

# INSIDER TRADING WITHOUT DISCLOSURE— THEORY OF LIABILITY

## I. INTRODUCTION

Ordinarily the law will not intervene in a securities transaction; it will allow the parties to sustain the consequences of their investment decisions in the absence of fraud or misrepresentation. But trading by those who have material information about a corporation which information has not been disclosed to the public constitutes a special area of consideration in the regulation of security transactions. The reasons for requiring disclosure have been discussed at length elsewhere, and shall not be repeated here.<sup>1</sup> This article evaluates the propriety of allowing insiders to trade within that period of time during which the law permits the corporation temporarily to withhold disclosure. The interests of three parties are usually involved in these cases: (1) the corporation whose securities are traded; (2) the one who has the material information (the "insider"); (3) and the party with whom the insider is trading (the "investor"). If the insider were permitted to disclose the information which the law allows to be temporarily withheld, the corporation might lose any advantage resulting from a business secret, although the party with whom the insider deals would not seem to be injured by the transaction.<sup>2</sup> If the insider were permitted to trade without disclosure, there would be no direct injury to the corporation, but the investor would have to bear any disadvantage from his trading without knowledge. A rule prohibiting such trading without disclosure, although possibly preventing injury to the corporation or investors, would require that the insider either forego a business advantage, or be required to hold a losing security. No matter which view is adopted, one party must lose. In seeking a justification for the

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<sup>1</sup> See Cohen, "Truth in Securities' Revisited," 79 Harv. L. Rev. 1340 (1966), wherein the author reviews the present statutory framework and suggests a coordination of all the security laws dealing with disclosure.

<sup>2</sup> Since it already has been determined that the corporation may temporarily withhold disclosure for valid business purposes, the allowance of disclosure by insiders desiring to trade would appear to be against the social policy allowing nondisclosure. Where the disclosure is made to a limited class of investors who do not use or reveal the information to the disadvantage of the corporation, there would appear to be no injury to any of the parties. However, the particular investors so trading would have an advantage over the general public trading without knowledge. Although this technique of limited disclosure might be advantageous to both parties in the transaction, it would be necessary to find a base to justify the selection of particular investors over others and to evaluate the probability of a news leak hurting the corporation. If two insiders were trading with each other, there would be less of a chance of spreading the news, but still trading insiders would have an advantage over the general public trading without knowledge.

selection of one of these parties to bear the loss, the approach here adopted first requires identification of the nature of the injury to the investors. Next, the effect on securities marketing is examined. Finally, having adopted a view as to the injuries resulting from inside trading without disclosure, various legal theories purporting to explain why the law intervenes to redress the wrongs necessarily associated with non-disclosure are analyzed.

After the decision of *Erie Railroad v. Tompkins*<sup>3</sup> all federal regulation of securities transactions has required a statutory base. The Securities and Exchange Act of 1934 addresses itself to the problem of insider transactions.<sup>4</sup> A specific provision establishes absolute liability for short-swing profits by directors and officers of corporations.<sup>5</sup> Other federal statutes affecting securities regulation deal with brokers<sup>6</sup> and use of the mail to defraud.<sup>7</sup> None of these cited provisions of the Securities Exchange Acts establish a general rule against insider trading without disclosure; each is limited to cover specific situations.<sup>8</sup>

It has been asserted, however, that the combination of two federal regulations lead to the establishment of such a general rule. Section 10(b) of the Securities Exchange Act of 1934<sup>9</sup> makes it unlawful to use a deceptive device in a security sale or purchase in contravention of a Securities and Exchange Commission rule for protection of investors. Pursuant to this enabling legislation, the SEC promulgated rule 10(b)-5<sup>10</sup> which makes it "unlawful for any person . . . to en-

<sup>3</sup> 304 U.S. 64 (1938).

<sup>4</sup> Securities Exchange Act of 1934 § 2, 15 U.S.C. § 78b (1934), provides in part: [T]ransactions in securities . . . are affected with a national public interest which makes . . . necessary . . . regulation and control of such transactions . . . , including transactions by officers, directors, and principal security holders . . . , in order to protect interstate commerce . . . and to insure the maintenance of fair and honest markets in such transactions . . . .

<sup>5</sup> Securities Exchange Act of 1934 § 16, 15 U.S.C. § 78p (1934).

<sup>6</sup> Investment Advisors Act of 1940 § 206, 15 U.S.C. § 80b-6 (1940).

<sup>7</sup> Securities Act of 1933 § 17(a), 15 U.S.C. § 77q (1933).

<sup>8</sup> The authoritative text on federal statutory regulation of securities transactions is L. Loss, *Securities Regulation*, (2d ed. 1961).

<sup>9</sup> Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j (1934) declares:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national security exchange

. . . .

