Insider Trading and Evolutionary Psychology: Strong Reciprocity, Cheater Detection, and the Expanding Boundaries of the Law

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Insider trading law has expanded in recent years to cover instances of trading on non-public information that fall outside of the fiduciary duty framework set forth in the landmark cases of *Chiarella* and *Dirks*. The trend towards a broader insider trading law moves the law closer towards what evolutionary psychology tells us humans desire when engaging in collective action: that individuals benefit in proportion to the effort or investment they make in a common enterprise. Insider trading law can therefore be understood as a societal response to cheating in group activities, and the recent expansion of the law as reflecting a proclivity for fairness as proportionality. An evolutionary psychology-based account of insider trading law also provides a basis for understanding the observed correlation between insider trading enforcement and various measures of the health of the financial markets, as well as a unified jurisprudence of insider trading law encompassing both consequentialist and deontological aspects.
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INTRODUCTION

Over the course of the past 15 years, the sweep of insider trading law has expanded beyond the boundaries articulated by the Supreme Court in the landmark cases *Chiarella v. United States*¹ and *Dirks v. SEC.*² In particular, lower level courts are dispensing with the requirement that a fiduciary duty be breached in order for an insider trading conviction to be sustained, thereby allowing application of Rule 10b-5 and the voluminous body of “insider” trading law to those who steal corporate information without any fiduciary duty to its source.³ While there has been intense academic debate concerning the wisdom of the insider trading prohibition, the courts, regulators and public opinion generally support broad laws⁴ and their vigorous enforcement⁵ in an effort to stamp out insider trading.

This article turns aside from the conventional arguments for and against the insider trading prohibition posed by law and economics scholars, which are mostly grounded either in utilitarianism (as implicit in most “law and economics” approaches) or deontological moral theory, to offer an analysis of insider trading law based on the discipline of evolutionary psychology. An evolutionary psychology-based explanation offers several advantages over the conventional explanations offered to date, as well as providing a very useful basis for further research into a number of key questions concerning insider trading.

First, the treatment of social exchange in evolutionary psychology provides a very convincing account of why incidents of insider trading generate the outrage they do, with the resulting demand for prosecution on the part of the public and the benefits regulators derive from being seen as responsive to these concerns. Conversely, arguments in favor of allowing insider trading as famously put forward by Henry Manne hold little public appeal. An

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⁴ See Part III.B, infra.
⁵ See Douglas Koff & Joshua Bennett, *Insider Trading Cases Likely to be Litigated in 2013 and Beyond*, N.Y.L.J., April 8, 2013 (detailing recent government efforts to prosecute insider trading).
evolutionary psychology account of why insider trading violates our moral sensibilities explains the overwhelming political support for the law as it has developed.

Second, evolutionary psychology provides a basis for understanding the current structure of insider trading law. The “core” insider trading offenses have always been instances of powerful corporate insiders trading on the basis of nonpublic information. Misappropriators, temporary insiders, tippees, computer hackers, family members and those learning of confidential information through luck, among other examples, comprise a broad array of cases on the periphery of “insider” trading. Some of these groups, such as tippees and temporary insiders, were fairly easily reached through expansion of existing law; others have posed more difficult challenges. I argue that the recent expansion of the law in this area corresponds quite closely to what evolutionary psychology tells us individuals seek when they engage in group activities.

In the wake of Chiarella and Dirks, insider trading doctrine has again expanded in the lower courts to encompass the misappropriation of material, non-public information that violates the property rights of shareholders or the corporation generally, not just a fiduciary duty owed to them. The current structure of insider trading law is congruent with the analysis of cheating in social exchange behaviors offered by evolutionary psychology. Cheating is understood as the violation of principles of proportionality, not equality, occurring when individuals derive benefits from group activities out of proportion to, or in complete neglect of, their contributions to communal endeavors. The old confines of the law, which tied violations to the breach of a fiduciary duty, are therefore under-inclusive from the point of view of evolutionary psychology. The recent expansion of insider trading law is moving towards a closer fit with the content of our moral intuitions as described by evolutionary psychology. However, the old focus of the law on the malfeasance of an often powerful or wealthy insider who misappropriates or otherwise misuses information, as opposed to the welfare of traders and shareholders in general, corresponds to what evolutionary psychology tells us we are primarily concerned with in social exchange, and so naturally makes up the core of insider trading law.

Third, an evolutionary psychology perspective on insider trading highlights the gap between our moral intuitions and a complex modern system such as the contemporary financial marketplace. Since investment in a corporate enterprise is fundamentally an act of exchange, our minds naturally apply concepts, beliefs, and fears developed during our long period of human evolution to the transaction. Stock trading on an exchange is anonymous, however, with no direct, human contact between the seller and the purchaser. As a result,

\textsuperscript{6} Of course, in the majority of these cases the individuals aren’t insiders at all.
early cases such as Goodwin v. Agassiz\textsuperscript{7} often permitted trading on inside information because of the impersonal nature of the trading venue. Despite the fact that there was nothing like a modern stock exchange in the context of the environment of evolutionary adaptedness\textsuperscript{8} (or “EEA”), we still bring our moral intuitions to the contemporary environment of complex technological and financial systems. The gap between contemporary financial markets and the social world our moral intuitions evolved in is highlighted by a central jurisprudential aporia of insider trading: to what extent can it really be conceived as fraud? We intuitively feel that it is unfair, but as Professor Langevoort emphasizes, insider trading is not fraudulent in any straightforward sense.\textsuperscript{9} One of the outcomes of an evolutionary psychology account of insider trading law therefore is the realization that, from a moral standpoint, the regulation of contemporary financial markets presents great difficulties in part because of their incredible difference from anything we encountered during our evolutionary history. This does not mean that moral considerations should play no part in financial regulation—at any rate, in democratic societies, political pressures will always force a moral input into financial regulation—but it does highlight the serious challenge of translating moral intuitions into law in this arena.

Finally, an evolutionary psychology perspective provides a fruitful basis for further research into some of the crucial questions in the recent insider trading literature. For example, research indicates a correlation between the enforcement of insider trading law and a number of markers of health of the financial markets, such as more dispersed stock ownership, greater liquidity, and more informational stock prices than markets lacking insider trading law and enforcement.\textsuperscript{10} An insider trading jurisprudence based on evolutionary psychology supports such findings because it indicates that a primary reaction to cheating within social groups is to withdraw from group interaction. Thus, empirical research on the likely benefits of insider trading law, the literature on trust on markets, and evolutionary psychology may combine to support the idea that insider trading law offers tangible benefits to markets.

\textsuperscript{7} Goodwin v. Agassiz, 283 Mass. 358 (1933).
\textsuperscript{8} See Leda Cosmides & John Tooby, \textit{Evolutionary Psychology: A Primer, available at http://www.cep.ucsb.edu/primer.html} (“. . . the environment of evolutionary adaptedness, or EEA, is not a place or time. It is the statistical composite of selection pressures that caused the design of an adaptation.”) [hereinafter, Cosmides & Tooby, \textit{Evolutionary Psychology: A Primer}].
Evolutionary psychology is also important for the jurisprudential debates in the insider trading literature concerning the strongest moral justification for insider trading law. While most law and economics scholars argue in terms of a utilitarian framework,\textsuperscript{11} where the law is to be evaluated in terms of its efficiency benefits for markets, there are also important voices arguing for a deontological basis to insider trading law.\textsuperscript{12} I argue that while an evolutionary psychology account encompasses utilitarian law, it ultimately points towards a deontological and not a utilitarian basis for insider trading law.\textsuperscript{13} There are two main reasons for this. First, evolutionary psychology’s emphasis on detecting cheating is reflected in a moral philosophy grounded in intention. Second, the concept of “strong reciprocity” in evolutionary psychology indicates that humans are willing to act in a manner that is genuinely altruistic from an economic standpoint, not to mention a biological one: we will expend resources to punish others with little or no prospect of benefit to us. This understanding of human moral intuition is at odds with the utilitarian cost/benefit analysis, where we are to choose the action resulting in the greatest amount of good. For a jurisprudence of insider trading, this implies that laws against insider trading would be morally justifiable (or that we would believe such laws are morally justifiable) regardless of whether they actually resulted in any tangible or identifiable material benefits for an economy.

In order to make these arguments the paper proceeds in four parts. Part I examines the trajectory of American case law on insider trading, arguing that while perhaps appealing from an administrative point of view, Justice Powell’s fiduciary duty-based jurisprudence is seriously under-inclusive from the point of view of evolutionary psychology. As a result, courts have allowed the law to stretch to encompass cases outside the confines of violations of a fiduciary duty but which offend moral sense.\textsuperscript{14} Part II then presents an overview of the treatment of social exchange in evolutionary psychology. Given the intense concern humans display over


\textsuperscript{13} See Part IV.B infra.

\textsuperscript{14} For an alternative account of the expansion of insider trading law away from a strict fiduciary duty approach which draws on the concept of path dependence, see Stephen M. Bainbridge, Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud, 52 S.M.U. L. Rev. 1589 (1999).
cheating in group activities, Part III looks at why insider trading would be of concern on a theoretical level, and given the available empirical evidence, to what extent it actually is. Part IV concludes by outlining further research that builds on an evolutionary psychology approach.

I THE MORAL ARC OF U.S. INSIDER TRADING LAW

The development of American insider trading law presents a complex and at times confusing trajectory, with the many decisions under a very general catch-all statute amounting to a body of federal common law. Although explicitly moral concerns have mostly remained under the surface during the course of this development, they have nonetheless influenced it at key points, particularly, and paradoxically, in Justice Powell’s landmark Chiarella and Dirks decisions. The development of insider trading law over the course of the past century demonstrates an expansion of the law towards a maximalist conception of fraud in accordance with what evolutionary psychology tells us humans desire from their trading partners.

Insider trading law also presents a definite structure, composed of a core and a periphery. As Justice Powell recognized, the core is found in the paradigmatic cases of insider trading where an insider uses information derived from his role in the corporate enterprise. The periphery involves less direct cases, as for example in instances of misappropriation, or the more recent computer hacker cases involving stolen information such as Dorozhko. As the psychological studies of Stuart Green & Matthew Kugler demonstrate, however, the degree of condemnation people give to cases in the periphery is nearly as great as in the core insider trading scenarios. This makes sense in terms of evolutionary psychology. The slight edge given to core cases probably stems from our suspicion and resentment over insiders, who tend to be wealthy or otherwise powerful individuals, taking advantage of their positions, but the general condemnation of all use of inside information follows from our

15 See Bainbridge, A Comprehensive Primer, supra note 11, at 39 (“The federal insider trading prohibition is thus best classified within the genus of federal common law.”); see also Nagy, The Gradual Demise of Fiduciary Principles, supra note 3, at 1322 (“In the United States, the law of insider trading is essentially judge-made.”).
16 See note 295 and accompanying text infra.
18 See notes 292-294 infra and accompanying text.
nature as “conditional cooperators,” and the desire that individuals should reap benefits from communal endeavors in proportion to their efforts.

A central administrative challenge of insider trading law is to reconcile our moral intuition about the use of non-public information with the economic technology of the stock exchange, which is essentially anonymous. Such anonymous environments are foreign to the EEA; the modern economic environment therefore fails to map onto our moral psychology in any neat way. While I follow commentators such as Prentice, Park, Langevoort, Nagy and Strudler & Orts in favoring the expansion of insider trading law beyond the fiduciary duty paradigm set up by Justice Powell, his focus on the traditional core insider trading scenarios illuminates a key challenge to its expansion: a broad interpretation of 10b-5 does run the risk of making law coextensive with morality, and may conceivably invite overreaching on the part of the Securities Exchange Commission (the “SEC”) and government prosecutors. That said, there are countervailing considerations, not the least of which is public demand for strong prosecution of perceived abuses by financial markets insiders, which weigh in favor of the current broad regime of insider trading law.

Part I surveys the development of American insider trading law in the 20th century beginning with its roots in state corporate law and ending with the current trend towards a maximalist state of the law represented by Rocklage, Evans and Dorozkho. As insider trading law oscillates between the refusal to prosecute trading on inside information by means of anonymous exchanges, to the broad standard of Texas Gulf Sulphur, to the retrenchment of Dirks and Chiarella, and then back to its present broad interpretation, we see the push and pull of moral versus other considerations. This history highlights the tension between what our moral intuitions desire and what traditional legal doctrines of fraud as well as prudent rule of law considerations indicate the law ought to be.

A Common Law Prehistory: The Majority Rule, the “Special Facts” Doctrine, and the Minority Rule

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20 See note 240 infra and accompanying text.
21 See Prentice, Permanently Reviving the Temporary Insider, supra note 3, at 344-345 (advocating more aggressive punishment of insider trading).
22 See Park, supra note 3, at 350 (a focus on unjust enrichment is an essential though second-order concern of insider trading law).
24 See Nagy, supra note 3, at 1373 (in the absence of statutory treatment, Burger’s theory is a good starting point).
25 See Strudler & Orts, Moral Principle in the Law of Insider Trading, supra note 9, at 386 (“a ‘deontological equitable disclosure’ rationale justifies a fraud-on-the-investor approach”).
26 See Pritchard, supra note 17, at 936 n.585 (“Powell’s greater concern with insider trading law was the risk posed by overaggressive enforcement of the prohibition by the SEC.”).
Long before the passage of the federal securities laws in the 1930s, state courts were confronted with insider trading cases. These late nineteenth and early twentieth century cases resulted in the diametrically opposed “majority” and “minority” rules, as well as the “special facts” (or “special circumstances”) doctrine set forth by the U.S. Supreme Court in Strong v. Repide. The common law thus offers no clear resolution of the problem insider trading represents, and there are good reasons to think that the “majority rule” of Goodwin v. Agassiz did not in fact predominate. These cases differ from later federal cases however in restricting any prohibition against insider trading to the realm of face-to-face transactions, or what would otherwise be face-to-face transactions were it not for deception, as in Strong v. Repide. The co-existence of the majority and minority rules leaves unresolved the tension between incentivizing business by allowing commonly accepted, if unscrupulous, business practices and a broader conception of unfairness grounded in moral indignation that ultimately reflects fairness as proportionality.

Like Texas Gulf Sulphur thirty-five years later, Goodwin v. Agassiz concerns trading in the stock of a mining company by its directors. Agassiz was a director of the Cliff Mining Company, which owned property in the “mineral belt” of northern Michigan. Agassiz was also an officer of another company in the area that had conducted extensive geological surveys indicating there was a strong possibility of profitable copper deposits. Upon learning of these results, the Cliff Mining Company decided to pursue exploration of its property in 1925, but the survey was unsuccessful and was ended in May 1926. Nonetheless, Agassiz and his co-defendant MacNaughton discussed the results of the geological surveys for the other company which indicated copper deposits in the area. When Goodwin read a news report of the cessation of exploration on the part of the Cliff Mining Company, he sold his shares on the Boston Stock Exchange. Because they still believed that the property of the Cliff Mining Company might contain valuable deposits which would cause the price of its stock to rise, Agassiz and MacNaughton purchased 700 shares through an agent. Goodwin sued the two for his loss.

28 See Ash, id. at 399-400.
30 Goodwin, 283 Mass. 358 (1933).
31 See Ash, supra note 27, at 399 (“Yet, long before even the promulgation of Rule 10b-5, the majority rule had been effectively rendered a minority position . . . .”); Bainbridge, supra note 3, at 38.
32 Goodwin, 283 Mass. at 359.
33 Id. at 359-360.
34 Id. at 360.
contending that their purchase of the shares without disclosure of the geologist’s theory was fraudulent.

The Massachusetts Supreme Judicial Council affirmed the trial court’s dismissal of the suit on the grounds that there was in fact no fiduciary relation between the directors and the shareholders that would prohibit a transaction in these circumstances. The court acknowledges that directors stand in a fiduciary relationship to the corporation, but denies that a trustee or other fiduciary relationship obtains between the directors and the shareholders. Citing the English case Percival v. Wright, the court states that this “principle thus established is supported by an imposing weight of authority in other jurisdictions . . . .” The court also discusses unusual situations in which trades of stock between directors or officers and shareholders should be set aside, citing Strong v. Repide, among other authorities. It determines however that “purchases and sales of stock dealt in on the stock exchange are commonly impersonal affairs . . . .” and that business “. . . . of that nature is 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.” The exception of Strong v. Repide will not therefore apply to anonymous trading on an exchange.

Similar to Justice Powell’s later observation in footnote 21 of Dirks, the Massachusetts court crystallizes its position on this point by drawing a distinction between law and morality and reflecting on its application to business practice:

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. On the other hand, directors cannot rightly be allowed to indulge with impunity in practices which do violence to prevailing standards of upright businessmen.

Because the defendants did not cross this line, their conduct was acceptable even though it may not be admirable. As in the “classical” insider trading doctrine represented by Chiarella and Dirks, Goodwin v. Agassiz steers a course between the possible highest standards of morality and business conduct which is truly wrong. The Massachusetts court does not believe

35 Id. at 361.
37 Goodwin, 283 Mass. at 362.
38 Id. at 362-363.
39 Id.
40 Id. at 363.
that failing to disclose such information in an anonymous transaction violates accepted business conduct.

