015/01/21/lucarelli-gets-prison-time-after-bizarre-courtroom-rant/; *see also* Complaint, SEC v. McGrath (S.D.N.Y. July 22, 2014) (No. 14 CV 5483), http://www.sec.gov/litigation/complaints/2014/comp-pr2014-142.pdf (charging investor relations firm employee with prerelease trading on quarterly earnings announcement); Complaint, SEC v. Gray (S.D. Tex. July 26, 2013) (No. 4:13-cv-2186), http://www.sec.gov/litigation/complaints/2013/comp-pr2013-135.pdf (same); Complaint, SEC v. Fraser (C.D. Cal. Sept. 5, 2012) (No. CV 12-7574), http://www.sec.gov/litigation/complaints/2012/comp-pr2012-179.pdf (charging public relations firm employee with trading on nonpublic client information).

195. Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges Investor Relations Firm

These words closely track the NYAG's rhetoric when describing the conduct underlying the news wire agreements,[196] yet the Commission has indicated no similar concern about news wire arrangements.[197] The Commission sued Michael Anthony Dupre Lucarelli and another investor relations firm employee, Kevin McGrath, mere months after the NYAG announced its agreement with Marketwired.[198] In light of the temporal proximity and factual parallels between Lucarelli's and McGrath's alleged schemes and the announcement of the news wire agreements, it is difficult to explain the SEC's silence and inaction regarding the latter as reflecting anything other than conscious acquiescence in the news wire arrangements. Most recently, five traders were arrested for trading on corporate press releases obtained by hacking into the computer servers of PR Newswire Association LLC, Marketwired, and Business Wire,[199] the same firms that the NYAG found had organized their own "legal hack" through advance access arrangements.

Executive with Insider Trading Ahead of News Announcements by Clients (Aug. 26, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542757594.

196. *See, e.g.*, NYAG Marketwired Press Release, *supra* note 84 ("High-frequency traders who drain the value out of market-moving information in the milliseconds before it becomes widely available to other investors erode confidence in our markets and skim from the rest of the investing public, which hurts the entire market. . . . [That] time lag allowed high-frequency trading firms to trade on the information ahead of, and at the expense of, other investors." (quoting Attorney General Schneiderman)).

197. For example, each of the following SEC speeches and testimony—made around the time of the news wire agreements—references insider trading, but notably includes no mention of the NYAG's Insider Trading 2.0 investigation: Andrew Ceresney, Dir., Sec. & Exch. Comm'n Div. of Enforcement, Remarks to the American Bar Association's Business Law Section Fall Meeting (Nov. 21, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370543515297#.VMPlbmTF8mU; Mary Jo White, Chair, Sec. & Exch. Comm'n, The Challenge of Coverage, Accountability and Deterrence in Global Enforcement, Remarks at the IOSCO 39th Annual Conference (Oct. 1, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370543090864#_ftn14; Mary Jo White, Chair, Sec. & Exch. Comm'n, Three Key Pressure Points in the Current Enforcement Environment, Remarks at the N.Y.C. Bar Association's Third Annual White Collar Crime Institute (May 19, 2014), http://www.sec.gov/news/speech/2014-spch051914mjw.html#.VMPmbmTF8mU; *Oversight of the SEC's Agenda, Operations and FY 2015 Budget Request*, *Hearing Before the H. Comm. on Fin. Servs.*, 114th Cong. (2014) (testimony of Mary Jo White, Chair, Sec. & Exch. Comm'n), http://financialservices.house.gov/uploadedfiles/hhrg-113-ba00-wstate-mwhite-20140429.pdf. The following speeches were given soon after the NYAG agreement with Reuters was announced in July 2013: Daniel M. Gallagher, Comm'r, Sec. & Exch. Comm'n, Remarks at FINRA Enforcement Conference (Nov. 7, 2013), http://www.sec.gov/News/Speech/Detail/Speech/1370540310199#.VMPnbmTF8mU; Mary Jo White, Chair, Sec. & Exch. Comm'n, Remarks at the Securities Enforcement Forum (Oct. 9 2013), http://www.sec.gov/News/Speech/Detail/Speech/1370539872100#.VMPn0WTF8mU; Mary Jo White, Chair, Sec. & Exch. Comm'n, Deploying the Full Enforcement Arsenal, Remarks at the Council of Institutional Investors Fall Conference (Sept. 26, 2013), http://www.sec.gov/News/Speech/Detail/Speech/1370539841202#.VPy9ZGTF_3o.