(b) To use or employ, in connection with the purchase or sale of any security . . . , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

<sup>10</sup> Rule 10b-5, 17 C.F.R. § 240.10b-5 (1948) provides in full text:

It shall be unlawful for any person, directly or indirectly, by the use of any

gage in any act . . . which would act as a fraud or deceit on any person in connection with the purchase or sale of any security." In interpreting these provisions, the federal district court in *SEC v. Texas Gulf Sulphur Co.*<sup>11</sup> declared: [T]rading by an insider on the basis of material undisclosed information constitutes a deceptive practice in violation of the statute and rule."<sup>12</sup> Thus the court would impose liability if it found that (1) the defendant was an insider, (2) the information withheld was material, and (3) there was a purchase or sale of securities.<sup>13</sup> Rule 10b-5 and section 10(b), however, require more than these three elements to constitute a violation. Rule 10b-5 requires an "artifice to defraud" or an act which would "operate as a fraud or deceit."<sup>14</sup> Section 10(b) further requires such an act to be a "manipulative or deceptive device" that violates an SEC regulation "in the public

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means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

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

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

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

<sup>11</sup> 258 F. Supp. 262 (S.D.N.Y. 1966).

<sup>12</sup> *SEC v. Texas Gulf Sulphur Co.*, 258 F. Supp. 262, 278 (S.D.N.Y. 1966). The logic of the court in reaching this conclusion appears to be: (1) that which "operates as a fraud" (rule 10b-5) is a "deceptive device" (§ 10(b)); (2) by the doctrine of *Strong v. Rapide*, 213 U.S. 419, 431 (1909) (a pre-Erie federal fiduciary duty case) the presence of "special facts" create a duty of directors to disclose to stockholders before purchasing from them; (3) "that which operates as a fraud" incorporates the "special facts" doctrine of *Strong v. Rapide*; (4) trading by an insider on the basis of undisclosed inside information constitutes "special facts." *SEC v. Texas Gulf Sulphur Co.*, *supra* at 278-79.

<sup>13</sup> *SEC v. Texas Gulf Sulphur Co.*, 258 F. Supp. 262, 278-80 (S.D.N.Y. 1966).

The court in *Texas Gulf Sulphur* looks to the language of rule 10b-5 and its judicial interpretation in determining the meaning of each of these three elements. It would thus appear that the court was going well beyond the "special facts" doctrine it professed to follow, since the "special facts" doctrine was limited to (1) corporate directors or fiduciaries, not "any person" (as in rule 10b-5); (2) "special facts," not "material facts"; (3) and purchase by a stockholder, not purchase or sale by any person. *Strong v. Rapide*, 213 U.S. 419, 431 (1909). As rule 10b-5 provides its own contents in substitution for each element of the "special facts" doctrine, there would appear to be no utility in associating the two doctrines. Further, the "special facts" doctrine was distinguished from the other common law doctrines of "majority rule" (holding that the corporate directors had no duties toward individual stockholders) and the "minority rule" (finding such a duty of directors to individual stockholders in all sales to stockholders). By giving the title "special facts" to the duty of disclosure by the insiders to any person, the court in fact abandons the "special facts" doctrine and goes well beyond the "minority rule."

<sup>14</sup> Rule 10b-5, 17 C.F.R. § 240.10b-5 (1948).

interest or for the protection of investors.<sup>15</sup> It is only within this statutory framework that we may evaluate the assertion in *Texas Gulf Sulphur* that there is a general prohibition against insider trading without disclosure. Therefore injury to the investors whom the statute seeks to protect must be found. This public injury is found when the market for securities has been affected. It is also helpful to examine legal theories in order to characterize behavior as deceitful or fraudulent.

## II. THE INJURY TO INVESTORS

Since there is usually no injury to the corporation or the insider by the insider trading without disclosure, imposition of liability in such transactions would seem to be justified primarily as a protection of investors. The concepts of "reliance," a special "relationship" of the parties, and shifting of another's loss have been utilized in finding a base of the injury. The "reliance" and "relationship" concepts would appear to have less significance in the impersonal atmosphere of an organized stock exchange.<sup>16</sup> Ordinarily the investor in securities will deal only with his broker, rather than directly negotiating with the other party. In the typical transaction the investor will either order his broker to buy or sell at the current price on the market, or will order his broker to complete the transaction only if the current market price is not above or below that price which the investor has set as his "limit."<sup>17</sup> Since the insider's offer would ordinarily be close to the market price,<sup>18</sup> and since it is likely the investor would have bought anyway and received the same class of stock, it is difficult to discover an injury. In the absence of misrepresentation or other inducements to trade, these same considerations are relevant in negotiations not on an organized stock exchange. Where an investor would have bought anyway and at the same price, the failure to disclose would lead to the same injury or absence of injury in either stock exchange or non-stock exchange transactions.<sup>19</sup> Since a corporation's securities of the same type are fungible, in the absence of an insider inducing an investor to trade, it is difficult to see why the investor dealing with the insider

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<sup>15</sup> Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j (1934).