The “special facts” of *Strong v. Repide* weigh against an insider’s purchase of stock, however. The case concerns an appeal from the Supreme Court of the Philippines to the United States Supreme Court. The Filipino Supreme Court earlier ruled against the plaintiff, Mrs. Strong, in her claim that Repide had purchased her shares in the Philippine Sugar Estates Development Company, Limited through deceit. The company held a parcel of land that the U.S. Government was trying to purchase, and Repide, as majority owner and general manager of the company, was in control of the negotiations.\(^41\) In order not to reveal his identity as the purchaser of the shares, which would signal his knowledge of their true value, he hired an agent to carry out the purchase.\(^42\) Strong sold her shares, which then increased in value tenfold within three months as the land sale was consummated. Mrs. Strong sued, alleging that Repide’s concealment of his identity and his knowledge as to the upcoming sale of the land constituted deceit and should result in a declaration of a void sale contract.

The U.S. Supreme Court begins by pointing out that Article 1265 of the Philippines Civil Code states that “[c]onsent given by error, under violence, by intimidation, or deceit, shall be void.”\(^43\) Furthermore, deceit here does not necessarily require words but can occur through misrepresentation or concealing material facts.\(^44\) And although the general rule is that directors of a corporation do not owe a fiduciary duty to shareholders, “special facts” can exist which require directors to act as fiduciaries for shareholders. Given that Repide was a director and owner of 72% of the shares, was in sole control of the negotiations for the sale of the land, and employed an agent to conceal his identity from Strong, the Court determines that there was “a legal obligation on the part of the defendant” to disclose the material facts surrounding this transaction.\(^45\)

While the Court does not explicitly focus on the morality of Repide’s conduct, it seems likely that the level of deceit involved is determinative in pushing this case into the “special facts” exception to the general rule then prevailing that transactions with insiders in possession of confidential information were permissible.\(^46\) Unlike *Goodwin*, the transaction here isn’t

\(^{41}\) *Strong*, 213 U.S. at 431-432
\(^{42}\) Id. at 432-433.
\(^{43}\) Id. at 430.
\(^{44}\) Id. (“Thus the deceit which avoids the contract need not be by means of misrepresentations in words. It exists where the party who intends to obtain the consent does so by means of concealing or admitting to state material facts, with intent to deceive, by reason of which omission or concealment the other party was induced to give a consent which he would not otherwise have given.”).
\(^{45}\) Id. at 434.
\(^{46}\) See id. at 432-433.
conducted over the impersonal mechanism of an exchange, but instead involves Repide approaching Strong through an agent. While intent is not an explicit focus of the case, it is clear from the facts that Repide intended to conceal his identity and the facts surrounding the transaction in order to purchase Strong’s shares at a small fraction of their true value.\footnote{See \textit{id.} ("Concealing his identity when procuring the purchase of stock, by his agent, was in itself strong evidence of fraud on the part of the defendant.").}

Finally, in the common law prehistory to the federal securities laws a number of states held to the “minority rule” that, in addition to their duty to the corporation, directors owe a fiduciary duty to shareholders.\footnote{In addition to \textit{Dawson v. National Life Ins. Co. of America}, 176 Iowa 362 (1916), \textit{see, e.g.}, \textit{Hotchkiss v. Fischer}, 16 P.2d 531 (Kan. 1930), \textit{Stewart v. Harris}, 77 P. 277 (Kan. 1904), \textit{Oliver v. Oliver}, 45 S.E. 232 (Ga. 1903). \textit{See also} Harold R. Smith, \textit{Purchase of Shares of a Corporation by a Director from a Shareholder}, 19 MICH. L. REV. 698 (1921).} In these cases, whatever the circumstances of the transaction, the state courts hold that it is improper for a director to profit at the expense of the shareholders; the language in \textit{Dawson v. National Life Insurance Company of America} is typical. Dawson owned a mere three shares in the Des Moines Life Insurance Company, and was induced to sell in a transaction where the insider shareholders received $550,000 for their 552 shares while holders of the remaining 448 shares received less than $99,600.\footnote{\textit{Dawson}, 176 Iowa at 367-368.}

In rejecting a defense based upon the “majority rule” that directors owe no independent fiduciary duty to shareholders, the Iowa Supreme Court uses strong moral language. Expressing an understanding of fairness as proportionality, the court declares that “[t]here is something wrong in any rule which will enable a director legally by his own position to obtain for himself alone profits all have won.”\footnote{\textit{Dawson v. Nat'l Life Ins. Co. of Am.}, 176 Iowa 362 (1916).} Pointing out that no stockholder would want a director who would take advantage of his own office in this way, the court states that “[t]he debate as to whether technically a fiduciary relation exists may and doubtless will go on, but a knowledge of the law is not required to enable one to appreciate the moral wrong perpetrated by a corporate officer in profiting by the ignorance of a stockholder by means of knowledge acquired by virtue of his position.”\footnote{\textit{Id.} at 375.}

The minority rule cases such as \textit{Dawson} then impose a fiduciary duty prohibiting transactions by insiders in circumstances considered to be unfair, where knowledge available to only a few allows them to benefit out of proportion to their ownership interests in the enterprise. This principle sits in tension with the more liberal majority rule, which allows insiders to profit from their knowledge. The co-existence of these rules illustrates that the common law was undecided as to whether such sharp dealing was a necessary inducement to

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\item \textit{Id.} at 375.
\end{enumerate}
entrepreneurs to take part in corporate activities, or a violation of the expectations of investors which should be prohibited.53 Despite the unresolved nature of this debate, Goodwin demonstrates that no early state court extended the prohibition on inside transactions based upon confidential information to the anonymous realm of the stock exchange, even though investors such as Goodwin obviously felt they had been taken advantage of.

B Federal Beginnings: In re Cady, Roberts & Co.

Even though there were many cases at the state level in the years after the passage of the ’34 Act, and Rule 10b-5 was promulgated in 1942,55 the first federal action for insider trading did not take place until 1961 with In re Cady, Roberts & Co.56 Cady, Roberts represents an aggressive step into the insider trading arena.57 While it is ultimately defensible on both moral and policy grounds, it arrives at its broad destination in a way that presages some of the perennial problems of insider trading law: the potential for significant legal indeterminacy, as well as the reliance on fairness grounds in taking the very significant step of extending the minority rule from the face-to-face arena to the anonymity of the stock exchange. Cady, Roberts is significant because it resolves the conflict in the earlier state law cases between incentivizing entrepreneurial activity and protecting investors on fairness grounds in favor of the latter. It is also the first decision to apply the minority rule to trading on an exchange.

The facts of Cady, Roberts are these: Robert Gintel was a broker at Cady, Roberts & Co. who sold Curtiss-Wright stock for clients as well as his wife’s account in the hour before a reduction in the expected dividend was made public.58 A representative of the brokerage firm, J. Cheever Cowdin, served as a director of Curtiss-Wright.59 During a recess in a board meeting shortly after 11:00 a.m. on Nov. 25, 1959, Cowdin left a telephone message for Gintel that the dividend had been reduced to $.375 from the $.625 paid in the previous three quarters. Due to a delay, the Dow Jones News Ticker Service did not receive this information until 11:45, and the New York Stock Exchange didn’t receive the news until 12:29.60 In the meantime, Gintel had sold 2,000 shares for 10 accounts at 40% at 11:15 a.m. and sold 5,000 shares short at 40% for 11 accounts at 11:18 a.m. After announcement of the reduction in dividend, trading in Curtiss-

58 40 S.E.C. at 907, 909.
59 Id. at 909.
60 Id.
Wright shares was suspended, resuming at 1:59 p.m. at 36½.\textsuperscript{61} It ranged between 34\% and 37 throughout the rest of the day and closed at 34\%\textsuperscript{62} Gintel’s conduct resulted in a fine of $3,000 from the New York Stock Exchange as well as a 20-day suspension from the stock exchange levied by the SEC.\textsuperscript{63} While on the surface this punishment may appear light, and one Commissioner dissents in part on these grounds, Commission Chair Cary points out that Gintel and Cowdin appeared to have no premeditated plan, but rather Gintel’s actions were a “spontaneous reaction to the dividend news . . . .”\textsuperscript{64}

Chairman Cary’s decision to sanction Robert Gintel under Rule 10b-5 relies on two basic legal strategies: an expansive reading of the applicable legal rule, and an extension of the “minority rule” concerning the duties of corporate insiders towards shareholders from the context of face-to-face interactions and other contextual elements implicating the “special facts” doctrine to the anonymity of the stock exchange. First, after reciting the provisions of Rule 10b-5 of the Exchange Act, Cary states that “[t]hese anti-fraud provisions are not intended as a specification of particular acts or practices which constitute fraud, but rather are designed to encompass the infinite variety of devices by which undue advantage may be taken of investors and others.”\textsuperscript{65} Furthermore, they will extend beyond what is covered by the common law, as they are “broad remedial provisions aimed at reaching misleading or deceptive activities, whether or not they are precisely and technically sufficient to sustain a common law action for fraud and deceit.”\textsuperscript{66} Cary goes on to say that while other provisions may also apply, clearly 10b-5(3), which prohibits “[e]ngaging 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 sale of a security is implicated here.\textsuperscript{67} Of course, as many commentators have pointed out, it is precisely the sale of a security on a stock exchange which does not appear to involve fraud or deceit, at least in any straightforward way.\textsuperscript{68} While Chairman Cary backs up his argument with a cite to legislative history indicating that the intent of Congress was to prohibit activity

\textsuperscript{61} Id. at 909-910.
\textsuperscript{62} Id. at 910.
\textsuperscript{63} Id. at 917-918.
\textsuperscript{64} Id. at 917. Because Gintel appeared to act spontaneously upon hearing this advantageous news, he may be seen as one who, like Coach Barry Switzer in \textit{SEC v. Switzer}, 590 F. Supp. 756 (W. D. Okla. 1984) or Ryan Evans in \textit{U.S. v. Evans}, 486 F.3d 315 (7th Cir. 2007), comes across inside information fortuitously and can’t resist taking advantage of it. While the \textit{Switzer} and \textit{Evans} cases come to opposite results on the question of whether a tipper must receive a benefit to in order to sustain an insider trading action against a tippee, Gintel’s violation would presumably be sustained under the \textit{Dirks} framework to come because Cowdin was Gintel’s business partner and would presumably have benefited from Gintel’s actions.
\textsuperscript{65} 40 S.E.C. at 911.
\textsuperscript{66} Id. at 910.
\textsuperscript{67} Id. at 913.
\textsuperscript{68} See \textit{supra} note 9 and accompanying text.
including insider trading, one of the hallmark problems of insider trading jurisprudence is interpreting the text of a statute, and then a rule, that is so broadly worded that it affords judges, prosecutors, and regulators incredible discretion in determining exactly what comes within it.  

Beginning from this rejection of a close reading of the statute and “fine distinctions and rigid classifications,” Cary goes on to ground the rule that insiders as well as others have a duty to either disclose or refrain from trading in “two principle elements”:

First, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a person takes advantage of such information knowing it is unavailable to those with whom he is dealing.

The first element bases the duty to disclose or abstain on insider status, or connection to an insider—Gintel was a partner in Cady, Roberts & Co. along with Cowdin, who sat on Curtis-Wright’s board as well—while the second grounds it in the principle of fairness. This second element involves the straightforward claim that it is fundamentally unfair for one person to profit from the corporate venture on the basis of non-public information. As outlined in Part II below, this follows from the deeply ingrained characteristic of human moral psychology to feel outrage upon discovering that fellow partners in a group endeavor are receiving more than their rightful proceeds from such activity. While various scholars have criticized the fairness rationale on the grounds that it is “artificial,” “amorphous,” “subjective,” even “puerile,”

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69 40 S.E.C. 912, n.15 (discussion of legislative history). On the legislative history of Section 10(b) generally, see Steve Thel, The Original Conception of Section 10(b) of the Exchange Act, 42 STAN. L. REV. 385 (1990). The Preamble to the Exchange Act states that it is an “[a]ct to provide for the regulation of the exchanges and of over-the-counter markets . . . to prevent inequitable and unfair practices on such exchanges and markets.” Securities Exchange Act of 1934 pmbl., 15 U.S.C. § 78. See also Nagy, The Gradual Demise of Fiduciary Principles, supra note 3, at 1335 n.117 (discussing Congressional intent behind Exchange Act § 20A); Prentice, Permanently Reviving the Temporary Insider, supra note 3, at 345-346 (“Although Congress has not clearly defined insider trading, it has signaled its strong antipathy for the practice.”). Cf. Bainbridge, A Comprehensive Primer, supra note 11, at 9 (“Careful examination of the relevant legislative history . . . suggests that regulating insider trading was not one of the Exchange Act’s original purposes.”).  


71 40 S.E.C. at 912.  

72 Id.  

73 See infra notes 238-241 and accompanying text.  


or otherwise indeterminate, these criticisms miss the mark. The fairness rationale is grounded in the principle of proportionality, and it can ultimately be as determinate and objective as the pro rata returns due to any shareholder or holder of other equity interests in a corporate enterprise.

Cady, Roberts is also important because it is the first case to extend the principle of the minority rule to the realm of anonymous stock trading. In response to Gintel’s argument that they made no express representations, Commissioner Cary rejects the suggestion that “in a transaction on an exchange there is no further duty such as may be required in a ‘face-to-face’ transaction.” He points out that “it would be anomalous indeed” if the prohibition on fraud did not extend to the stock exchanges, the primary markets for securities transactions. As long as the investment decisions of purchasers on an exchange would be affected by the material information known to the insider sellers, insiders must disclose or abstain. While this application of the minority rule to the anonymous realm of the stock exchange encounters the legal difficulty that the common law requirements of fraud are not really present, because there is no representation, either express or implied, that one party to the exchange makes and the other relies on, it is still a logical extension of the fairness principle.

This extension does however reveal an important discrepancy on the level of moral psychology. Because we most likely lived in bands of 20 to 150 individuals in the EEA, human moral intuition is geared towards face-to-face interactions with individuals with which we have some measure of familiarity. This means that ordinary conditions of exchange would not have been anonymous, but we would have judged the trustworthiness of our partners in social interactions upon which our material sustenance as well as social standing in the group or tribe depended through their reputations, facial expressions, body language and material interests, etc. Thus, the extension of the minority rule principle of fairness to the realm of the anonymous exchange reflects both a legal claim and a moral one. Just as the traditional legal

79 See Bainbridge, A Comprehensive Primer, supra note 11, at 12 (Cady, Roberts as a case of first impression).
80 40 S.E.C. at 914
requirements for fraud are not really met in the case of trading on inside information by means of an exchange, our moral intuition finds itself operating out of its ordinary context of face-to-face interactions.

C The “Equal Access” Rationale of Texas Gulf Sulphur

Building on Commissioner Cary’s ruling in Cady, Roberts, as well as its understanding of the policy basis behind the Exchange Act, SEC v. Texas Gulf Sulphur Co., sets forth a broad prohibition on trading on any inside information built on the principle of equal access to all material “basic facts” concerning the corporate enterprise. While Texas Gulf Sulphur is not devoid of outrage towards the act of insider trading, its rationale is grounded in the principle of equality of access to information, and so the decision represents a turning away from the focus on the moral core of insider trading towards a broader principle of equality. In addition, Judge Waterman’s opinion for the majority contains a revealing discussion of scienter in the context of Rule 10b-5 that reinforces the notion that culpable intent is not the focus of its understanding of insider trading.

Sitting en banc, in Texas Gulf Sulphur the Second Circuit reverses a lower court decision determining that, with two exceptions, stock purchases by executives of the Texas Gulf Sulphur Company (“TGS”) did not violate Rule 10b-5. In November 1963, TGS conducted a test drill that revealed very rich deposits of copper, zinc and silver in land it possessed mineral rights to located in Ontario, Canada. The results of the drilling were kept confidential, with even the TGS board of directors remaining uninformed. During this period, a group of executives and their tippees increased their shareholdings from 1,135 shares and no options to 8,235 shares and 12,300 options. On November 8, at the beginning of this period, TGS stock was trading at 17⅜, whereas by the time the results were announced on April 16, 1964 it closed at 36⅜ and by May 15, 1964 it was trading at 58¼.

Judge Waterman’s majority opinion represents a high watermark of the crusade against insider trading. While the decision can be seen as merely applying the policy previously articulated by the SEC in Cady, Roberts, it takes the further theoretical step of grounding this in a policy objective of equality of information (or parity of information), declaring that Rule 10b-5 “is based in policy on the justifiable expectation of the securities marketplace that all investors

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82 401 F.2d 833 (2d Cir. 1968).
83 Id. at 849.
84 Id. at 844.
85 Id. at 847.
86 See Bainbridge, A Comprehensive Primer, supra note 11 at 12-15.
trading on impersonal exchanges have relatively equal access to material information." While the court clarifies that this does not mean that everyone trading in the markets must have the same information (i.e., it does not attempt to enforce complete equality of information, which would indeed be nonsensical), it does mean that, as a regulatory objective, “access to material information” should “be enjoyed equally . . . .” Insiders will have to disclose “basic facts so that outsiders may draw upon their own evaluative expertise in reaching their own investment decisions with knowledge equal to that of insiders.”