198. The Marketwired agreement was announced in March 2014. *See* Patterson, *Speed Traders Get an Edge*, *supra* note 85. The SEC's cases against McGrath and Lucarelli, discussed *supra* notes 194–98 and accompanying text, were announced, respectively, in July and August 2014.

199. Keri Geiger, *U.S. Identifies Insider Trading Ring with Ukraine Hackers*, BLOOMBERG BUS. (Aug. 11, 2015, 1:20 AM), http://www.bloomberg.com/news/articles/2015-08-11/u-s-identifies-insider-trading-ring-including-ukraine-hackers.

The SEC's recent prosecution of traders' use of expert networks also illustrates its Mannean enforcement model.[200] In these cases, an expert network creates a market in which purchasers of expert services receive material, nonpublic information, such as the results of FDA drug tests. However, the expert network does not create a market in which all buyers can participate equally, that is, on the same terms provided that the trader is willing to pay the going rate. Rather, the trader receives the information through a one-on-one communication with the insider. For example, the Commission recently prosecuted Matthew Martoma for trading on tips about nonpublic studies on bapineuzumab, a potential Alzheimer drug, and Dr. Sid Gilman for providing the tips to Martoma on behalf of expert network Gerson Lehrman Group.[201]

Would traders using expert networks be prosecuted if they purchased the information through a subscription service such as AlphaFlash?[202] Prosecutors' nonprosecution of news wire and NRSRO advance access arrangements suggests that the answer is no. This would be consistent with the Mannean model's goal of quickly incorporating new information into security prices. Unlike trading by participants in an advance access arrangement, discrete trading by individuals such as Mssrs. Lucarelli, McGrath, and Martoma could not be relied on to move stock prices toward the correct equilibrium point.[203] The fact that insider trading results in pre-announcement price movements has been widely documented.[204]

The SEC's Regulation FD enforcement program provides a more refined picture of the kind of insider trading the agency chooses not to prosecute. A primary purpose of Regulation FD is to deter selective disclosure of material, nonpublic corporation information in conference calls with Wall Street analysts.[205] The Commission emphasized this purpose in its first Regulation FD enforcement actions, all of which involved selective disclosure to a handful of analysts in conference calls and one-on-one communications.[206] The facts of

200. *See* Daniel H. Jeng, Comment, *Expert Networks and Insider Trading: An Introduction and Recommendation*, 32 REV. BANKING & FIN. L. 245, 245–46 (2013).

201. *See* Patrick Radden Keefe, *The Empire of Edge*, NEW YORKER (Oct. 13, 2014), http://www.newyorker.com/magazine/2014/10/13/empire-edge (describing the friendship between Gilman and Martoma and detailing how Gilman divulged secret inside information to Martoma).

202. See *supra* notes 120–21 and accompanying text for a discussion of AlphaFlash.

203. It is possible that huge insider trades such as those executed by Martoma, *see* Keefe, *supra* note 201 (citing that hedge fund that employed Martoma sold $700 million in, and made $275 million shorting, Elan and Wyeth shares), could have a material effect on the stock prices of the companies traded, but there is no evidence to this effect.

204. *See supra* notes 76–77.

205. *See* Selective Disclosure and Insider Trading, Exchange Act Release No. 7881, 2000 WL 1201556, at *11 (Aug. 15, 2000) ("One common situation that raises special concerns about selective disclosure has been the practice of securities analysts seeking 'guidance' from issuers regarding earnings forecasts.").