Looking to the conduct of the defendants, the court determines that it is clear that by purchasing TGS stock and options while in possession of this confidential information, the profits obtained by the defendants were a form of “secret corporate compensation . . . derived at the expense of the uninformed investing public . . . .” Furthermore, the “insiders here were not trading on an equal footing with the outside investors . . . . Such inequities based upon unequal access to knowledge should not be shrugged off as inevitable in our way of life, or, in view of the congressional concern in the area, remain uncorrected.” The court therefore holds that “all transactions in TGS stock or calls by individuals apprised of the drilling results . . . were made in violation of Rule 10b-5.”

The maximal stance of Texas Gulf Sulphur satisfies our desire for proportionality of results from participants in the corporate enterprise. The phrase “equality of access” should not be read as implying some sort of equality transcending the type of “fairness” examined above in the work of Jonathan Haidt and others, i.e., fairness as proportionality. At the same time, however, it does involve an important implicit claim, as did Cady, Roberts, that the expectations generated by our moral intuition in the context of the EEA properly apply to trading on anonymous exchanges. This claim is consistent with our assumptions about fairness in undertaking corporate enterprises, that we assume that shareholders, as investors, will not

87 401 F.2d at 848 (citing Cary, Insider Trading in Stocks, 21 BUS. LAW. 1009, 1010 (1966)).
88 Id., 401 F.2d at 849.
89 Id.
90 Id. at 851, citing Cary, Corporate Standards and Legal Rules, 50 CALIF. L. REV. 408, 409-410 (1962).
91 Id., 401 F.2d at 852.
92 Id. While Texas Gulf Sulphur represents a maximal statement of the prohibition against insider trading, it is nonetheless important to recognize the parameters of its doctrine. First, the ‘parity of information’ standard only applies to disclosure of basic facts. It does not mandate that everyone trading in markets actually have the same understanding of the risks involved—such understandings are the result of the analysis individuals bring to bear on the primary information presented to them. Indeed, an extension of the parity of information standard to all knowledge held by market actors would be nonsensical. While the theoretical basis of the result in Texas Gulf Sulphur is maximal, practically speaking its holding follows from Cady, Roberts. See also O’Hagan, 521 U.S. at 658 (“. . . informational disparity is inevitable in the securities markets . . . .”); SEC v. Dorozhko, 606 F. Supp. 2d 321, 331 (S.D.N.Y. 2008) (“Markets flourish on—and at the same time require—informational disparities.”) [hereinafter Dorozhko I].
93 See notes 235-246 infra and accompanying text.
be placed in an arbitrary and lesser position to those they trust with their capital.\textsuperscript{94} \textit{Texas Gulf Sulphur} applies expectations of openness, honesty, and fair dealing to the economic environment of the stock exchange, a financial technology far removed from the EEA our moral intuitions developed in.

Finally, in addition to broadening the focus of insider trading law from the insider trader to equal access to information, \textit{Texas Gulf Sulphur} also sets a low bar for the level of \textit{scienter} required for a Rule 10b-5 violation. Three of the defendants in the case, Coates, Crawford and Clayton, argued that they believed that information concerning the results of the geological findings would have become public by the time they made their purchase orders, which were placed after the close of trading on April 15, were executed on April 16\textsuperscript{th}.\textsuperscript{95} They argued that scattered rumors concerning the ore strike were circulating, an announcement would be made in the Canadian trade journal \textit{The Northern Miner}, and that TGS's official announcement would be made on April 16\textsuperscript{th} at 10 a.m., all before their trades would be placed. The court however determines that to expect this would amount to full dissemination of the information was unreasonable. The court determines that this negligence concerning whether in fact the information concerning the ore strikes would be properly disseminated is enough to qualify as \textit{scienter}, and that "proof of specific intent to defraud is unnecessary."\textsuperscript{96} Citing \textit{SEC v. Capital Gains Research Bureau},\textsuperscript{97} the court states that "[a]bsent any clear indication of a legislative intention to require a showing of fraudulent intent . . . the securities laws should be interpreted as an expansion of the common law both to effectuate the broad remedial design of Congress . . . and to ensure uniformity of enforcement."\textsuperscript{98} Lowering the level of culpable intent required from the high common law standard required to demonstrate fraud to mere negligence indicates that, while the equality of access standard may be a reasonable ideal, the \textit{Texas Gulf Sulphur} decision casts a wide net.

D \textbf{Chiarella and Dirks: Retrenchment through the Fiduciary Duty Requirement}

\textit{Chiarella} and \textit{Dirks} represent both the first Supreme Court cases in the modern era to tackle insider trading as well as a significant retrenchment in the sweep of insider trading law. Authored by Justice Lewis Powell, these decisions undercut the expansive sweep of the \textit{Texas Gulf Sulphur} “disclose or abstain” rule by grounding insider trading violations not in a policy of equal access to information but in the common law roots of insider trading doctrine based on the fiduciary duty of corporate insiders have towards shareholders. In short, without the

\textsuperscript{94} See \textit{supra} notes 274-277 and accompanying text.
\textsuperscript{95} 401 F.2d at 855-856.
\textsuperscript{96} \textit{Id}. at 854.
\textsuperscript{98} 401 F.2d at 855.
violation of a fiduciary duty by an insider, there cannot be an insider trading violation under Rule 10b-5 in the framework of Chiarella and Dirks.99

Because Justice Powell’s decisions radically restrict the sweep of the federal insider trading prohibition, they could perhaps be thought to neglect the full extent of the moral concerns animating insider trading law. While there is a measure of truth to this, they must simultaneously be understood as furthering values which themselves have a strong public policy justification.100 First, they do cover what Green & Kugler’s survey data indicate is the traditional “moral core” of insider trading, the abuse of positions of trust by powerful corporate insiders.101 Many of the most important abuses will be captured under the fiduciary duty-based proscription of Chiarella and Dirks. Furthermore, the fiduciary duty framework leaves open the path to misappropriation, which will cover other important abuses outside the purview of the classical theory.102 Second, important higher-order principles which are themselves grounded in positions with a moral component motivate Powell’s framework. Foremost among these is respect for the rule of law. There is also the need to strike a balance between zealous enforcement of the law, on the one hand, and trust in the moral culture of American businesspersons and respect for their autonomy on the other.103

Chiarella concerns the insider trading conviction of Vincent Chiarella, who worked as a “mark-up man” for the Pandick Press in New York City. Pandick printed financial documents for acquirors in takeover battles, and while the names of the would-be acquirors were redacted, Chiarella was able to deduce their identities through other information supplied. Using that information he purchased shares in the target companies in such transactions, making “slightly more than $30,000 in the course of 14 months.”104 The SEC uncovered this trading and he agreed to return his profits to the sellers. The SEC also charged him with 17 counts of violating Section 10(b) of the ’34 Act and Rule 10b-5. The Second Circuit affirmed his conviction, and he appealed to the Supreme Court.

Justice Powell frames the question before the Court as “whether a person who learns from the confidential documents of one corporation that it is planning an attempt to secure control of a second corporation violates § 10(b) of the Exchange Act if he fails to disclose the

99 That is, until the Second Circuit’s decision in SEC v. Dorozkho, 574 F.3d 42 (2d. Cir. 2009) [hereinafter Dorozhko II].
101 See supra note 295 and accompanying text.
102 See Pritchard, supra note 17, at 932-934.
103 See Pritchard, supra note 17, at 947, n.585.
104 Chiarella, 445 U.S. at 224.
impending takeover before trading in the target company’s securities?"\textsuperscript{105} His decision begins by looking first to the text of the statute and then to Congressional history. Given the failure of both Section 10(b) and Rule 10b-5 to explicitly mention insider trading, the statute is not of much help. Neither is the legislative history of the ’34 Act, with only one specific mention of insider trading that is arguably directed to other forms of securities manipulation.\textsuperscript{106} Powell concludes that “neither the legislative history nor the statute itself affords specific guidance for the resolution of this case.”\textsuperscript{107}

Powell turns next to the common law, which forms the keystone of his fiduciary duty framework. At common law, “misrepresentation made for the purpose of inducing reliance upon the false statement is fraudulent.”\textsuperscript{108} This silence is only fraudulent however when “one who fails to disclose material information prior to the consummation of a transaction . . . is under a duty to do so.”\textsuperscript{109} The adoption of this position represents a return to the position of the minority rule discussed above,\textsuperscript{110} where a corporate insider had a duty to disclose to shareholders material information before engaging in transactions with them (of course with the difference that we are now discussing exchange transactions).\textsuperscript{111} While Powell’s intuition has much to recommend it, given the deep conceptual problems with building a law of insider trading upon such open-ended statutory language and virtually non-existent legislative history, it is open to criticism from skeptics and proponents of a broad federal insider trading law alike.

From the side of the critics, there is the question of whether the use of precedent here is sound. Powell begins with the common law principle that silence is only fraudulent when there is a duty to speak, which arises when there is information one party has a right to know “because of a fiduciary or other similar relation of trust and confidence”\textsuperscript{112} between the parties. As Professor Bainbridge points out, though, this principle existed only in the context of face-to-face transactions.\textsuperscript{113} Powell’s use of the principle in the context of market transactions therefore, for these critics at least, represents the transposition of a common law rule into a much different context, leading to complications regarding the status of the law under Rule 10b-5 as a body of federal common law. But more importantly, it applies a principle which in its common law context is obviously associated with deceit, where one individual relies on another in a face-to-face context, often concerning investment in a close corporation, to a context

\textsuperscript{105} Id. at 224.  
\textsuperscript{106} See note 69, supra.  
\textsuperscript{107} Chiarella, 445 U.S. at 226.  
\textsuperscript{108} Id. at 227-228.  
\textsuperscript{109} Id. at 228.  
\textsuperscript{110} See supra notes 48-52 and accompanying text.  
\textsuperscript{111} See A.C. Pritchard, supra note 100, at 22, 26.  
\textsuperscript{112} Chiarella, 445 U.S. at 228.  
\textsuperscript{113} See Bainbridge, supra note 3, at 6; Pritchard, supra note 17, at 22-26.
where the traditional indicia of deceit are lacking. Given the anonymity of a stock exchange, any one individual’s transaction on a stock exchange is matched with her counterparty’s in a random manner. There may be good reasons to prohibit insider trading, but as critics have noted, it is difficult to understand it as fraud in any conventional sense.\(^{114}\)

Justice Powell’s interpretation of the Restatement (Second) of Torts § 551(2)(a) is likewise subject to criticism from those espousing a broad insider trading rule.\(^{115}\) In his reading of the Restatement, Powell neglects the other four exceptions to the principle that silence does not constitute misrepresentation, instead only focusing on the first dealing with a fiduciary duty or “other similar relation of trust and confidence.” Justice Blackmun, joined by Marshall, focuses on this in his dissent\(^{116}\) as does Professor Nagy.\(^{117}\) The fifth and final exception is that a knowledgeable party must disclose

- facts basic to the transaction, if he knows that the other is about to enter into it under a mistake as to them, and that the other, because of the relationship between them, the customs of the trade or other objective circumstances, would reasonably expect a disclosure of those facts.\(^{118}\)

This could conceivably cover trading on a stock exchange—while we might initially think that Professor Bainbridge’s objection that basing an insider trading proscription on this principle involves its application to a context far different than the one it developed in, the language of the Restatement explicitly encompasses “customs of the trade” and other circumstances where one “would reasonably expect a disclosure of those facts.” If then we expect that individuals transacting on stock exchanges are not trading on inside information—something given the beliefs discussed in Parts II and III below we would certainly want, whether or not we expect it—this exception could cover insider trading, as Justice Blackmun for example argued.

Next, \textit{Dirks v. SEC}\(^{119}\) extends the fiduciary duty-based framework of \textit{Chiarella} to tippees. Raymond Dirks was a securities analyst who learned of significant accounting fraud at Equity Funding of America, a large insurance company.\(^{120}\) During the two week course of his investigation, he discussed what he learned with several of his institutional clients as well as a reporter for the Wall Street Journal. While the newspaper declined to publish a story on Equity

\(^{114}\) See supra note 9 and accompanying text.
\(^{115}\) This line of criticism begins with Justice Blackmun’s dissent; see \textit{Chiarella}, 445 U.S. at 247-249. See also Nagy, \textit{The Gradual Demise of Fiduciary Principles}, supra note 3 at 1325-1326; Pritchard, supra note 17, at 18-19.
\(^{116}\) \textit{Chiarella}, 445 U.S. at 248
\(^{118}\) \textit{RESTATEMENT (SECOND) OF TORTS} § 551(2)(e).
\(^{120}\) \textit{Dirks}, 463 U.S. at 648-649.
Funding during this period, some of the institutions and investors he talked to sold their holdings as share price fell from $26 to $15. Dirks was censured by the SEC for aiding and abetting violations of Section 10(b) of the Exchange Act, among other allegations.

Dirks confirms that tippees can be subject to insider trading liability just as insiders can, but only if the tippee has inherited a fiduciary duty to the shareholders from the tipper. The decision therefore threads a middle course between a return to the broad liability of Cady, Roberts and Texas Gulf Sulphur and a narrow view of liability that would end with direct insiders. The Court states that “the tippee’s duty to disclose or abstain is derivative from that of the insider’s duty,” and that “a tippee assumes a fiduciary duty only when the insider has breached his fiduciary duty to shareholders by disclosing the information to the tippee, and the tippee knows or should know that there has been a breach.” In addition, the test of tippee liability will be whether the insider personally will benefit, either directly or indirectly, from his disclosure. In this way, tippee liability comes under traditional or classical insider trading theory, and is directly dependent on the violation of a fiduciary duty by an insider.

Justice Powell is careful to delimit this extension of Chiarella from the earlier blanket prohibition. Echoing the language of Goodwin v. Agassiz, footnote 21 of Dirks emphasizes that there may be circumstances where trading on inside information is therefore permissible under law, but that this may at the same time amount to “behavior that may fall below the standards of ethical conduct.” Citing the SEC’s Report of Special Studies of Securities Markets, Justice Powell states that “in a statutory area of the law such as securities regulation, where legal principles of general application must be applied, ‘there may be significant distinctions between actual legal obligations and ethical ideals.’”

The distinction between what is required by law and what is required by morality is important to Justice Powell’s reshaping of the law of insider trading because it reflects his understanding of business practice and the role the law should play in policing it. As Professor Pritchard explains, he believed that American businesspersons generally conducted themselves

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121 Id. at 650.
122 Id. at 650-652.
123 “In determining whether a tippee is under an obligation to disclose or abstain, it is thus necessary to determine whether the insider’s ‘tip’ constituted a breach of the insider’s fiduciary duty.” Dirks, 463 U.S. at 661.
124 Id. at 659.
125 Id. at 660.
126 Id. at 662.
127 Id. at 661.
129 Dirks, 463 U.S. at 661.
ethically, and that overreaching by the SEC and government prosecutors was a real danger to the free conduct of corporate activity. The fiduciary framework therefore prohibits the most egregious forms of insider trading—which Lewis Powell believed were shameful—while allowing for legitimate business conduct, particularly that of securities analysts, as well as preventing prosecutorial overreach.

E Re-Expansion through Misappropriation: O’Hagan

U.S. v. O’Hagan continues the expansion of insider trading law begun in Dirks, but on a significantly different conceptual basis from that of Chiarella and Dirks that at the same time purports to remain within Powell’s fiduciary duty framework. While it is primarily important because it expands insider trading prosecutions out from their core to perhaps less typical but still morally objectionable peripheral cases, it is also open to serious criticism of legal incoherence, as it stretches the fiduciary duty framework to its “breaking point.”

In her opinion, Justice Ginsburg relies on the concept of fiduciary duty without however focusing on it explicitly, instead working through the elements of a 10(b) violation of using a “deceptive device” “in connection with a securities transaction.” It appears that O’Hagan represents more of a formalistic attempt to stay within Powell’s framework in order not to have to engage in a fundamental redrawing of the bases of insider trading law (as developing Chief Justice Burger’s fraud-on-investors approach of his Chiarella dissent, for example, would have required) than it does a well thought-out jurisprudence of insider trading.

Its extension of insider trading to a category of individuals most would say should be subject to liability reaches the right result, but for reasons which are at best unclear. It satisfies our moral intuition while creating problems at the level of the law itself, ultimately adding to the conceptual problems with insider trading law instead of resolving them.

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130 See Pritchard, supra note 17, at 947 (2003) (“Powell’s nearly forty years of experience in corporate boardrooms led him to trust the character of the average American businessman.”).
131 Pritchard, id. at 936 n.585.
133 Bainbridge, A Comprehensive Primer, supra note 3, at 12 (“Stretching fiduciary duty to the breaking point”).
134 For criticism of O’Hagan, see Bainbridge, id., at 10 (Ginsburg’s approach is “difficult to square with the basic premises of securities regulation”); Karmel, supra note 53 at 94 (O’Hagan as offering no theoretical justification for insider trading law other than it promotes confidence in markets”); Nagy, The Gradual Demise of Fiduciary Principles, supra note 3, at 1335 (the opinion never explains why misappropriation theory is limited to those who have breached a fiduciary duty); Park, supra note 3, at 370 (“O’Hagan is unclear with respect to the source and scope of this duty of nondeception”); Saikrishna Prakash, Our Dysfunctional Insider Trading Regime, 99 COLUM. L. REV. 1491, 1506 (O’Hagan as a phryic victory for the SEC); but see Randall W. Quinn, The Misappropriation Theory of Insider Trading in the Supreme Court: A (Brief) Response to the (Many) Critics of United States v. O’Hagan, 8 FORD. J. CORP. & FIN. L. 865 (2003).
James O’Hagan was a partner in the Minneapolis law firm of Dorsey & Whitney, which was engaged to represent Grand Metropolitan PLC in a tender offer for shares of the Pillsbury Corporation. In order to cover his illegal withdrawals of funds from client accounts, he used confidential information to purchase options and shares in Pillsbury that he gleaned from sneaking into the offices of his partners. He ultimately netted $4.3 million from his insider trading activity. At trial he was convicted on all counts under Rule 10(b) but the Eighth Circuit then reversed, rejecting the misappropriation theory as the 4th Circuit had done in *U.S. v. Bryan*. The Supreme Court in turn reversed the Eighth Circuit. Justice Ginsburg first determines that misappropriation meets the requirement of a “deceptive device” just as much as trading on inside information does in ‘traditional’ or ‘classical’ insider trading. First, misappropriation “defrauds the principal of the exclusive use” of the information just as an insider defrauds a shareholder of the use of confidential information in traditional insider trading. The misappropriation theory substitutes the deception of those who entrusted him with information for the deception of a purchaser or seller by a company insider in the traditional theory. Next, misappropriation meets the requirement that the deception occur “in connection with the purchase or sale of a security” because the insider gains an advantage in the marketplace through his deception. In this way, both elements of a 10(b) violation are met when trading occurs on the basis of misappropriated information.

*O’Hagan* is primarily important because it extends coverage of the law of insider trading out from core to periphery. While the insiders of traditional theory constitute the “moral core” of insider trading, misappropriators are also important, as courts and commentators recognized. In terms of evolutionary psychology, there may be some difference between a company vice president who trades on inside information and a lawyer such as O’Hagan, who comes across such information in the course of his partners’ representation of the firm, but not

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135 *O’Hagan*, 521 U.S. at 647.
140 *O’Hagan*, 521 U.S. at 652.
141 *Id.*
142 *Id.* at 656.
much. Both have access through their powerful positions to confidential information, and Green & Kugler’s results show that our disapproval of them is about the same.\textsuperscript{144} While misappropriation isn’t the most common and oldest type of trading on inside information, it is about as objectionable. The difference between “core” and “periphery” in insider trading law then refers more to its historical genesis than the intrinsic moral significance of different forms of insider trading. By extending the insider trading proscription to the periphery, \textit{O’Hagan} advances the moral objectives of the law.

The second important consequence of \textit{O’Hagan} is not so beneficial. This stems from its muddy conceptual basis. As seen above, the law of insider trading began as state corporate law, which under the “minority rule” prohibited insiders from trading with shareholders on the basis of inside information because to do so would violate the duty of loyalty.\textsuperscript{145} The fiduciary duty framework of \textit{Chiarella} and \textit{Dirks} correspondingly makes sense as a federalized, modern version of the minority rule, but there is no analogous duty of loyalty or other fiduciary duty between someone possessing confidential information and a misappropriator. While \textit{O’Hagan} explains that a misappropriator “defrauds the principal of the exclusive use of that information,”\textsuperscript{146} such actions may be better understood as examples of violations of fraud-on-the-market generally, or property rights, not state law fiduciary duties between principal and agent.

It is shortsighted then to say that \textit{O’Hagan} reaches the “right result for the wrong reason” and then to consider the matter closed, because conceptual clarity has real benefits. In the decade and a half since \textit{O’Hagan}, courts have begun to discard the fiduciary duty framework laid down in \textit{Chiarella} and \textit{Dirks} and affirmed in \textit{O’Hagan} because of its legal unsuitability in reaching other morally distasteful types of insider trading. So far the Supreme Court has apparently signaled its approval of these moves by silence but they can result in circuit splits\textsuperscript{147} and the inability of market actors and lawyers to know exactly what the law is. Rule of law depends on clarity of the law, and the current state of the law of insider trading does not advance this important societal interest.

\textbf{F \quad Abandoning the Fiduciary Duty Framework}

\textsuperscript{144} See notes 292-293 \textit{infra} and accompanying text.
\textsuperscript{145} See notes 48-52 \textit{supra} and accompanying text.
\textsuperscript{146} \textit{O’Hagan}, 521 U.S. at 652.
\textsuperscript{147} For example, the circuits are currently split on the issue of “use vs. possession” of inside information, with the Second Circuit following its early determination that trading while in possession of inside information will suffice for an insider trading conviction, with other circuits holding that prosecutors must establish use of such information. Compare \textit{U.S. v. Teicher}, 987 F.2d 112, 120-121 (2d Cir. 1993) and \textit{U.S. v. Royer}, 549 F.3d 886, 899 (2d Cir. 2008) with \textit{SEC v. Adler}, 137 F.3d 1325 (11\textsuperscript{th} Cir. 1998), \textit{U.S. v. Smith}, 155 F.3d 1051 (9\textsuperscript{th} Cir. 1998), \textit{cert. denied}, 525 U.S. 1071.
Since *O’Hagan*, lower courts have continued to advance the expansion of insider trading law beyond the narrow confines of the classical theory. Until the Second Circuit’s decision in *Dorozhko*, they had done so in ways which are in significant tension or even implicit contradiction with the fiduciary duty framework, but without openly qualifying or flouting that basis for insider trading law. The array of post-*O’Hagan* cases shows the law grappling with types of insider trading in the peripheral zone of the law, usually but not always expanding its reach, but at significant cost to the law’s internal coherence. In what follows I survey recent decisions governing the “brazen fiduciary,” tippee liability where there is no benefit to the tipper, the “use vs. possession” debate, and misappropriation through computer hacking.

In order to sustain the notion that it is deception of a fiduciary that results in a finding of a “deceptive device,” the *O’Hagan* court states that in cases coming under the misappropriation theory, “if the fiduciary discloses to the source that he plans to trade on the nonpublic information, there is no ‘deceptive device’ and thus no § 10(b) violation . . . .” This logical extension of the fiduciary duty principle gives rise to the problem of the “brazen fiduciary,” one who intentionally discloses to the source of confidential information her intention to trade on such information. *SEC v. Rocklage* presents just such a defendant. Mrs. Patricia Rocklage was married to the CEO of biotech firm Cubist Pharmaceuticals, Inc. Her husband was in the habit of informing her about important corporate events, and on December 31, 2001, he confided in her news of disappointing results in recent drug trials. Unbeknownst to him, Mrs. Rocklage had a pre-existing plan with her brother, William Beaver, to inform him of significant corporate news regarding her husband’s company. When Mr. Rocklage informed her of the disappointing drug trials, she told him that she would be informing her brother. Despite his protests, she went ahead and did so.

In affirming the District Court’s conviction of Mrs. Rocklage and Beaver, the court makes a conceptual separation between her original, deceptive acquisition of the information concerning Cubist’s stock price and the deceptive trading she enabled through tipping her

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148 And also to square the decision with *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977). The Court found there that the complaint failed to allege a “material misrepresentation or failure to disclose,” *Santa Fe Industries*, 430 U.S. at 474, and therefore a fraud charge under Section 10(b) was inappropriate. *See O’Hagan*, 521 U.S. at 655.
149 *O’Hagan*, 521 U.S. at 655.
150 *SEC v. Rocklage*, 470 F.3d 1 (1st Cir. 2006).
151 470 F.3d at 3.
152 *Id.*
153 *Id.* at 4.
154 *Id.*
brother. \footnote{155} Distinguishing this case from that of James O’Hagan, \footnote{156} the court then determines that the disclosure immediately prior to her tip to her brother does not negate the original deceptive acquisition of information. \footnote{157} On this basis, then, her original acquisition of information qualifies as a deceptive device used in connection with a securities transaction.

\textit{Rocklage} illustrates a court engaging in contrived reasoning in order to sustain a conviction of a defendant that most would feel engaged in seriously objectionable conduct. \footnote{158} Most importantly, the case illustrates a court disregarding the straightforward principle of \textit{O’Hagan} that if a fiduciary discloses her intent to trade to the source of the nonpublic information, this cannot be deemed a deceptive device under Section 10(b). \footnote{159} The \textit{Rocklage} court extends liability to a type of misappropriator we instinctively feel has acted improperly, but who has met the stated requirement of disclosure that would make such actions non-deceptive under the governing fiduciary duty framework. \textit{Rocklage} is therefore an important step towards the outer limit of insider trading liability.

Next, \textit{U.S. v. Evans} \footnote{160} shows an appellate court extending liability to a tippee arguably in violation of the fiduciary duty framework. \footnote{161} Ryan Evans’s college roommate, Paul Gianamore, was an investment banking associate at Credit Suisse First Boston. \footnote{162} Both men were acquitted of conspiracy charges at their first trial; the jury also acquitted Gianamore of securities fraud but deadlocked on the question of whether Evans committed securities fraud. \footnote{163} Upon retrial, 

\footnote{155} \textit{Id}. \footnote{156} Professor Nagy observes that the \textit{Rocklage} court appears to interpret the facts of \textit{O’Hagan} incorrectly. Nagy, \textit{The Gradual Demise of Fiduciary Principles}, supra note 3, at 1346. The \textit{Rocklage} court assumes that O’Hagan was entrusted with the information concerning the tender offer of Grand Metropolitan for Nabisco by his law firm, whereas he actually uncovered this information by rifling through the desks of his colleagues. \textit{See Prentice, Permanently Reviving the Temporary Insider}, supra note 3, at 350. \footnote{157} 470 F.3d at 12-13. \footnote{158} The closest scenario to \textit{Rocklage} in Green & Kugler’s work is their comparison of tipper and tippee liability in Study 2. \textit{See} Stuart P. Green & Matthew B. Kugler, \textit{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, 469-472 (2011). In Pair 3, they ask respondents to gauge the wrongfulness of an executive who tips his brother in order to impress him. \textit{Id.}, at 472. Respondents give the executive doing the tipping a blameworthiness rating of 5.10, while the brother tipped receives a blameworthiness rating of 4.78. \textit{Id.}, at 475. Neither exactly corresponds to Mrs. Rocklage, who is a family member receiving a tip who then tips another family member, but both estimations of blameworthiness in Study 2 Pair 3 are rather high on the 7-point scale they use. \footnote{159} \textit{See} Nagy, \textit{The Gradual Demise of Fiduciary Principles}, supra note 3, at 1344-1346; Kim, \textit{supra} note 19, at [19] (the court “all but eviscerated the fraud requirement.”). \footnote{160} U.S. v. Evans, 486 F.3d 315 (7th Cir. 2007). \footnote{161} \textit{See also} United States v. Gansman, 657 F.3d 85 (2d Cir. 2011) (defendant entitled to present jury instruction explaining tipper may not be liable even though tippee is); United States v. Corbin, 729 F.Supp. 2d 607 (S.D.N.Y. 2011) (wife discusses confidential information with husband who then tips another); SEC v. Yun, 327 F.3d 1263 (11th Cir. 2003) (wife of corporate officer tips co-worker). \footnote{162} \textit{Evans}, 486 F.3d at 319. \footnote{163} \textit{Id}. at 320.
Evans was convicted of insider trading under Section 10(b). At appeal, he argued that since his tipper had not personally benefitted from the tip, as seemingly required by Dirks, he could not be guilty of insider trading either. The Seventh Circuit rejected this argument as a matter of law, affirming Evans’s conviction. The court cites United States v. Standefer for the proposition that the government is not estopped from arguing that a defendant aided and abetted a criminal offense even where the principal is acquitted. Furthermore, the court reasons that while Gianamore did not willfully intend to tip Evans, but rather did so negligently, this would still suffice to find Evans as the tippee guilty. As Professor Nagy notes, this violates the fiduciary duty framework of Chiarella and Dirks in that it allows for tippee liability when the tipper has violated the duty of care, but not the duty of loyalty. Yet it is the duty of loyalty that is at stake in the fiduciary duty framework for insider trading, not the duty of care.

The third set of recent cases shows the courts adopting a principle restricting, not extending, insider trading liability, but in a manner that is in direct contradiction with the fiduciary duty framework. In both SEC v. Adler and United States v. Smith the courts considered the question of whether “mere possession” of material inside information was enough to sustain a conviction for insider trading or whether the government had to further demonstrate use of such information. In these cases, the 11th and 9th Circuits respectively held that the government must demonstrate actual use of inside information, i.e., a causal connection between the inside information and the trades carried out. While the Adler court specifies that there is a prima facie inference in favor of use when an insider is aware of such information, the possibility that one could trade while in possession of inside information conflicts with the principle implicit in the fiduciary framework that silence about a material fact while trading with shareholders (or prospective shareholders) itself constitutes deception, and is thus a violation of an insider’s fiduciary duty.

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164 *Id.*
165 *Id.*
167 *Evans*, 486 F.3d at 322.
168 *Id.* at 323. *Cf.* SEC v. Obus, 693 F.3d 276, 286 (2d Cir. 2012) (recklessness, though not negligence, on the part of tipper will suffice for insider trading liability).
170 SEC v. Adler, 137 F.3d 1325 (11th Cir. 1998).
171 United States v. Smith, 155 F.3d 1051 (9th Cir. 1998).
Given the intrinsic fear human beings have of being taken advantage of in group endeavors, the resolution of the “use versus possession” debate in favor of use runs counter to the general trend of the post-O’Hagan decisions to expand the coverage of insider trading law in accordance with what individuals would find naturally suspicious or offensive. Here the courts require demonstration of a causal connection in part to avoid wading into the legally problematic territory of making criminal liability turn upon a mere state of mind, as opposed to an actual offense or action. Adler, Smith and the other possession versus use cases then come down in favor of the legal considerations that govern insider trading cases, even if these are in tension with our psychological proclivities as revealed by evolutionary psychology. The current cases holding that use must be demonstrated to sustain an insider trading charge may thus be seen as instances of law restraining our natural psychological suspicion as to the motives of others in the interests of justice.

The final recent important case involves an issue previously assumed as settled: whether or not a computer hacker could be held liable under insider trading law. Because a hacker lacks any fiduciary duty owed to either those whom he trades with, or the source of his information, it was previously thought to be settled law that such an individual did not violate Section 10(b). In the words of Professor Bainbridge, the Second Circuit’s decision in SEC v. Dorozhko involves an “end run” around the fiduciary duty requirement of Chiarella, O’Hagan, and Zandford. Dorozhko is important not only in its great expansion of those now subject to insider trading law, but because of its inventive (or alternatively, “shoddy”) legal reasoning. At the very least, it highlights the indeterminacy of the law of insider trading. While many have thought that an individual trading on stolen information should be liable under

174 See notes 238-246 infra and accompanying text.
175 See Smith, 155 F.3d at 1068 n.25, where the court states “[i]n fact, a knowing-possession standard would, we think, go a long way towards making insider trading a strict liability crime.” The Smith court thus believes that it is important to preserve the requirement that the SEC demonstrate scienter as an element of an insider trading action. Both the Smith and the Adler courts balance this burden on the government in insider trading cases by establishing that there is a prima facie inference that when an individual trades while in possession of inside information, he has done so using such information. Smith, id. at 1069; Adler, 137 F.3d at 1337.
177 SEC v. Dorozhko, 574 F.3d 42 (2d Cir. 2009) [hereinafter Dorozhko II].
180 See Bainbridge, supra note 178.
Section 10(b),\(^\text{181}\) accomplishing this goal through a debatable reading of the complicated precedent case law in this area can only add to the sense of legal uncertainty surrounding insider trading law.

Oleksandr Dorozhko was a Ukrainian national who opened a securities trading account with $42,500 in early October, 2007.\(^\text{182}\) IMS Health, Inc. was set to announce its 3\(^{\text{rd}}\) quarter earnings results on October 17 after the close of trading, and Thomson Financial had been hired to assist them in investor relations for this matter.\(^\text{183}\) At 2:15 p.m., a hacker accessed the Thomson Financial computer system, and at 2:52 p.m. Dorozhko placed an order purchasing $41,670 worth of IMS Health options.\(^\text{184}\) At 4:33 p.m., IMS Health announced that its 3\(^{\text{rd}}\) quarter earnings would miss analysts’ expectations by 28%, and at the beginning of trading the next day its share price fell from $29.56 to $21.20.\(^\text{185}\) Dorozhko sold his options 6 minutes after the market opening, netting a profit of $286,456.\(^\text{186}\) His options amounted to 90% of the options purchased on IMS Health stock in the six weeks prior to October 17.\(^\text{187}\) Based on this circumstantial evidence, the SEC charged Dorozhko with securities fraud under Section 10(b).\(^\text{188}\)

Reviewing both the controlling precedent of Chiarella, O’Hagan, Zandford, as well as the determinations of the Fourth Circuit in U.S. v. Bryan\(^\text{189}\) and the Fifth Circuit in Regents of University of California v. Credit Suisse First Boston (USA), Inc.\(^\text{190}\) and scholarly opinion, the District Court determined that seeing as Dorozhko had not breached any fiduciary duty, there could be no securities fraud charge under Section 10(b). Judge Buchwald emphasized that the law of insider trading contained “lacunae,”\(^\text{191}\) and that there were important policy reasons why the law of insider trading required breach of a fiduciary duty.\(^\text{192}\) In particular, the requirement of a “deceptive device” under the law of insider trading requires breach of a fiduciary duty.\(^\text{193}\) Given that Dorozhko had not breached any fiduciary duty, but had rather stolen information, a Section 10(b) claim was inappropriate.