206. *See* Secure Computing Corp., Exchange Act Release No. 46895, 2002 WL 31643024 (Nov. 25, 2002) ("Chief Executive Officer . . . disclosed non-public information about a significant contract to two portfolio managers at two institutional advisers in violation of Regulation FD . . . ."); Office Depot, Inc., Exchange Act Release No. 3199, 2010 WL 4134972 (Oct. 21, 2010) (selective disclosure to sell-side analysts); Black, Exchange Act Release No. 21222, 96 SEC Docket 2473, 2009 WL 3047574 (Sept. 24, 2009) (selective disclosure by email to sell-side analysts); Motorola, Inc., Exchange Act

these Regulation FD cases have noteworthy similarities to the news wire and NRSRO arrangements. The analysts' dissemination of the issuer-provided information to their clients is structurally similar to the news wires' dissemination of issuer-provided information to their advance access subscribers.[207] Indeed, in one case the selective disclosure to an analyst was distributed electronically to subscribers to Thomson's First Call, after which the company's stock price rose.[208]

The Regulation FD cases differ from the news wire and NRSRO arrangements in ways that may provide insight into what kinds of advance arrangements will trigger an enforcement response. In contrast with the news wire and NRSRO arrangements, the prosecuted selective disclosures to analysts and subsequent dissemination to clients were ad hoc, the terms of access were uncertain, and the payment scheme was, at most, indirect and opaque. These distinguishing features may indicate that the Commission is willing to overlook only more formal, established advance access arrangements. This issue is beyond the scope of this Article, but the SEC's prosecution of issuers and their executives in the analyst-disclosure cases may provide a starting point for future research on the precise structure and breadth that a Mannean marketplace must comprise in order to avoid SEC prosecution.

Regulation FD appears to have been a success,[209] but the selective disclosure that was commonplace before Regulation FD may simply have been replaced by news wire and NRSRO arrangements. Issuers previously provided earnings announcements to analysts and institutional investors before providing them to the general public, a practice that Regulation FD was intended to eliminate. Some studies have found that Regulation FD has reduced leakage of such information into the market prior to public release,[210] which would mean less competition for participants in advance access arrangements to be the first to

Release No. 46898, 2002 WL 31650174 (Nov. 25, 2002) (selective disclosure of decline in sales and orders in calls to analysts).

207. *Cf.* Jill Fisch, *Regulation FD: An Alternative Approach to Addressing Informational Asymmetry*, *in* RESEARCH HANDBOOK ON INSIDER TRADING 112, 128 (Stephen Bainbridge ed., 2013) (discussing an SEC letter expressing concern that CEO's Twitter and blog posts, which disseminated corporate information in a manner similar to news wires' advance access arrangements, may violate Regulation FD).

208. *See* Flowserve, Corp., Exchange Act Release No. 19154, 85 SEC Docket 146, 2005 WL 677813, at *1 (Mar. 25, 2005) (stock price rose six percent the day after selective disclosure provided to analyst was disseminated via Thomson's First Call). The Flowserve matter is also interesting because it implies that distribution by Thomson's First Call would not constitute simultaneous public dissemination for purposes of Regulation FD.

209. *See* Fisch, *supra* note 207, at 129.

210. *See e.g.*, Frank Heflin, K.R. Subramanyan & Yuan Zhang, *Regulation FD and the Financial Information Environment: Early Evidence*, 78 ACCT. REV. 1, 2 (2003) (finding improved incorporation of announcements into security prices after adoption of Regulation FD); Praveen Sinha & Christopher Gadarowski, *The Efficacy of Regulation Fair Disclosure*, 45 FIN. REV. 331, 332 (2010); Bei Dong, Edward Xuejun Li, K. Ramesh & Min Shen, The Effects of Regulation FD on Informal and Institutionalized Leakages of Information in Earnings Press Releases 16 (Jan. 3, 2012) (unpublished working paper), http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.404.1962&rep=rep1&type=pdf (citing post-Regulation FD data).

receive and trade on material, nonpublic information. Regulation FD's success may thereby have spurred the development of the news wire and NRSRO arrangements, while insider trading under cover of Rule 10b5-1 plans may have had the opposite effect.