\(^{181}\) Judge Buchwald makes exactly this point in her district court opinion. See SEC v. Dorozhko, 606 F.Supp. 2d 321, at 341 [hereinafter Dorozhko I].

\(^{182}\) Dorozhko II, 574 F.3d at 44.

\(^{183}\) Id.

\(^{184}\) Id.

\(^{185}\) Id.

\(^{186}\) Id.

\(^{187}\) Id.

\(^{188}\) Id. at 44-45.

\(^{189}\) U.S. v. Bryan, 583 F.3d 933 (4\(^{\text{th}}\) Cir. 1995).

\(^{190}\) Regents of the Univ. of Cal. v. Credit Suisse First Boston (USA), Inc., 482 F.3d 372 (5\(^{\text{th}}\) Cir. 2007).

\(^{191}\) Dorozhko I, 606 F.Supp at 335.

\(^{192}\) Id., at 342-343.

\(^{193}\) Id. at 329-330.
The Second Circuit reversed. The court first reasoned that the “deceptive” element of a Section 10(b) claim only requires breach of a fiduciary duty where the deception is based on silence. In particular, it declared that “what is sufficient is not always what is necessary, and none of the Supreme Court opinions reviewed by the District Court require a fiduciary relationship as an element of an actionable securities claim under Section 10(b).” While logically possible, in substance this goes against the understanding of the entire basis of insider trading law since Chiarella, when Justice Powell firmly grounded it in the fiduciary duty of loyalty and not in a broader fraud-on-the-market (or fraud on investors) theory as advocated by Chief Justice Burger in his dissent. Given that computer hacking could then be a deceptive device within the meaning of Section 10(b), the court remanded the matter to the District Court for further determination.

Dorozhko is an important decision on a number of levels. First, it applies the law to the burgeoning world of online trading, and in a way that satisfies our moral intuitions about insider trading. In terms of the theme of this Article, it is further evidence of the law of insider trading expanding to encompass those we feel improperly capture market benefits. It is also further evidence that the fiduciary duty framework given by Justice Powell is legally incapable of doing what we seem to want insider trading law to do. In attempting to cabin the requirement of a fiduciary duty to instances of fraud based on silence—in effect, creating a category of fraud by active misrepresentation in insider trading law—it takes a further step away from the fiduciary duty framework of Chiarella and Dirks, without however openly announcing a repudiation of that law, which the Second Circuit would not have the authority to do. So far, however, the Supreme Court has signaled its agreement with this development through acquiescence.

These four areas show the courts grappling with the implications of the fiduciary duty framework in the modern context; with the exception of the “possession vs. use” debate, courts are moving to expand the reach of insider trading law. The expansionary movement corresponds to what evolutionary psychology shows humans generally desire in social interaction.

II EVOLUTIONARY PSYCHOLOGY AND SOCIAL EXCHANGE

194 Dorozhko II, 574 F.3d at 49.
195 See, e.g., Prentice, supra note 176, at 299-200 (Justice Ginsburg’s opinion, which does not capture theft as misappropriation, as “unsatisfying”); cf. Kim, supra note 19, at 16 (Dorozhko II as an example of a court succumbing to the instinct to punish people . . . .”).
196 Cf. Judge Buchwald’s statement in Dorozhko I, 606 F.Supp. 2d at 323, that it would be “beyond the purview of this Court” to “eliminate the fiduciary duty requirement” from § 10(b) jurisprudence.
197 [cites. Appeals for cert?]
Evolutionary psychology attempts to explain the basic tendencies of human behavior in terms of evolutionary concepts. In so doing it constructs a general model of human nature that is grounded in the social circumstances of our development in the EEA over the course of the past 10 million years or so.\textsuperscript{198} Because social exchange is a key feature of life within human communities, evolutionary psychology is deeply relevant to a broad understanding of economics, at the same time that its methodology differs considerably from economic methodology dominant in recent decades. Instead of beginning with an assumption that the human person is a self-interested, rational individual, i.e., \textit{homo economicus}, evolutionary psychology begins with the recognition of social facts such as altruism, spitefulness, attention to purity codes, among other things, and then attempts to explain them using the central concepts of evolutionary biology.\textsuperscript{199} While its conclusions are deeply controversial, it also provides a highly persuasive account of our social life, explaining many important features of human psychology, moral life, and reproductive success and failure, among others.

The relevance of evolutionary psychology to economic issues stems from the embryonic picture it draws of the development of markets, as well as law.\textsuperscript{200} For the problem of insider trading, most important are its treatment of the psychology of dyadic social exchange, and generalizing from this, what we perceive to be our due when we participate in communal activities. Part and parcel of the cognitive machinery of social exchange is our exquisite sensitivity to fears of cheating, i.e., that by engaging in free-riding behaviors others may receive more than they deserve from such activities. Part II therefore begins with a review of the problem of altruism, explores how the criticism of the original treatment of altruism leads to a full conception of social exchange and our moral intuitions, and concludes by contrasting the


picture of human nature drawn by evolutionary psychology with the rational actor of neoclassical economics.

A Trivers’s The Evolution of Reciprocal Altruism

Robert Trivers’s *The Evolution of Reciprocal Altruism* is one of the founding texts of evolutionary psychology. Trivers’s goal is to provide a formal account of how evolution could favor individuals who displayed a propensity for altruistic behavior, i.e., “behavior that benefits another organism, not closely related, while being apparently detrimental to the organism performing the behavior, benefit and detriment being defined in terms of contribution to inclusive fitness.” Such behavior presents a puzzle to evolutionary theory, since altruism often puts the individual performing it at risk, thereby potentially reducing its ultimate chances of reproduction. On the other hand, the behavior of various types of animals, particularly humans, provides evidence of consistently altruistic action towards non-kin. Trivers therefore attempts to provide a formal account of how such behavior could be selected for under certainly evolutionary conditions.

He begins by considering the case of a drowning man. If the drowning man has a 50% chance of dying if not rescued, and the rescuer only a 5% chance of drowning himself, the costs of altruism would be far outweighed by the benefits given certain conditions: if the risk of drowning were in fact widespread, so that everyone in the given population could expect to be faced with it at some point over the course of their lives, and individuals would choose to reciprocate if someone had rescued them but not if they had not done so earlier. In this stylized world, individuals who fail to act altruistically in the first instance would likely die when at risk of drowning, whereas those who had earlier rescued someone could expect to be saved. Certain biological parameters will increase the likelihood that this result will obtain. Trivers explains that long lifetimes will maximize the chance that individuals will “encounter many altruistic situations,” and a low dispersal rate will increase the chance of repeated interactions.

202 Id. at 35.
203 All genuinely altruistic behavior towards non-kin is *prima facie* puzzling, because there appears to be no benefit in terms of genetic fitness to risking one’s physical well-being or sacrificing material interests to unrelated individuals. The persuasiveness of Trivers’s theory however led evolutionary theorists to see reciprocal altruism as “really just long run self-interest.” See Herbert Gintis, Samuel Bowles, Robert Boyd & Ernst Fehr, *Explaining altruistic behavior in humans*, 24 EVO & HUM. BEHAV. 153, 154 (2003). See also Baily Kuklin, *The Nature of Universal Moralties*, 75 BROOK. L. REV. 463, 466 (2009).
between individuals, as will mutual interdependence among individuals living in proximity.\textsuperscript{205} Furthermore, certain parental-care situations typical of primates could increase this effect, where individuals “are capable of performing an altruistic act for the parents or even another offspring,” as would a relatively flat dominance hierarchy, or where individuals could offer aid to others in combat.\textsuperscript{206}

Altruistic behavior can also be understood as a mechanism for overcoming the prisoner’s dilemma, where individuals have an incentive to defect in order to reach a potentially higher individual payoff as opposed to taking a chance on their partner to reach a cumulatively superior outcome.\textsuperscript{207} Trivers shows that unless the payoff to the defecting player is far greater than the benefit to be achieved by both parties confessing (cooperating), cooperation will occur where the advantages to be gained outweigh “the initial losses to non-altruistic types.”\textsuperscript{208} Reciprocal altruism can thus be characterized as “symbiosis [with] a time lag,”\textsuperscript{209} where helping others results in mutual benefit. If such conduct is controlled by our genes, under the appropriate circumstances it should spread within the population when individuals dispense altruism by reference to the altruistic tendencies of the recipient.

Moving from the theoretical to the world of observed behavior, Trivers then argues that we do in fact observe reciprocal altruism in three areas: symbiotic grooming behavior of certain fishes, warning calls among certain birds, and in human reciprocal altruism. Many aspects of human psychology are tied to reciprocal altruism, but for consideration of the emotional reaction to insider trading, four in particular are important: development of complex, regulating systems, moralistic aggression, detection of “subtle cheating,” and the ability afforded by language to develop rules of exchange in multiparty interactions.\textsuperscript{210} Developmental plasticity is also important.\textsuperscript{211} In addition, the distinction between gross cheating, where a partner fails to reciprocate an altruistic act whatsoever, and subtle cheating, where she just attempts to reciprocate less than the value of the act originally performed, plays an important role.\textsuperscript{212}

\textsuperscript{205} Id. at 37
\textsuperscript{206} Id. at 38.
\textsuperscript{207} Id. at 38-39. For the related argument that individuals can overcome social dilemmas through “credible ex ante commitments without relying on external authorities” see Elinor Ostrom, James Walker & Roy Gardner, Covenants With and Without a Sword, 86 AM. POL. SCI. REV. 404 (1992).
\textsuperscript{208} Id. at 39.
\textsuperscript{209} Id. See also Jon Elster, Social Norms and Economic Theory, 3 J. ECON. PERSPS. 99, 106 (1989) (social norms as solving “the problem of time inconsistency.”).
\textsuperscript{210} Id. at 48-53.
\textsuperscript{211} Id. at 53. For the issue of plasticity in connection with moral intuitions concerning insider trading, see Part III.B infra.
\textsuperscript{212} Id. at 50-51.
Subtle cheating will often be evolutionarily adaptive; conversely, because it will often be difficult to discern when someone is engaged in subtle cheating, human psychology will be finely tuned to detect it. As a result, individuals will be tempted to cheat, and “natural selection will rapidly favor a complex psychological system in each individual regulating both his own altruistic and cheating tendencies and his responses to these tendencies in others.” \(^{213}\) Humans will become sensitive to their responses to cheating, at the same time that they will seek out ways to cheat without themselves being detected. Due to the dangers of cheating, we will develop a mechanism to protect against the exploitation of our initial propensity towards altruism. Trivers refers to this as “moralistic aggression,” \(^{214}\) and we will often react to “injustice, unfairness and lack of reciprocity” in ways that seem “out of all proportion to the offenses committed.” \(^{215}\)

Given the complexity of subtle cheating, Trivers argues that natural “selection should favor the ability to discern and discriminate against subtle cheaters.” \(^{216}\) We will therefore attempt to connect generosity with the emotional basis for actions; where actions are believed to be due to false or calculating motives, we will distrust the individuals performing them. And finally, due to the difficulty of detecting cheating in multiparty interactions, we will have the propensity to formulate rules of conduct for such exchanges, which will be facilitated by our capacity for language. Cheating will be detected when the rules are violated. In this way natural selection may provide for the development of law. \(^{217}\)

Trivers revolutionized the evolutionary understanding of human groups by presenting a persuasive and formal case for non-kinship based altruism, offering a sophisticated account of many behaviors that we actually observe in both human and other living beings. In particular, his theory offers the prospect of explaining many observed social and psychological phenomena that seem to run counter to overly simplistic notions of Darwinian theory and the “survival of the fittest.” *The Evolution of Reciprocal Altruism* is one of the founding texts of evolutionary psychology, and has important applications in psychology, moral theory, economics, and all social sciences that attempt to explain group behavior. For the purposes of analyzing insider trading, the emphasis on cheating and our sensitivity to it is key.

\(^{213}\) *Id.* 48.
\(^{214}\) *Id.* at 49.
\(^{215}\) *Id.*
\(^{216}\) *Id.* at 50.
B Strong Reciprocity, Social Exchange, and Public Goods

While Trivers was instrumental in launching the discipline of evolutionary psychology, his doctrine of reciprocal altruism faced a crucial objection: it relies on the individual’s concern for her reputation and the resulting propensity of others to dispense altruistic acts in light of this reputation in the future. Through the mechanism of reputation, reciprocal altruism would appear to be a form of “enlightened self-interest,” in the words of Jonathan Haidt. Many evolutionary psychologists think that such a mechanism is too weak to properly account for the cooperation we in fact observe in the social world. Something more is needed.

In particular, Trivers’s theory of reciprocal altruism requires that individuals reciprocate because they have an interest in receiving such benefits from others in the future. Such reciprocity would occur through the maintenance of reputation in small groups, meaning that reputational motives will drive reciprocal altruism. For an individual’s reputation to serve as an effective mechanism for such altruism, however, the group she is in must be reasonably likely to stay together. As pointed out by Herbert Gintis, though, when groups have the greatest need for reciprocity, in conditions of famine, war, or other crisis, they will simultaneously be most prone to dispersal. Therefore, according to the critics, reciprocal altruism alone is unlikely to be strong enough to counter the effects of immediate self-interest in times of crisis. Evolutionary psychologists therefore have proposed and tested further mechanisms to explain the pro-social behaviors that individuals in groups often display. These theories come under the label “strong reciprocity” and rely heavily on the concept of altruistic punishment.

Strong reciprocity goes beyond reciprocal altruism by positing that we have a psychological predisposition not just to discern cheating, but to actively punish it even when it doesn’t directly affect us as individuals. This “taste for punishing free riders” itself operates altruistically, i.e., it exacts a net cost on the part of individuals who indulge in it. Economists Ernst Fehr and Simon Gächter offer persuasive experimental evidence for altruistic punishment

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220 See Trivers, Reciprocal Altruism, supra note 201, at 37 (condition (2) for an “altruistic situation” is “when a given altruist repeatedly interacts with the same small set of individuals.”).
221 Gintis, Strong Reciprocity and Human Sociality, supra note 219, at 172-3.
222 Cosmides & Tooby, Evolutionary Psychology, Moral Heuristics and the Law, supra note 217, at 198.
They begin by framing cooperative activity as a public good. Free riders are those who enjoy the benefits of the public good without contributing to its creation and maintenance, or by contributing in amounts less than the benefits they derive. Punishment of free riders thus constitutes a second-order public good, one that contributes to the existence of public goods.

In order to test for the existence of altruistic punishment, Fehr & Gächter recruited 240 students from the University of Zurich. The students joined groups of 4 members each and were assigned an endowment of 20 money units (“MUs”) each. While subjects could keep the MUs they did not invest into a common scheme, for each MU invested the group received a return of 1.6, or 0.4 per group member. In order to test for altruistic punishment Fehr & Gächter ran two versions of the game, one with a punishment condition and one without. In the punishment condition, individuals could pay 1 MU to punish others for insufficient cooperation, which punishment would cost the recipient 3 MUs. In order to rule out reputational effects and reciprocity, the members of each group had anonymity and were also changed at each iteration of the game so that group members did not encounter each other more than once.

The results indicate that despite the cost of inflicting punishment, 84.3% of subjects punished a fellow subject at least once, with 34.3% punishing more than five times during the six iterations and 9.3% more than ten times. Furthermore, the great majority (74.2%) of punishments were inflicted by those making above average contributions on those who made below average contributions, and “the more a subject’s investment fell short of the average investment of the other three group members, the more the subject was punished.”

Fehr & Gächter also found that “[t]he punishment of non-cooperators substantially increased the amount that subjects invested in the public good.” 94.2% of participants made a higher investment in games with the punishment condition than without. Furthermore, while cooperation increased over time in the punishment condition, it tailed off sharply in the non-punishment condition. 38.9% of participants contributed their whole endowments in the final period of the punishment condition and 77.8% contributing 15 MUs or more, whereas 58.9% of subjects in the non-punishment game contributed nothing in the final period and

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224 *Id.* at 137 (“. . . the punishment of free riders constitutes a second-order public good.”).
225 *Id.*
226 *Id.* at 137.
227 *Id.* at 138.
228 *Id.*
229 *Id.*
75.6% contributed 5 MUs or less. In addition, not just the possibility of being punished but actual punishment increased cooperation levels, with subjects who were punished before the 6th period of the game raising their investments by an average of 1.62 MUs.\(^{230}\)

Fehr & Gächter’s experiment therefore provides convincing evidence for the notion that individuals will “pay to punish,” i.e., engage in altruistic punishment. Furthermore, it also indicates that punishments have very real effects on group behavior, with amounts of cooperation remaining stable in groups where punishment is operative while falling off in those where it is not, which would presumably lead to group disintegration in many real-world situations. In positing that third parties to interactions will intervene at their own expense to make sure their fellow group members do not free-ride on group endeavors, the concept of strong reciprocity goes beyond reciprocal altruism, offering a theoretical explanation for the high level of cooperative activity observed in human affairs.