The SEC's position on advance access arrangements may explain why it has not prosecuted illegal insider trading under cover of Rule 10b5-1 plans. Empirical studies demonstrate that trading by insiders in advance of company announcements is commonplace,[211] yet the Commission has made virtually no attempt to counter such trading.[212] This nonprosecution policy is consistent with the views of those who contend that companies should be permitted to reward their employees by allowing them to trade on nonpublic company information.[213] Alternatively, the Commission may tolerate 10b5-1 plan insider trading because public company executives must publicly disclose their trades, which allows private plaintiffs to substitute for public enforcement as private

211. *See*, *e.g.*, Allan Horwich, *The Origin, Application, Validity, and Potential Misuse of Rule 10b5-1*, 62 BUS. LAW. 913, 949–53 (2007) (discussing liability issues); Alan D. Jagolinzer, *Do Insiders Trade Strategically Within the SEC Rule 10b5-1 Safe Harbor?*, 55 MGMT. SCI. 224, 234 (2009); Robert E. Wagner, *Gordon Gekko to the Rescue?: Insider Trading as a Tool to Combat Accounting Fraud*, 79 U. CIN. L. REV. 973, 994 (2011) (citing M. Todd Henderson, *Insider Trading and CEO Pay* 10 (Chi. Law Research Paper Series, Working Paper No. 521, 2010), http://papers.ssrn.com/abstract=1605170)); M. Todd Henderson, Alan D. Jagolinzer & Karl A. Muller, *Hiding in Plain Sight: Can Disclosure Enhance Insiders' Trade Returns?* (Chi. Law Working Paper Series, Working Paper No. 411, 2012), http://dx.doi.org/10.2139/ssrn.1137928 (contending that 10b5-1 plans can create cover for opportunistic insider trading); *see also* Susan Pulliam, Jean Eaglesham & Rob Barry, *Insider-Trading Probe Widens: U.S. Launches Criminal Investigation into Stock Sales by Company Executives*, WALL ST. J., Dec. 11, 2012, at A1 (finding fourteen percent of trades in 10b5-1 plans had a ten percent gain or a ten percent loss within one week of their trades).

212. SEC staff has stated that 10b5-1 plans would be reviewed for abuse. Linda Chatman Thomson, Dir., Division of Enforcement, U.S. Sec. & Exch. Comm'n, Remarks at the 2007 Corporate Counsel Institute (Mar. 8, 2007), http://www.sec.gov/news/speech/2007/spch030807lct2.htm ("We're looking at this—hard."). However, there have been almost no enforcement actions regarding the opportunistic use of 10b5-1 plans. *See* SEC v. Mozilo, No. CV 09–3994–JFW (MANx), 2010 WL 3656068 (C.D. Cal. 2010). The SEC's inactivity stands in stark contrast to the frequency of such claims in private lawsuits. *See, e.g.*, *In r*e Questcor Sec. Litig., No. SA CV 12–01623 DMG (FMOx), 2013 WL 5486762, *16 (C.D. Cal. Oct. 1, 2013) (citing cases); Freudenberg v. E*Trade Fin. Corp., 712 F. Supp. 2d 171, 200–01 (S.D.N.Y. 2010) (citing cases); Backe v. Novatel Wireless, Inc., 642 F. Supp. 2d 1169, 1191 (S.D. Cal. 2009) ("Plaintiff's allegations concerning Defendants' suspicious stock sales support an inference of scienter, as their sales are out of proportion with prior trading practices and suspiciously timed."). *But see In re* Gildan Activewear, Inc. Sec. Litig., 636 F. Supp. 2d 261, 272 (S.D.N.Y. 2009) ("[A] non-discretionary Rule 10b5-1 trading plan . . . undermines any allegation that the timing or amounts of the trades was unusual or suspicious."). Although at least one commentator has asserted that such abuse would not violate the securities laws, he did not analyze whether such abuse would fail Rule 10b5-1's requirement that the plan be "entered into in good faith and not as part of a plan or scheme to evade the prohibitions" of the rule. *See* Horwich, *supra* note 211, at 953 (quoting 17 C.F.R. § 240.10b5-1(c)(1)(ii) (2007)). Such abuse has been widely accepted by federal courts as a basis for liability. See cases, *supra*, for judicial analyses of this issue.

213. *See, e.g.*, John P. Anderson, *Anticipating a Sea Change for Insider Trading Law: From Trading Plan Crisis to Rational Reform*, 2015 UTAH. L. REV. 339, 381 (arguing for legalization of limited insider trading inside 10b5-1 plans).

attorneys general.[214]

If the SEC's permissive view of free markets in material, nonpublic information were not already clear enough, its insouciance regarding its own contractor's providing preferred subscribers with advance access to SEC filings makes its position explicit. A recent study showed that a private vendor responsible for operating the SEC's filings database EDGAR provides preferred subscribers with corporate filings before they are available on EDGAR.[215] The authors found that fifty-seven percent of insider trading disclosures on Form 4[216] were available to preferred subscribers before they were posted on EDGAR, and that trading prices, volumes, and spreads moved fifteen to thirty minutes before posting. They concluded that the data

> show that the SEC's process for the dissemination of insider filings (and likely other types of filings as well) is not a level playing field, in that certain intermediaries and investors have access to insider filings submitted to EDGAR before others, and that prices, volumes, and spreads move in the direction of the news in advance of it being posted (and publicly-available) on EDGAR.[217]

Advance access to SEC filings is not a new issue. Prior to 2002 the Commission had allowed preferred subscribers advance access to SEC filings twenty-four hours before they were available to the public.[218] Even after the

214. *See id.* at 344 (citing private insider trading claims). Private insider trading claims against nonexecutives are negligible. *See id.* at 354 (noting that the 10b5-1 executive trading plans have accounted for billions of dollars in recent years).

215. Jonathan L. Rogers, Douglas J. Skinner & Sarah L. C. Zechman, *Run EDGAR Run: SEC Dissemination in a High-Frequency World* 22–23 (Chi. Booth Sch. of Bus, Research Paper Series, Paper No. 14-36, 2015), ssrn.com/abstract=2513350 (finding that about twenty subscribers sequentially receive a majority of SEC Form 4 filings before they are posted on EDGAR, and market data show trading on advance access). The authors found that

> the SEC's process for the dissemination of insider filings (and likely other types of filings as well) is not a level playing field, in that certain intermediaries and investors have access to insider filings submitted to EDGAR before others, and that prices, volumes, and spreads move in the direction of the news in advance of it being posted (and publicly-available) on EDGAR.

Id. at 3; *see also* Dave Michaels, *Fast Traders Can Gain from Early Look at Filings, Study Says*, BLOOMBERG BUS. (Nov. 7, 2014, 12:24 PM), http://www.bloomberg.com/news/articles/2014-11-07/speed-traders-can-profit-from-early-look-at-filings-study-says; Matt Levine, *High-Speed Traders Avoid Low-Speed Website*, BLOOMBERG VIEW (Oct. 29, 2014, 2:24 PM), www.bloombergview.com/articles/2014-10-29/high-speed-traders-avoid-low-speed-website; Ryan Tracy & Scott Patterson, *Fast Traders Are Getting Data from SEC Seconds Early*, WALL ST. J (Oct. 29, 2014, 2:18 PM), http://www.wsj.com/articles/fast-traders-are-getting-data-from-sec-seconds-early-1414539997.

216. Form 4 shows changes in holdings in ownership of a company's shares by its directors, officers, and ten percent shareholders. *See* U.S. SEC. EXCH. COMM'N, FORM 4: STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP (expires Feb. 28, 2018), https://www.sec.gov/about/forms/form4.pdf.