Another important strand of the evolutionary psychology literature explores the psychological ramifications of strong reciprocity. If humans are inclined to punish cheaters, this should mean that in the model of the human mind put forward by evolutionary psychology, humans have developed heightened sensitivity to detecting free riders or “cheaters,” those who contribute less than the amount of benefit they derive from group projects. Indeed, Cosmides & Tooby find evidence of this in their study of the psychology of social exchange.\(^{231}\) Their study compares Wason selection tasks that test the reasoning power of subjects regarding \textit{If P, then Q}-type statements.\(^{232}\) In general, individuals don’t do well on such tests, even when they have formal training in logical reasoning.\(^{233}\) When the subject of such questions concerns social exchange, however, success rates increase markedly. Cosmides & Tooby report that “65-80% of subjects get” questions relating to detection of cheaters in social

\(^{230}\) \textit{Id.} As discussed in Part IV.A, \textit{infra}, this is commensurate with the findings of Laura Nyantung Beny, \textit{supra} note 10.


\(^{232}\) Wason selection tasks ask individuals to choose the correct answer to questions involving “\textit{If P, then Q}” statements. \textit{See} P.C. Wason & Diana Shapiro, \textit{Natural and Contrived Experience in a Reasoning Problem}, 23 Q. J. EXP. PSYCH. 63 (1971). Wason and Shapiro found that individuals had a surprisingly difficult time choosing the correct answer to such questions when they were presented abstractly, but when they were given experiential context the rate of correct responses jumped dramatically.

exchanges correct, suggesting that there is a “pop-out” effect relating to social exchange: humans have an ability to detect cheating but not other kinds of subtle rule violations.\(^{234}\)

In *Cognitive Adaptations for n-person Exchange: The Evolutionary Roots of Organizational Behavior*, Tooby, Cosmides & Price present the concept of mental “accounts” in dyadic exchange that are used to monitor the amount of effort individuals put into a relationship versus how much benefit they receive.\(^{235}\) Dyadic exchange is defined as “where two parties deliver benefits to each other, each delivery being made conditional on the other.”\(^{236}\) They postulate that “[w]hen single exchanges morph into extended series or enduring exchange relationships,” the tit-for-tat pattern of occasional interchanges is replaced by an accounting of the “welfare trade-off ratio” the individuals in the relationship experience.\(^{237}\) Where one party “incurs high costs in order to deliver benefits to another” the recipient would accrue a debt or obligation in the mind of the one bestowing such benefits. Ordinarily, one would expect that the mental accounts in a freely entered into relationship would be roughly even. If a party expresses indifference, or worse yet cheats in a relationship, “anger and punitive sentiment” will follow on the part of the other, with the usual result being a cessation of the relationship or even an attempt at punishment.\(^{238}\)

Tooby, Cosmides & Price believe that the basic intellectual mechanisms that allow for dyadic exchange, such as accounts and concepts such as “owe,” “debt,” “obligation,” exploitation,” “cheating,” etc., pave the way for the more complex interactions of n-party exchanges. By generalizing the formula “I will do x if you do y,” to “For individuals 1 through n, I (individual\(_1\)) will do x\(_1\) if individual\(_2\) does x\(_2\) and individual\(_3\) does x\(_3\) . . .”\(^{239}\) we enable larger-scale communal endeavors, despite the limiting factors of the difficulty of communicating effectively and monitoring cheating in complex environments. While cooperation in human groups culminates in the production of public goods, the gain produced does not necessarily need to be public, but can also be private. The same mechanisms involved in simple trade and exchange relationships between individuals give rise to a wide variety of complex partnership


\(^{235}\) Tooby, Cosmides & Price, *Cognitive Adaptations for n-person Exchange*, supra note 200; see also McGuire, supra note 234.

\(^{236}\) Id. at 105.

\(^{237}\) Id. at 108.

\(^{238}\) Id. at 109.

\(^{239}\) Id.
and corporate activities, as well as those producing public goods. At heart, individuals in social situations are “conditional cooperators,” willing to partake in communal endeavors if they are assured others aren’t exploiting their efforts, and cooperating “more when they perceive that co-players are more willing to cooperate . . . and less when they believe that co-players are free riding.” As a result, “[h]ow free riding is treated is the central determinant of the survival and health of cooperative organizations.”

The work of psychologist Jonathan Haidt on moral intuition also sheds light on the psychology of exchange. Like Gintis, Haidt believes that the theory of reciprocal altruism originally proposed by Trivers does not offer a strong enough explanation for the psychological mechanisms at work in sustained group interactions. In his theory of moral intuition, Haidt proposes a set of basic “moral modules” that explain our moral feelings: care/harm, fairness/cheating, loyalty/betrayal, authority/subversion, sanctity/degradation, and liberty/oppression. The fairness/cheating module governs our perceptions of group members in social exchange situations. Like Cosmides & Tooby, he believes we have evolved a heightened sensitivity to fairness in social interactions involving group endeavors. For Haidt, fairness is about protecting society from cheaters and slackers, not about ensuring equality of outcomes—a key point to emphasize in market transactions. Haidt emphasizes that we have a desire to protect our societies from those who would cause them to unravel by taking more than their just deserts: “The fairness/cheating foundation is about proportionality and the law of karma. It is about making sure that people get what they deserve, and do not get the things they do not deserve.” Like the notion of mental “accounts” that facilitate sustained exchange relationships, proportionality is a way of expressing our basic feeling that individuals are entitled to rewards in measure of how much effort, time or other resources they have put into a project.

Human activities vary however in the rules governing the distribution of benefits, with some resources being divided on a relatively equal, or even communistic, basis while others are not shared at all, or shared strictly with respect to the effort expended in producing them. A

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240 Id. at 119. For a similar conception, see John R. Hibbing & John R. Alford, Humans as Wary Cooperators, 48 AM. J. POL. SCI. 62-76 (2004).
241 Id. at 120.
243 HAITI, THE RIGHTEOUS MIND, supra note 218, at 206-207.
244 HAITI, THE RIGHTEOUS MIND, supra note 218, at 146; Haidt & Joseph, supra note 242.
245 HAITI, THE RIGHTEOUS MIND, supra note 218, at 196.
246 Id., at 212.
study of food-sharing among the Aché, a South American tribe living in Paraguay, found that with the exception of meat acquired through hunting, food is not generally shared at the group level, but instead is consumed by individuals and their immediate families.\textsuperscript{247} When animals are hunted, however, the game harvested is shared among all. The explanation Cosmides & Tooby offer for this is that while foraging is relatively predictable, with the food obtained fairly closely corresponding to the quality of the efforts expended to derive it, hunting involves a considerable amount of luck.\textsuperscript{248} Where a hunting party is successful in obtaining meat, it will be shared with all, as other parties may have not happened to encounter any animals in the forest through no fault of their own.\textsuperscript{249} The findings of Cosmides & Tooby and the anthropologists they rely on support a general principle of fairness as proportionality, not equality: to each according to his efforts. Where the context is significantly different, this rule may be modified or suspended, but where results can be relatively accurately gauged according to effort expended, proportionality reigns as a distributive principle.

Finally, it is important to note that just as the mental faculties that enable reciprocal exchange can give rise to more complex collective actions, collective actions undertaken to pursue non-public goods can eventually result in significant public goods. This can occur both through explicit group decisions to produce public goods, or, more subtly, as a byproduct of private yet collective action.\textsuperscript{250} Public goods are defined as goods that are both non-excludable and non-rivalrous; that is, it is difficult or impossible to prevent individuals from enjoying or benefitting from them, and such enjoyment or benefit does not result in their diminishment.\textsuperscript{251} Classic examples of public goods include national defense, a clean environment, and a stable economy. By monitoring the contributions of individuals to group actions, and attempting to exclude or sanction those who do not contribute in appropriate amounts, societies enable the production of public goods.\textsuperscript{252} In addition, the functioning of significant private collective

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\textsuperscript{249} Cosmides & Tooby report that “[a]mong the Aché of Paraguay, for example, hunters making a good faith effort come back empty-handed four out of ten times.” \textit{Id}. at 90.

\textsuperscript{250} Tooby, Cosmides & Price, \textit{Cognitive Adaptations for n-person Exchange}, supra note 200, note that “many groups that may initially emerge to pursue nonpublic goods eventually also produce public goods.” \textit{Id}. at 111. In particular, they believe that our membership in groups naturally leads to identification with a group, and that this itself is a public good: “The representations in the minds of observers of the status of a coalition are a common resource that has the properties diagnostic of a public good.” \textit{Id}. at 114.


actions gives rise to many public goods, including a sense of orderliness in society and the willingness to cooperate in hierarchical, directed projects. Even pervasive social infrastructure such as the rule of law, the legal system itself and healthy, stable financial markets can be seen as public goods. Their creation is often due to a mix of deliberate political decisions and inadvertent by-products of other collective actions, but as infrastructure they are to a large degree non-excludable and non-rivalrous. Evolutionary psychology has much to contribute to an explanation as to how these features of successful societies are created and sustained.

In sum, evolutionary psychology presents a picture of the human psyche as intensely concerned with fairness in exchange relations. We possess a faculty of moral intuition that generally frames fairness in terms of proportionality or ‘just deserts,’ with the exception of group activities where outcomes for individuals involve a large measure of chance. Furthermore, humans have a natural propensity to police the fairness of benefits individuals derive from group activities, even when they are not directly affected. The phenomena of third-party punishment greatly strengthens social sanctions, including those against cheating, making it likely that group norms can emerge and persist as stable social phenomena.

A central claim of evolutionary psychology is simply that the moral intuitions supporting social norms lead to increased genic fitness in the EEA on the part of those holding them. Evolutionary psychologists do not take the further step of concluding that whatever these intuitions prescribe is in fact good, although moral philosophy may reach the conclusion that...
the content of moral intuitions is good in fact, or largely so. Furthermore, life in the contemporary world will present numerous instances where we naturally attempt to apply these moral intuitions in contexts that bear little or no resemblance to anything we encountered during the course of our evolutionary history.

C The Human Person According to Evolutionary Psychology versus the ‘Rational Actor’ of Neoclassical Economics

Evolutionary psychology implicitly contains a definite view of the nature of the human person, and in fact, can be seen as the quest for a definite picture of “human nature.”\textsuperscript{258} Moreover, there is significant tension between the human person according to evolutionary psychology and the ‘rational actor’ or \textit{homo economicus} assumed by neoclassical economics.\textsuperscript{259} In short, evolutionary psychology’s person is primarily emotional and intensely social, whereas the rational actor of standard economic thought displays a calculating rationality in furtherance of its (apparent) self-interest and acts in an individualistic, not a communitarian fashion. While there is a substantial body of literature attempting to integrate the understanding of the human person presented by evolutionary psychology into the law, generally coming under the heading “behavioral law and economics,”\textsuperscript{260} the understanding of the person offered by

\textsuperscript{258} See Gintis, \textit{supra} note 198, at 192 (evolutionary psychology implies that “there is a human nature, the product of our species’ long evolutionary trajectory . . . .”); Leda Cosmides & John Tooby, \textit{Social Exchange: The Evolutionary Design of a Neurocognitive System}, \textit{THE NEW COGNITIVE NEUROSCIENCES}, III 1295, 1307 (M. Gazzaniga, ed. 2005) (“social contract algorithms are a reliably developing component of a universal human nature, designed by natural selection to produce an evolutionarily stable strategy for conditional helping.”); Cosmides & Tooby, \textit{supra} note 257, at 55 (“human nature is comprised of programs that were selected for merely because they outreproduced alternative programs in the past.”).

\textsuperscript{259} For general discussions of this contrast, see Ostrom, \textit{supra} note 256, at 139-144 (contrasting the “rational egoist” with the “conditional cooperater” and “willing punisher” needed to explain collective action situations); Tooby, Cosmides & Price, \textit{Cognitive Adaptations for n-person Exchange}, \textit{supra} note 200, at 104-105 (contrasting “ecological rationality” as put forward by evolutionary psychology with “both formalized normative theories of rationality and common sense intuitions about functionality.”); Russell Korobkin, \textit{A Multi-Disciplinary Approach to Legal Scholarship: Economics, Behavioral Economics, and Evolutionary Psychology}, \textit{41 JURIMETRICS} 319 (2001); Colin Camerer, \textit{Behavioral Economics: Reunifying Psychology and Economics}, 96 PROC. NATL. ACAD. SCI. 10575 (1999); Owen D. Jones, \textit{Time Shifted Rationality and the Law of Law’s Leverage: Behavioral Economics Meets Behavioral Biology}, 95 NW. U. L. REV. 1141 (2001). Haidt also draws a sharp contrast between his view of moral intuition and the view that rationality is key to morality as found in thinkers such as Kant and Kohlberg; see HAITD, \textit{THE RIGHTEOUS MIND}, \textit{supra} note 218.

evolutionary psychology still presents a challenge to traditional economic theory, primarily due to methodological issues, but also to some degree political ones.\textsuperscript{261}

First, the person according to evolutionary psychology is genuinely altruistic insofar as she will act in ways which are contrary to her biological—or for that matter, economic—self-interest.\textsuperscript{262} Trivers begins with the example of an individual saving a drowning person, with the expectation that this action would be reciprocated in the future if the circumstances so required it. Trivers characterizes this as “symbiosis [with] a time lag,”\textsuperscript{263} and Haidt as an example of “enlightened self-interest.” But as outlined above, the theory of strong reciprocity goes beyond this to describe a mechanism whereby individuals acting as third parties will expend resources to engage in punishment which is of no direct benefit to them. Such punishment appears to be psychologically gratifying,\textsuperscript{264} but in an economic or a biological sense it is of no benefit to them as individuals; any non-psychical, material benefit that may accrue to an individual from the enforcement of a social norm in a group is far too small to justify the expenditure of resources required to obtain it.

The person who would act in such a manner is therefore far different from the rational actor assumed by mainstream economics, who acts in such a way that tangible, material gains accruing to him are maximized and losses and inefficiencies minimized. While the rational actor could operate in an altruistic fashion if that were understood to further his interests indirectly, as when altruistic acts are performed for the benefit of kin, or in reciprocal altruism, the stronger form of altruism that Gintis, Henrich & Boyd, Fehr & Fischbacher, Haidt and others argue for is contrary to \textit{homo economicus}. Tooby, Cosmides & Price characterize the rationality depicted by evolutionary psychology as “ecological rationality,” which does not aim to maximize utility but rather simply to produce outputs that promote genic fitness in the conditions humans evolved in.\textsuperscript{265}

\textsuperscript{261} For a philosophical examination of standard law and economics scholarship and its political implications, see Jeanne L. Schroeder, \textit{The Economics of Race and Gender: Rationality in Law and Economics Scholarship}, 79 Or. L. Rev. 147 (2000).

\textsuperscript{262} See de Quervain, et al., \textit{supra} note 234 (noting that punishment is altruistic in a biological sense, but not a psychological one).

\textsuperscript{263} Trivers, \textit{The Evolution of Reciprocal Altruism, supra} note 201, at 39.

\textsuperscript{264} See de Quervain, et al., \textit{supra} note 234; see also McGuire, supra note 234.

In addition to this primary difference surrounding self-interest, evolutionary psychology and mainstream economics employ significantly different conceptions of the decision-making process their representative individual carries out. For traditional economists, *homo economicus* is a rational actor, in the sense that choices are always the product of the calculation of the costs and benefits of various possible plans of action, with the one resulting in the greatest gain, or least cost, being the one chosen.\(^{266}\) *Homo economicus* therefore seeks to maximize his utility in a straightforward way. Furthermore, a sort of godly rationality is assumed, with *homo economicus* capable of any calculations necessary to this task, and indeed, omniscience as to all possible states of affairs necessary to carry them out.\(^{267}\) Evolutionary psychology on the other hand espouses a modular view of the human mind, in which specific tasks required of the information-processing organ that is the human mind are carried out by specific ‘circuits’ or ‘modules’ that act as individual components of the mind.\(^{268}\) And because our mental faculties are the product of evolution we possess a bounded rationality, whereby individual mental abilities and tendencies only exist insofar as they furthered natural selection in the EEA—there is no guarantee that such faculties reach any sort of “truth” or possess any inherent accuracy apart from their success in contributing to the evolutionary prospects of the organism possessing them.\(^{269}\)

Evolutionary psychologists also reject a strict conceptual separation of reason from emotion. Instead of assuming a Cartesian worldview, in which reason is fundamentally separate from emotion, evolutionary psychologists view reason as intrinsically conditioned by

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\(^{267}\) See SCHLEFER, *THE ASSUMPTIONS ECONOMISTS MAKE*, *supra* note 266, at 271-272 (in rational expectations models, “God . . . grants everyone in the model knowledge of the truth.”); FRANK H. KNIGHT, *RISK, UNCERTAINTY, AND PROFIT* 197 (1921) (“Chief among the simplifications of reality requisite to the achievement of perfect competition is . . . the assumption of practical omniscience on the part of every member of the competitive system.”); GEORGE J. STIGLER, *THE THEORY OF PRICE* 82 (4th ed. 1987) (a “ perfect market is one characterized by perfect knowledge on the part of the traders.”).