217. Rogers et al., *supra* note 215, at 3.

218. *See* Edward Xuejen Li, K. Ramesh, & Min Shen, *The Role of Newswires in Screening and Disseminating Value Relevant Information in Periodic SEC Reports*, 86 ACCT. REV. 669, 677 n.10 (2011). This practice ceased in 2002, when the Commission claimed to provide "timely access" to all investors as part of its initiative "to level the playing field for all investors." Press Release, U.S. Sec. &

Commission received significant negative publicity regarding the most recent revelations of advance access to EDGAR filings,[219] it did not immediately shut down the advance access arrangements.[220]

The SEC's continued "aiding and abetting" of advance access arrangements operated by its contractor[221] supports this Article's thesis that it has decided to tolerate free markets in material, nonpublic information. The SEC's indifference to advance access to SEC filings stands in remarkable contrast to significant efforts by other agencies—for which insider trading prevention is not a primary concern—to ensure that the material, nonpublic information that they produce is disseminated in a tightly controlled environment. But it is hard to imagine the Commission itself knowingly participating, albeit indirectly, in an advance access arrangement.

The SEC's nonprosecution policy as to systemic insider trading in Mannean marketplaces leaves enforcement of insider trading prohibitions to private attorneys general. This type of case is difficult to bring against traders, however, because the identity of the traders and the specific trades are difficult or impossible to determine. Insider trading cases can be brought against insiders based on their public disclosures in position reports and 10b5-1 plans, but the trades and traders involving news wire and NRSRO announcements are not publicly disclosed. Investors do not know precisely which announcements have been provided early to high-speed traders, which would make it difficult to plead a case against the news wires or NRSROs with sufficient particularity to survive a motion to dismiss. Such plaintiffs would have to persuade a court that public reports of the news wires and NRSROs providing advance access warranted discovery of the particular instances in which such access was provided. Alternatively, empirical backtesting of trading around market-moving

Exch. Comm'n, SEC Announces Free, Real-Time Public Access to EDGAR Database (May 30, 2002), www.sec.gov/news/press/2002-75.htm (quoting SEC Chairman Harvey Pitt).

219. *See, e.g.*, Tracy & Patterson, *supra* note 215 ("It is extremely distressing that a select few insiders have been getting an early look at public filings for so long . . . . It violates the basic principles of fairness that underpin our markets, and I urge the SEC to put a stop to this as soon as possible." (quoting Rep. Caroline Maloney (D., N.Y.)).

220. *See* Scott Patterson, Ryan Tracy & Andrew Ackerman, *Gap Narrows in Access to SEC Filings*, WALL ST. J. (Nov. 3, 2014, 5:20 PM), http://www.wsj.com/articles/gap-narrows-in-access-to-sec-filings-1415053230 (citing that preferred access continued one week after revelations although lag time had been reduced to 2.5 seconds). On December 15, 2014, SEC Chair White wrote to Congress that the Commission was "implementing an enhancement to [its] system designed to ensure that Edgar filings are available to the public on the SEC website before such filings are made available to PDS subscribers." Scott Patterson, *SEC Plans to Fix Flaw in Electronic Distribution System*, WALL ST. J. (Dec. 26, 2014, 4:33 PM), http://www.wsj.com/articles/sec-plans-to-fix-flaw-in-electronic-distribution-system-14196214.

28. *But see* Aaron Kurilof & Ryan Tracy, *Doral Bank Fails After Years of Tumult*, WALL ST. J. (Feb. 27, 2015, 7:12 PM), http://www.wsj.com/articles/fdic-releases-doral-bank-failure-news-early-1425070689?mod=djem_jiewr_FN_domainid (reporting that the FDIC inadvertently released an announcement of bank closure during market hours, resulting in a forty-six percent stock decline).

221. Stephen Gandel, *The SEC Is Aiding and Abetting High Frequency Traders*, FORTUNE (Oct. 30, 2014, 10: 20 AM), http://fortune.com/2014/10/30/sec-high-frequency-traders/.

announcements that showed pre-announcement trading could provide sufficiently strong circumstantial evidence that the news wire that was responsible for disseminating the information had provided early access in violation of Rule 10b-5.

The strongest claim may lie with issuers that have contractual rights to confidentiality, and subscribers who have a contractual right to undisseminated information, whose contracts may have been breached by the news wires and NRSROs. These contractual breaches may entitle plaintiffs to only contractual damages, such as the return of subscription fees, but these claims could be just as effective as a trading claim in addressing the attendant insider trading. These claims also would avoid the hurdles to successful private securities claims that Congress and the courts have created over the last two decades. Alternatively, a private attorney general could allege a tort based on the misrepresentation that the information had not been previously disseminated, but as a class action such a claim could be viewed as being based on a misrepresentation in connection with the purchase or sale of a security and thereby trigger the aforementioned hurdles to bringing a successful private securities claim. It is unlikely that private attorneys general will fill the enforcement gap created by the SEC's enforcement policy.

The SEC's nonprosecution of insider trading in connection with advance access arrangements reflects a pragmatic balancing of public policy and practical exigencies. On the one hand, prosecuting insider trading where tippers provide material, nonpublic information to tippees in discrete, non-market-based transactions reinforces populist conceptions of fairness and equal access.[222] This is the SEC-favored, *Cady, Roberts* and *Texas Gulf Sulphur* model, which rests on "the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure."[223] The utility of insider trading law and enforcement may be primarily (or even exclusively) the public perception of fairness it creates.[224] On the other hand, simultaneously permitting insider

222. "Discrete" transactions may involve a large number of defendants. *See*, *e.g.*, Dominic Rushe, *Former Goldman Sachs Director Rajat Gupta Guilty of Leaking Insider Secrets*, THE GUARDIAN (Jun. 15, 2012, 1:51 PM), http://www.guardian.co.uk/business/2012/jun/15/rajat-gupta-guilty-leaking-insider ("So far 66 cases have been brought against people involved in the insider dealing associated with Galleon, once a $7 [billion] hedge fund."). However, those transactions do not involve the distribution of information through an organized market.

223. Chiarella v. United States, 445 U.S. 222, 227 (1980). However, at least one set of studies showed that respondents assigned greater blameworthiness to traders who had a duty of confidentiality as opposed to those who acquired advance access by happenstance. *See* Stuart P. Green & Matthew B. Kugler, *When Is It Wrong to Trade Stocks on the Basis of Non-Public Information? Public Views of the Morality of Insider Trading*, 39 FORDHAM URB. L.J. 445, 462–64 (2011).

224. *See* Anderson, *supra* note 2, at 32 (discussing possible disutility of perceived unfairness); Peter H. Huang, *How Do Securities Laws Influence Affect, Happiness, & Trust?*, 3 J. BUS. & TECH. L. 257, 296–97 (2008) (discussing the perception of fairness as a policy animating insider trading regulation); *see also* Green & Kugler, *supra* note 223, at 452–53 (discussing the importance of conformity with the law and social norms by citing studies showing higher approbation toward insider trading in the U.S. than other countries). *See generally* Meir Statman, *Is It Fair? Perceptions of Fair Investment Behavior Across Countries*, 12 BEHAVIORAL FIN. 47 (2011). Laura Beny finds that countries with more democratic political systems have stronger insider trading enforcement than less

trading based on market-based transactions, which are easily accessible (at a price), allows for the efficient distribution of nonpublic information that, without wholesale market reform, will necessarily be first received and traded on before it becomes public regardless of whether it is obtained in violation of a *Chiarella/O'Hagan* duty.[225] Thus, efficiency goals are served without compromising public confidence in markets.[226] The Mannean model is realized in practice, if not practiced as policy.

V. Conclusion

This Article contends that the Commission consciously permits illegal insider trading when the material, nonpublic information traded on is obtained in a free market. The Commission has taken no action with respect to widely publicized arrangements in which high-speed traders obtained material, nonpublic corporate announcements from news wires that the news wires disclosed for compensation, in violation of a fiduciary duty, thereby satisfying all elements of insider trading liability. This Article also describes previously unreported arrangements under which NRSROs appear to have entered into

democratic governments. Laura Nyantung Beny, *The Political Economy of Insider Trading Laws and Enforcement: Law vs. Politics? International Evidence*, *in* INSIDER TRADING RESEARCH HANDBOOK 266, 297 (Stephen Bainbridge ed., 2013). Considering these countries' greater commitment to free market policies, Professor Beny argues that her findings contradict the view that insider trading regulation is market-inhibiting. *Id.* at 297–98. However, this correlation is also consistent with a greater need for democratic countries to create and maintain the *appearance* of effective insider trading regulation, possibly because in such free market economies the material, nonpublic information markets may be more developed, or press reports of such markets more frequent and prominent, and such markets may therefore pose a greater threat to public confidence than they do in less democratic countries.