\(^{268}\) See Cosmides & Tooby, *supra* note 258, at 1260-1261.

\(^{269}\) See Ostrom, *supra* note 256, at 143 (“humans do not develop general analytic skills that are then applied to a wide variety of specific problems . . . . Rather, the human brain appears to have evolved a domain-specific, human-reasoning architecture.”); Herbert Simon, *Altruism and Economics*, 83 Am. ECON. Rev. 156-161 (1993) (“human beings are capable only of very approximate and bounded rationality.”). Note however that from an evolutionary perspective, the faculties of the human mind are better than a general purpose, rational mind would be; see Cosmides & Tooby, *supra* note 200, at 327-332 (“For the problem domains they are designed to operate on, specialized problem-solving methods perform in a matter that is better than rational . . . .”)
emotion in such a way that the very distinction begins to break down. The person is understood to be primarily motivated by emotion, so that emotion is the dog wagging the tail of rationality, and reason is the mere “tip of the iceberg” so to speak of human behavior. And there is no assumption that our moral intuitions, or the decisions they lead us to, are made in any perfect or complete fashion; rather, they are made by means of feelings and heuristics that lead to reproductive success in the EEA. Such feelings and heuristics presumably were better than their alternatives, at least for the purpose of attaining the goal of relative reproductive success on the part of those who held them, but they are not intrinsically accurate, complete or even ‘rational.’

The contrast of the person according to evolutionary psychology and *homo economicus* reflects the problem Part II began with: reciprocal altruism. The theory of reciprocal altruism is meant to account for the altruistic phenomena we observe in the social world without reducing altruism to something else, at the same time that it stays within the parameters of evolutionary biology. In providing its account, the theories of reciprocal altruism and strong reciprocity use the concepts of a time lag and our fundamental social embeddedness to show how the genes carried by an individual will prosper if that individual possesses such traits as a conditional willingness to assist others, sophisticated cheating detection mechanisms, and an inclination to punish parties violating norms of fairness even where such violations don’t directly affect the individual. This more sophisticated construct of concepts still basically operates within the parameters of the ‘selfish gene’ theory while at the same time explaining genuinely altruistic behavior. Likewise, the theory of mind that evolutionary psychologists espouse still sees rationality as serving to advance the goals of the individual—defined as being able to pass its genes on in the context of the EEA—but with a more sophisticated and realistic set of tools than that presumed by the abstractions of traditional economic theory or rational choice theory. Rationality according to the evolutionary psychologists is a set of tools reflecting an intensely social human nature, where loyalty and success within the tribe determines one’s success in

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270 As in Haidt’s title, *The Emotional Dog and Its Rational Tail*, supra note 242. Haidt also uses the image of emotion as an elephant and reason as its rider; see Haidt, *The Righteous Mind*, supra note 218, at 52. See also Leda Cosmides & John Tooby, *Evolutionary Psychology and the Emotions*, HANDBOOK OF EMOTIONS, 2ND ED., 91-115 (M. Lewis & J. M. Haviland-Jones, eds. 2000) (emotions as “superordinate programs” that coordinate the various “components of the cognitive architecture”).

271 Cosmides & Tooby, supra note 270, at 92.

272 The dominant view among evolutionary psychologists is that there is no need to resort to a concept of “group selection” to explain human prosocial phenomena such as reciprocal altruism; see, e.g., Steven Pinker, *The False Allure of Group Selection*, available at edge.org/conversation/the-false-allure-of-group-selection#rc. See also H. Gintis, S. Bowles, R. Boyd & E. Fehr, *Gene Culture Coevolution and the Emergence of Altruistic Behavior in Humans*, in FOUNDATIONS OF EVOLUTIONARY PSYCHOLOGY 314 (C. Crawford & D. Krebs, 2008) (gene-culture coevolutionary models supporting cooperative behavior among non-kin are not “vulnerable to the classic critiques of group selection by Williams (1966), Dawkins (1976), Maynard Smith (1976), Rogers (1990), and others.”). But see Alexander J. Field, *Why Multilevel Selection Matters*, 10 J. BIOECON. 203 (2008).
life. It is not a general faculty of ratiocination with all information available to it relevant to the goal of maximizing an individual’s preferences.

III INSIDER TRADING AND THE PSYCHOLOGY OF SOCIAL EXCHANGE

What then is the likely reaction of investors and others to reports of insider trading if the picture of social exchange drawn by evolutionary psychologists is accurate? The answer to this question involves the intersection of two radically different arenas of development—our moral intuitions, as developed over the millions of years of evolutionary history, on the one hand, and the system of trading interests in corporate enterprises on anonymous exchanges on the other. Nonetheless, the answer to this question is not a matter of speculation. The psychological evidence generally confirms what a theoretical examination of insider trading in terms of evolutionary psychology tells us, that humans are highly averse to insider trading because it is felt to violate the very basic principle of fairness as proportionality in group endeavors.

A A Theoretical Perspective

As the discussion below illustrates, the varieties of insider trading, let alone other forms of transacting in financial interests using nonpublic information, are many. Insider trading is carried out by executives at firms, bankers, accountants, lawyers, journalists, and others who become privy to confidential information during the course of their work, and friends, relatives, and acquaintances of all of these parties. And while this is not “insider trading,” properly speaking, the doctrine of insider trading law under the Securities Exchange Act of 1934 (the “Exchange Act”) Section 10 has now been applied to the use of stolen information in SEC v. Dorozhko.273 For the purposes of a theoretical examination of how trading on inside information might be perceived given the model of human moral beliefs reviewed in Part II above, however, a few basic assumptions are necessary.

First, we must assume a broad definition of insider trading: that it involves the use of confidential information by an individual, well-placed in the corporate situation or not, to achieve a gain (or avoid a loss) without the knowledge of other investors in the enterprise or the financial markets in general.274 Second, we need to assume a number of investors in the

273 Dorozhko II, 574 F.3d 42 (2d. Cir. 2009).
274 The requirement of lack of knowledge would occur even in the implausible situation where investors had pre-approved insider trading by contract, as advocated by Carlton & Fischel, supra note 11, because for such information to have any financial advantage, it is essential that it not be a matter of public knowledge. For further development of the argument that companies and insiders ought to be able to modify the insider trading regime by contract, see David D. Haddock & Jonathan R. Macey, A Coasian Model of Insider Trading, 80 NW. U. L. REV. 1449.
corporate enterprise, either as other shareholders or as employees holding equity interests or options on such interests. Third, we must assume there is an implicit understanding that the return shareholders receive from their investments will be pro rata in proportion to their equity interests in the company, or if there are multiple, differing classes of stock, in proportion to such classes as specified in the terms and conditions governing a particular class of interest. (While it is theoretically possible that investors might authorize individual shareholders or classes of shareholders to trade on inside information, if this were permitted by law, as advocated by Carlton & Fischel, see supra note 76, at 498-499 (2001).) This third assumption is grounded in the wariness we have in engaging in group endeavors where our efforts might be susceptible to free-riding on the part of others. In this case, a shareholder who engaged in insider trading would be engaged in a form of “subtle cheating,” where he extracts a benefit from the corporate enterprise out of proportion to his pro rata interest. Regardless of whether such insider trading could have other benefits for shareholders, an individual shareholder who missed out on a potential gain or suffered a loss because she did not have access to such information while someone else did, thereby capturing a gain or avoiding a loss, would feel consternation or anger upon learning of the insider’s good fortune. Fourth, it is necessary to understand the corporate enterprise as a group activity or communal endeavor, as understood by evolutionary psychology.

Given these assumptions, insider trading violates our deeply held sense of proportionality as fairness. Because we are “conditional cooperators,” willing to engage in

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(1986); Kimberly D. Krawiec, supra note 75, at 498-499 (2001). See also Beny, supra note 10, at 252-254; Saikrishna Prakash, supra note 134, at 1517-1518. 275 See Carlson & Fischel, supra note 11.

276 See Stephen Bainbridge, The Insider Trading Prohibition: A Legal and Economic Enigma, 38 FLA. L. REV. 35, 50-54 (1986) (discussing Carlton & Fischel’s approach); James D. Cox, Insider Trading and Contracting: A Critical Response to the Chicago School, 1986 DUKE L. J. 628, 657 (allowing insider trading is tantamount to licensing managers to embezzle); A.C. Pritchard, supra note 100, at 46 (authorizing insider trading could result in state law violations). 277 See Stephen Bainbridge, supra note 276, at 44 (arguments are inconclusive as to whether insider trading is beneficial for shareholders); Stephen Clark, supra note 76, at 61-63 (evidence mixed on whether insider trading has an aggregate net benefit for both shareholders and traders); Cox, supra note 276, at 654 (costs and benefits of insider trading very difficult to quantify); Strudler & Orts, Moral Principle in the Law of Insider Trading, supra note 9, at 383 (the debate over whether insider trading is beneficial is inconclusive because it is empirical, and costs and benefits are very hard to ascertain in complex financial markets). For arguments that insider trading has no victims, or they are very hard to identify, see Peter-Jan Engelen & Luc van Liedekerke, The Ethics of Insider Trading Revisited, 74 J. BUS. ETHICS 497 (2007); William Carney, Signaling and Causation in Insider Trading, 36 CATH. U. L. REV. 863 (1987); Haddock & Macey, supra note 274, at 1449 (shareholders who “buy and hold” should be indifferent to insider trading); William Wang, Trading on Material Nonpublic Information on Impersonal Stock Markets: Who is Harmed, and Who Can Sue Whom Under SEC Rule 10b-5?, 54 S. CAL. L. REV. 1217 (1981). On the other hand, for the argument that insider trading results in tangible harm, see Norman S. Douglas, Insider Trading: The Case against the “Victimless Crime” Hypothesis, 23 FIN. REV. 127 (1998).

278 For a related analysis, see Park, The Unjust Enrichment Principle, supra note 3, at 368 (the idea that insider trading involves unjust enrichment is grounded in a “common-sense intuition”); but see Kim, supra note 19, at [20]
communal endeavors only when others do so on the same terms and conditions\textsuperscript{279}—i.e., that an individual should receive a return on her investment into common activities only in proportion to the efforts she puts in—by allowing certain individuals a quiet way to benefit in unpredictable, variable amounts, insider trading triggers a powerful negative emotional response. Just as Tooby, Cosmides & Price posit “mental accounts” that keep track of an individual’s net benefit received in dyadic exchange or group activities, the return to investors based on their pro rata ownership interests enforces a proportionality of return based upon the original investment in the enterprise.\textsuperscript{280} Altering this in unpredictable ways which are fundamentally open to chance, as occurs in insider trading, runs directly counter to our desire for proportionality and, as much as possible, predictability in the benefits stemming from group activities.

It is important to note that this understanding of insider trading holds good whether or not success in the corporate enterprise is thought to be a mostly predictable result of hard work or a matter open to a great deal of luck. Comparing this with the Aché of Paraguay, who made an exception for the communal sharing of meat from the hunt to the general rule governing food gathering, that individuals only share foraging bounty with their immediate family, is instructive.\textsuperscript{281} Even if we hold that investment success is open to a considerable measure of luck, and that individuals may receive gains (or losses) out of proportion to their effort, insider trading is still unlike the communal sharing of meat. First, while the communal sharing of meat is not keyed to an individual’s direct efforts in the hunt, it is public—how much any particular individual receives of the hunt would be a matter of common knowledge.\textsuperscript{282} Second, the amounts distributed are not a matter of chance, but follow a pattern where each person receives a roughly predictable, proportional amount.\textsuperscript{283} Even if we attempt to justify insider trading on the belief that returns to investors (typically this argument would focus on managers who would be entitled to trade on inside information as an ‘emolument’ of office) are fundamentally open to chance, insider trading goes far beyond the exception to the general rule of predictability which governs sharing of meat from the hunt in tribal society.

\footnotesize{\textsuperscript{279} See supra note 240 and accompanying text.} \textsuperscript{280} Payouts of dividends in the corporate environment, based on the rights each class of stock carries with it accomplishes exactly this, as does the mechanism of “capital accounts” in a partnership or limited liability company. \textsuperscript{See Laura E. Cunningham & Noel B. Cunningham, The Logic of Subchapter K: A Conceptual Guide to the Taxation of Partnerships (3\textsuperscript{rd} ed. 2006) 31-42 (“Financial Accounting and Maintenance of Capital Accounts”).} \textsuperscript{281} See supra notes 247-249 and accompanying text. \textsuperscript{282} Cashdan, supra note 247, at 37. \textsuperscript{283} Id., at 37-38.
Finally, our moral intuition that insider trading is unfair exists even if the counterarguments that it will result in generalized good, typically conceived of as increases in “social welfare,” hold true. These arguments by Manne and his compatriots are principally that insider trading results in general gains for financial markets because it improves the efficiency of securities prices, and that it allows for a useful form of executive compensation. 284 Notwithstanding the obvious and frequently stated objections to the pro-insider trading lines of argument, 285 even if they do hold a measure of truth, this would only mean that the dictates of economic efficiency clash with the content of our moral intuitions. In all likelihood, however, insider trading does not bring such gains to financial markets. Instead, combating insider trading appears to lead to, or at least be strongly correlated with, quantifiable benefits. 286 The upshot of this is that the economic activity is deeply dependent upon trust, a result that is beyond the scope of this paper but which follows from the application of evolutionary considerations to economic affairs. 287

B Evidence from the Empirical Realm

There are two recent surveys providing detailed responses to two thorough sets of questions concerning the moral import of various scenarios where individuals trade on inside information: *When is it Wrong to Trade Stocks on the Basis of Non-Public Information? Public Views of the Morality of Insider Trading?*, 288 by Stuart P. Green & Matthew B. Kugler, and *Is it Fair? Perceptions of Fair Investment Behavior Across Countries*, 289 by Meir Statman. The results of these papers by and large confirm what evolutionary psychology predicts, with the beliefs people hold about various insider trading fact patterns often demonstrating deep condemnation of those perceived as taking advantage of others. Green & Kugler’s surveys indicate that people feel that the basic wrong of insider trading involves the use of an unfair advantage against others, not the violation of a fiduciary duty, as the legal framework from *Chiarella* relies on. Additionally, Statman’s study shows that culture has significant influence on beliefs concerning the moral status of insider trading.

285 See *supra*, note 277.
In their first survey, Green & Kugler asked participants to evaluate the moral status of seven different fact patterns. The first three concern insiders to a pending corporate acquisition, a senior executive at the target company, a person in a secretarial role at the target, and an executive at the acquirer. The second two present a “mark-up man” at a printer printing documents for corporate transactions, mirroring the facts of Chiarella, and an investigative reporter who learns of an impending merger and trades in the stock before the news is announced, as in Carpenter v. United States.\footnote{Carpenter v. U.S., 791 F.2d 1024 (2d Cir. 1986), aff’d on other grounds, 484 U.S. 19 (1987).} The final two scenarios concern an individual who finds a memo in a taxi cab marked “Confidential—Not for Release” detailing the facts of a proposed merger, and an individual who overhears a discussion of a proposed merger at a baseball game, similar to the facts of SEC v. Switzer.\footnote{SEC v. Switzer, 590 F. Supp. 756 (W.D. Okla. 1984).} These three sets of scenarios comprise three different “bands” or groups which Green & Kugler predict survey respondents will have different reactions to.

Indeed, they do. The first set of scenarios, corresponding to “classic” insider trading, garner blameworthiness ratings of 5.69 (1.64), 5.52 (1.74) and 5.13 (1.81), respectively, on a seven-point scale ranging from one (not at all blameworthy) to seven (very blameworthy).\footnote{Green & Kugler, supra note 288, at 463.} (Standard deviations are in parentheses.) The second set, representing the misappropriation scenarios of Chiarella and Carpenter, received scores of 4.71 (1.77) and 4.63 (1.92), respectively.\footnote{Id.} And the third set of “lucky outsiders” garnered blameworthiness ratings of 3.81 (2.14) and 2.94 (1.96).\footnote{Id.} These results illustrate that, in general, survey participants feel that the classic insider trading offenses are the most blameworthy, with misappropriation offenses still meriting significant condemnation, and outsiders finding or overhearing non-public information meriting the least condemnation. While only the final scenario of a remark overheard by accident was less blameworthy than not, all other scenarios merit some disapproval, with the classic insider cases meriting the most. The results of Green & Kugler’s first survey support the notion of a “moral core” of insider trading offenses, with less blame attaching as we move further away from that core.\footnote{Green & Kugler use the concept of “core” (as well as outlying) cases of insider trading. See Green & Kugler, supra note 288, at 446, 453. See also Prentice, Permanently Reviving the Temporary Insider, supra note 3, at 345 ([I]t is clear that the core notion of insider trading occurs when corporate insiders trade in their firms’ securities on the basis of material, nonpublic information.”).}

Regardless of whether conduct is seen as connected with the violation of a fiduciary duty, however, the intent to unfairly take advantage of others is what appears to result in moral
condemnation. First, in Band 1 of the Study 1 results, respondents rated Scenario 3 as essentially equivalent to Scenarios 1 and 2 in terms of blameworthiness and whether it was deserving of criminal sanction. Recall that Scenarios 1 and 2 pose examples of traditional or classic insider trading, where an executive and a secretary at an acquiring company and an acquired company, respectively, engage in insider trading. In Scenario 3, an executive at the acquiring company misappropriates information from his employer concerning the target, and uses that information to purchases target shares. Scenarios 1 and 2 received ratings of 5.52 and 5.13, respectively, on the blameworthiness scale, and 79.2% and 77.1% ratings on the question of whether they should receive a criminal penalty, while the misappropriation scenario received a rating of 5.69, with 83.3% of respondents recommending a criminal penalty. Green & Kugler remark that “[r]espondents thus made essentially no distinction between the classical and misappropriation theories with respect to criminalization, blameworthiness, or punishment.”296 If the classical theory represents the “moral core” of insider trading law, and misappropriation its extension, here they are judged equivalent (actually, misappropriation is perceived as slightly more serious).

Another interesting result is that in Study 2, tippees garner more blame from survey respondents than tippers. Since the tippees are further away from the interests harmed, the shareholders in the company in which they trade, and at a remove from the breach of fiduciary duty between the tippers and their source of information, this means that respondents don’t evaluate the morality of actions in terms of closeness to the interests harmed, but in some other way. Green & Kugler found that respondents gave a 5.10 blameworthiness rating in the case of an executive tipping for personal gain, but a 5.35 rating to the analyst tippee.297 29% believed that the executive in this scenario should be punished criminally, while 39% of respondents said the same for the analyst.298 In the case of an executive tipping for good motives, as in Dirks, the executive received only a 3.03 blameworthiness rating, while the reporter trading on such a tip received a 5.81 blameworthiness score, the very highest of all the Study 2 scenarios.299 The results of these two tippee scenarios seem to indicate that what we feel is morally blameworthy is some specific conduct, not the direct proximity to wrongdoing in terms of breach of a fiduciary duty. As in the case of misappropriation, the fact that the individual committing the insider trading is at a remove from the company and the source of the information is not determinative of the moral status of the act.

296 Green & Kugler, supra note 288, at 462.
297 Id. at 475.
298 Id.
299 Id.
What then might account for these blameworthiness ratings? A plausible explanation is that we are very attuned to an individual’s act of wrongdoing, and have a psychological need to condemn such conduct. Green & Kugler’s explanation of the results indicates that they believe that if a tippee is understood as committing the more serious wrong, that indicates that “the basic wrong of insider trading lies in the fact that the insider uses an unfair advantage against other traders and thereby ‘cheats’ them . . . .”300 If, on the other hand, the tipper is thought of as committing the “more basic wrong,” “the basic wrong in insider trading is the misappropriation of information.”301

This way of understanding the contrast between tipper and tippee liability sets up a contrast between a narrow conception of the violation of a fiduciary duty and a broader conception of unfairness.302 It seems to me that the participants in Green & Kugler’s surveys express this as a contrast between instances of insider trading that evidence a strong intention to cheat, harm or otherwise deceive others, and those that don’t. The contrast then becomes, psychologically speaking, one between a focus on the intention of the actor, and the harm suffered by particular individuals. Both are wrong, but respondents rate cases where individuals seem to have a direct intention to cheat much more harshly than those where they don’t. A review of a few important examples shows that where it appears that a trader blatantly abuses the trust of others or is otherwise engaged in objectionable conduct, respondents rate the action as very objectionable. Furthermore, even where there is no violation of a fiduciary duty, as in the case of the tippee in Survey 2 reviewed above, respondents condemn it. It therefore appears that the basic wrong of insider trading is taking advantage of others, as Green & Kugler observe.303 When we evaluate the morality of insider trading cases, we focus on the wrongness of the insider trader’s actions, not on the harm their counterparties suffer.

A second point is that tippees in two of the three scenarios tested in Study 2 received higher blameworthiness marks than tippers.304 In Scenario 1, an executive tipping for gain receives a blameworthiness award of 5.10, while her tippee receives a rating of 5.35.305 In Scenario 2, an executive tipping to reveal a fraud, similar to the facts of Dirks, receives a blameworthiness grade of only 3.03 while the reporter trading on this information receives a

300 Id. at 469-470.
301 Id. at 470.
302 Note that this conception of unfairness is commensurate with that offered by evolutionary psychology, i.e, fairness as proportionality. The insider trader violates this by receiving more than her due.
303 Green & Kugler, supra note 288, at 471-472.
304 Cf. U.S. v. Evans v. U.S., 486 F.3d 315 (7th Cir. 2007), discussed supra at Part I.F.
305 Green & Kugler, supra note 288, at 475.
grade of 5.81, the highest of any recorded in the entire set of three studies.\textsuperscript{306} In these scenarios, the tippee is at a remove from the entity owed a fiduciary duty; as in the case of misappropriation, there is another link of the chain of attenuation from the company and the shareholders owed a fiduciary duty. This does not matter to survey respondents. Green & Kugler interpret this as evidence that the principal wrong in insider trading is an unfair advantage vis-à-vis other traders,\textsuperscript{307} but it could also be interpreted as respondents focusing on the individual who is perceived to be primarily carrying out the unfair or wrong activity, i.e., the tippee trading on the information, not the tipper. Even where the tipper expects to gain, this wrong is somewhat less blameworthy than that of the tippee. Another instance of a trader receiving a high blameworthiness rating without a fiduciary duty is the case of an FDA official who trades on advance knowledge of a drug approval; such conduct received a 5.16 rating on the blameworthiness scale.\textsuperscript{308} Such conduct violates the trust given to a government official.

Finally, Meir Statman’s study also presents interesting evidence on the effects of culture on moral beliefs concerning insider trading. He tested both students and finance professionals in eight different countries: Australia, India, Israel, Italy, the Netherlands, Tunisia, Turkey and the United States. In a fact pattern modeled on \textit{U.S. v. O’Hagan},\textsuperscript{309} students judging the insider trader’s conduct acceptable ranged from a low of 36% in the United States to a high of 76% in India.\textsuperscript{310} As for professionals, acceptability ratings ranged from 5% in the United States to 56% in Turkey.\textsuperscript{311} Individuals from countries with insider trading regimes such as the United States, the Netherlands and Australia consistently rated insider trading actions as less acceptable than individuals from countries with little or no enforcement, such as Italy, India, Turkey and Tunisia. Statman interprets this as demonstrating the effect of the existence of a legal regime on the beliefs of individuals concerning the conduct.\textsuperscript{312} Statman’s study is also interesting as it shows differences in how face-to-face transactions are judged, as well as differences in how observers gauge the acceptability of insider trading transactions based on the power held by the person committing them.\textsuperscript{313} Evolutionary psychology would predict both of these differences, as individuals gauge the wrong in an action depending on the face-to-face deception involved as well as the level of threat emanating from a particular individual. While evolutionary psychologists such as Haidt posit that the mental modules forming our moral intuition are to

\begin{itemize}
  \item \textsuperscript{306}Id.\textsuperscript{306}
  \item \textsuperscript{307}Id. at 469-470.
  \item \textsuperscript{308}Id. at 472, 475.
  \item \textsuperscript{309}521 U.S. 642 (1997).
  \item \textsuperscript{310}Statman, supra note 289, at 49 (Table 1).
  \item \textsuperscript{311}Id.
  \item \textsuperscript{312}Id. at 48 (“[T]he street between fairness and the law is a two-way street where the law affects perceptions of fairness while perceptions of fairness shape the law.”)
  \item \textsuperscript{313}Id. at 51-53.
\end{itemize}
some extent universal, as a product of human evolution, they also recognize significant variation in their expression from one society to another.  

The empirical studies confirm what evolutionary psychology teaches: that insider trading feels wrong to us because at some level it is perceived to be fundamentally unfair. This fairness is not a utopian or other conception of equality or overweening attention to harm, but rather one focused on an individual attempting to claim more than his rightful due in a group activity. Secondarily, there is significant variation of this perception of wrongness from culture to culture. Where individuals have a basic expectation that trading in financial markets will be conducted without the use of inside information, there is much higher estimation of the moral wrongness of insider trading. By creating the framework within which such economic activity occurs, the legal system itself then can have a significant influence on our moral beliefs.

IV TOPICS FOR FURTHER RESEARCH

The evolutionary psychology approach is a fruitful one and is gradually being applied to numerous problems in social psychology and applied ethics. While it has received some attention in the legal literature, particularly in the areas of family law and criminal law, it has received only minimal attention in the areas of corporate or financial law. This article is meant as a beginning step in this direction in a field of legal scholarship which has received sustained attention since the late 1960s but little resolution of its central debates. An approach to insider trading law based on evolutionary psychology offers the appeal of a scientific grounding of a theoretical position that is in principle amenable to empirical

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314 See, e.g., Haidt, The Righteous Mind, supra note 218, at 111-130 (“Beyond WEIRD Morality.” (“WEIRD” stands for Western, educated, industrialized, rich, and democratic)).

315 Green & Kugler’s results support this interpretation, at the same time that they say there are other plausible explanations for why insider trading is viewed as wrong, such as a “breach of duty to the source of confidential information.” Green & Kugler, supra note 288, at 453. At the same time, however, their results indicate that it is primarily the perception of unfairness that drives our views on insider trading. Id. at 479.


317 In the insider trading literature, Robert Prentice touches upon evolutionary psychology explanations for the fairness argument in Permanently Reviving the Temporary Outsider, supra note 3, at 379 (“the study of evolution has made it clear that social emotions are at the root of human morality.”). In the literature on antitrust law, see Thomas J. Horton, Fairness and Antitrust Reconsidered: An Evolutionary Perspective, 44 McGeorge L. Rev. 823 (2013).

318 See Clark, supra note 76, at 65 (“In summary, there are many supporters on both sides of the insider trading debate, so the issue is not likely to be resolved in the near future.”).
confirmation of many of its claims. While it does not resolve all fundamental moral and political questions that insider trading gives rise to, it offers a persuasive explanation for many of the phenomena associated with insider trading. Two further issues it is particularly relevant to are the question of whether and how insider trading regulation contributes to the growth of financial markets, and creating a jurisprudence or “theory” of insider trading.

A Evolutionary Psychology, Trust, and the Health of Financial Markets

Given an account of market behavior that emphasizes the desire to punish cheaters, how does the development of insider trading law, and more importantly, the enforcement of this law, lead to the development of financial markets as a public good? The research of Laura Beny suggests that it does, because she documents a correlation (she is careful not to say causation) between insider trading enforcement and healthy, active financial markets.319 This result would seem to confirm the supposition that we shy away from participating in group endeavors where we cannot trust that their benefits will be distributed equitably, that is, in a manner free from cheating. An account of our psychological proclivities in market interactions can shed light on trust in markets and their successful creation and maintenance.

B A Unified Jurisprudence of Insider Trading Law

Does the understanding of moral intuitions concerning market interactions offered here point in the direction of a utilitarian or a deontological justification for insider trading law? Even though the combination gives rise to some deep questions about their compatibility, evolutionary psychology is, I submit, more compatible with a deontological ethic than a utilitarian one. This is primarily because our moral intuitions are expressed as commands,

oughts and prohibitions, and we are focused on discerning others’ intentions and whether or not they comport with the rules we formulate for social interaction. Furthermore, our rules expressing moral intuitions are not couched in terms of cost/benefit analyses but as absolutes. Therefore, deontological ethics seems much closer to an evolutionary psychology perspective than a utilitarian one both in terms of content and method,\(^{320}\) even though in other very important ways evolutionary psychology represents a severe challenge to a Kantian-style ethics.\(^{321}\)

There is however an important unresolved conundrum here: on a more fundamental level, the commands of moral intuition require the individual to engage in actions that are not to her direct benefit, i.e., to engage in genuinely altruistic behavior. What about at the level of the group, though? Is all behavior commanded by our moral intuitions ultimately in service of the reproductive fitness of the group, or could there be moral commands that ultimately are not of biological or economic benefit? This is an important question because it raises the issue of the differences between the EEA and current environments, including the “ecosystem” of the financial markets and the appropriate rules governing behavior in them. Are contemporary financial markets so different from the conditions in the EEA that our moral intuitions, which evolutionary psychology tells us are geared towards success in the EEA, do not or should not apply to behavior in the financial markets?

\(^{320}\) See also Part II.C supra, contrasting the picture drawn of the human person by evolutionary psychology with that associated with the standard view of the person in neoclassical economics. Because it attempts to compare various alternatives in terms of quantifiable costs and benefits, the standard economic perspective is associated with utilitarianism. See, e.g., Kenneth J. Arrow, Some Ordinalist-Utilitarian Notes on Rawls’ Theory of Justice, 70(9) J. PHILOS. 245-253, 246 (1979) (“The implicit ethical basis of economic policy judgment is some version of utilitarianism.”).

\(^{321}\) In Kant’s thought itself, this is because the commands of morality are intrinsically opposed to dictates of the natural world, which are governed by physical causes and so are necessarily determined by other physical states of affairs preceding them in time. See e.g., IMMANUEL KANT, CRITIQUE OF PRACTICAL REASON 28 (L.W. Beck trans. 1956) (a free will “must be conceived as wholly independent of the natural law of appearances in their mutual relations, i.e., the law of causality.”); see also J.B. Schneewind, Autonomy, Obligation, and Virtue: An Overview of Kant’s Moral Philosophy, THE CAMBRIDGE COMPANION TO KANT 309, 314 (P. Guyer ed., 1992) (“Kant was a Newtonian. He held that the sequence of events in the world is necessary. But its laws involve no commands and no sanctions. Morality, however, is not science.”) Because it ultimately comes under biology, for Kant himself evolutionary psychology could not ground a proper moral philosophy. Most modern evolutionary psychologists would likewise reject a Kantian stance on ethical questions; see, e.g., HAIDT, THE RIGHTEOUS MIND, supra note 218, at 32-60, contrasting a “rationalist” perspective in psychology drawing from Plato, Kant and Kohlberg with a Humean one, and associating himself firmly with the latter. On the other hand, evolutionary psychology seems to draw a picture of human ethical life that is more compatible with a deontological philosophy of commands and prohibitions than one advocating (often indeterminate, given the complexity of the world) cost/benefit analyses to arrive at determinations of what to do. As a result, it may be possible that while the method evolutionary psychology uses to arrive at its results is far different from the one Kant advocates, the picture it draws of human ethical life looks similar to the one deontological moral theory prescribes.
These are two of the many sets of questions I submit an evolutionary psychology approach gives rise to when applied to the issue of insider trading. At any rate, I hope I have shed light on exactly why many of us feel that insider trading is deeply unfair. An evolutionary psychology approach to insider trading also illuminates the internal structure of insider trading doctrine, with violations by powerful insiders as its moral core and harm to traders and shareholders its periphery. Since Justice Powell’s fiduciary duty approach is however under-inclusive from a moral point of view, prosecutors and judges have responded to pressure to expand the law against insider trading. While legally defective, because it is fractured to the point of incoherence, the current state of the law is morally satisfying.

**Conclusion**

The sweep of insider trading law shows a movement of expansion to *Texas Gulf Sulphur*, then contraction in *Chiarella*, and then expansion again with the near abandonment of the fiduciary duty framework in the lower courts. In coming to occupy more and more of the “periphery” of insider trading, it satisfies the human desire to prevent individuals from taking more than their fair share of the profits of modern capitalist enterprise. The survey of the law presented above in Part III however shows that this expansion comes at a significant cost: given its status as a multifarious collection of case law decisions, insider trading law has become a mess on the doctrinal level. A detailed look at the *Chiarella* and *Dorozhko* decisions in particular shows judges failing to interpret the applicable source materials accurately, leading to questions about the rule of law in a common law system based on the honest and rigorous use of precedent. While the Supreme Court has the power to announce radical shifts in the law should it choose to do so, a lower court is not vested with that authority in our system. And there is a significant measure of irony in both the *Chiarella* and *Dorozhko* decisions: Justice Powell’s retrenchment of the law is driven in part by his faith in the moral character of American businesspersons to obey the law and his fear of prosecutorial overreach; likewise, the *Dorozkho* decision is satisfying to those who believe trading on stolen information is wrong, but its ultimate effect may well be to reduce respect for the law.

At this point, I hope to have demonstrated that the post-*Chiarella* trajectory of insider trading law reaches a terminus that corresponds to what evolutionary psychology indicates humans generally desire in group endeavors. On the descriptive level then there is a correspondence between our general moral predispositions and the current state of the law. Such a correspondence however does not necessarily mean that this state of the law is good. As David Hume pointed out, we cannot infer the “ought” from the “is.”\(^\text{322}\) As the pendulum of insider trading law has swung back and forth and back again, we have reached a state of

\(^{322}\) *See* Hume, A TREATISE OF HUMAN NATURE, *supra* note 257, at 469.
doctrinal incoherence that reminds us of the value of good law, to guide human conduct through clearly delineated rules that put into effect generally agreed upon societal values.