225. This position is consistent with a property rights theory (rather than an investor protection theory) of insider trading regulation. Permitting a free market in nonpublic corporate and NRSRO announcements is consistent with the view that those who pay for information should "reap the profit from it." *See* Stephen M. Bainbridge, *Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud*, 52 SMU L. REV. 1589, 1606–11 (1999) (quoting United States v. Chestman, 947 F.2d 551, 576–77 (2d Cir. 1991) (Winter, J., concurring in part and dissenting in part)). No investors have been deprived of their investment in developing information; it is being sold by the person (ultimately, the corporation) that generated it. It is questionable whether corporations should be prohibited from trading on their own inside information. *See* Mark J. Loewenstein & William K.S. Wang, *The Corporation as Insider Trader*, 30 DEL. J. CORP. L. 45, 47–53, 73 (2005) (stating that misappropriation from a corporation is absent when the corporation trades on its own inside information).

226. The SEC's enforcement program undermines research showing a positive correlation between prohibitive insider trading laws and efficient markets, which assumes—as has virtually all academic research—that practice follows law. *See, e.g.*, Laura Nyantung Beny, *Do Insider Trading Laws Matter? Some Preliminary Comparative Evidence*, 7 AM. L. ECON. REV. 144, 144 (2004) (finding "that countries with more prohibitive insider trading laws have *more diffuse* equity ownership, *more accurate* stock prices, and *more liquid* stock markets"). It may be more likely that public, high profile enforcement—not the absence of insider trading—has such an effect. *Cf.* Utpal Bhattacharya & Hazem Daouk, *The World Price of Insider Trading*, 57 J. FIN. 75, 96–97 (2002) (finding that enforcement of insider trading laws reduces cost of equity by seven percent—the existence of insider prohibitions does not).

similar arrangements with respect to material, nonpublic ratings-related information.

The SEC's apparent acquiescence in free markets in material, nonpublic information reflects the realization of the free market that Henry Manne first argued for almost five decades ago. In 1966, he asserted that permitting insider trading would increase net social wealth by causing information to be incorporated into security prices more quickly, thereby enhancing efficient capital formation. This is one argument for the SEC's position. Another argument is that corporate and NRSRO announcements will inevitably be traded on by an elite group of traders before that information is publicly available. If equal access to such announcements is not possible, then prosecuting participants in advance access arrangements only when the information is disclosed in violation of a *Chiarella*/*O'Hagan* duty accomplishes nothing. In any case, the same elite group of traders will be the first to trade. In contrast, prosecuting those who trade on information that is not obtainable in a free market strengthens the perception that markets are fair, promotes efficiency by funneling trading to advance access arrangements, and conserves limited enforcement resources.

This Article's thesis contradicts decades of insider trading scholarship that generally has incorrectly assumed that regulators have rejected the Mannean marketplace. For example, a recent study found that vigorous insider trading prosecution in countries such as the United States correlates positively with innovation,[227] but it may be it is actually channeling insider trading through Mannean marketplaces—not prohibiting it—that has the innovation enhancing effect. Instead, the insider trading research agenda going forward should focus on the empirical question of what effect advance access arrangements have on the incorporation of information into market prices. The record shows that traders are paying for advance access to information and spending substantial sums on being first to trade on it, so this business model presumably is profitable for some of them. But are the efficiency benefits that Manne promised being realized? If not, could regulators improve the efficiency of Mannean markets by fine-tuning their (non)prosecution policy? The answer to whether permitting insider trading is efficient is out there, available to those willing to overthrow conventional wisdom and look in the right place.

227. *See* Ross Levine, Chen Lin & Lai Wei, Insider Trading and Innovation 32 (unpublished working paper) (Oct. 5, 2015), http://ssrn.com/abstract=2649295.