<sup>16</sup> *Goodwin v. Agassiz*, 283 Mass. 358, 186 N.E. 659 (1933).

<sup>17</sup> G. Leffler & L. Farwell, *The Stock Market* 169 (3rd ed. 1963) [hereinafter cited as *Leffler-Farwell*].

<sup>18</sup> Usually the insider's offer would have little effect on the market price. Any deviation from this price would accrue to the benefit of the investor, since to complete the transaction the insider's offer must beat the offers of others or at least meet such offers. Additionally, the insider would be willing to trade at a price better than that of current market offers, since he expects a change in value to his benefit.

<sup>19</sup> See Comment, "Civil Liabilities Under Section 10b and Rule 10b-5: A Suggestion for Replacing the Doctrine of Privity," 74 *Yale L.J.* 658 (1965).

is given a cause of action, while other investors who by mere chance do not deal with the insider are not afforded a remedy. At least the allowance of a remedy to this particular class of investors may not be based on a theory that this remedy is designed for his particular protection, although it may be consistent with other public policies.<sup>20</sup>

Even if the insider actively sought the investor with whom he traded without disclosure and induced the culmination of a transaction that would ordinarily not have occurred, in the absence of misrepresentation it is difficult to say the investor was injured due to reliance on the insider. The fact that the insider action is opposite that of the investor in the securities transaction should lead to suspicion on the part of the investor who knows that the party with whom he is dealing has access to material information. Reliance in this circumstance would be justified only in light of a legal requirement of disclosure. It is arguing in a circle to assert that (1) there is a duty of disclosure because the law says there is justifiable reliance on such disclosure and (2) there is justifiable reliance because the law says there is a duty of disclosure. Where there is no reliance in fact, a rule requiring disclosure may be justified only on social policy.<sup>21</sup>

Although ordinarily it is unlikely that an investor is injured by reliance on disclosure, perhaps reliance on disclosure is justified in those instances where the insider bears such a relation to the investor as to lead to an expectancy of disclosure. Where the investor does not know of this relationship he bears to the insider, certainly there is no reliance, whether the transaction is on the market or private. Even where a stockholder knows that the insider has duties to the corporation, this investor also knows that the director is functioning in a private capacity in the transaction, and that the insider is neither an agent nor fiduciary of the investor, but rather the opposite party in the transaction. Where the investor is not a stockholder in the corporation to which the insider is associated, but rather a purchaser from the insider, there is even less reason for an expectation of a relation leading to an

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<sup>20</sup> If the action of the insider is declared unlawful, it does not follow that the conduct should remain unpunished merely because the particular investor dealing with the insider is not prejudiced. Sanctions such as criminal penalties or civil liability could be imposed. Even if there were no private loss leading to a compensatory remedy, still the availability of a private cause of action could effectuate a policy of discouraging the prohibited conduct, just as punitive damages serve this function in the law of torts.

<sup>21</sup> If a general rule of insider liability for nondisclosure were adopted, the rule could act independently of any theory of reliance. Thus if "tippees" (individuals who may have no connection to the corporation and who have gained material information through mistake or limited disclosure) were considered insiders, they could be held liable, even in the absence of any ground for reliance.

assumption of disclosure. The relation of the parties here is independent of an existing relation within the corporate organization. Reliance in such a case would be justifiable only if the law imposed a duty of disclosure by insiders to all persons, which duty would be a principle of law that was not based upon any other pre-existing fiduciary duties, and could operate in the absence of investor knowledge of the relationship.

It has been shown that there is often no general reliance on disclosure and no reliance on disclosure that is founded on a special relation of the parties. Nevertheless, even without reliance there is an economic loss. A rule prohibiting the trading by insiders with material undisclosed information would require the insider holding a losing security to bear the loss which is expected, or would require that the insider forego purchase of a security which is expected to increase in value. Without such a rule *some* investor would be substituted for the insider and the injury would be shifted to this investor. Even if no way is found to identify the particular investor who is injured, still the aggregate quantity of good securities owned by investors is diminished,<sup>22</sup> or the quantity of losing stock in the hands of investors is increased. The imposition of a stock market system between the investors and insiders only increases the ease of shifting the loss. The only difference between this situation and the ordinary securities transactions is the possession by one party of material undisclosed information. If the law were to adopt this distinction as the basis of liability, it would no longer be necessary to find an injury to particular investors. No longer would there be a need for utilization of the concepts of fiduciary duty and reliance in identifying the injury the law seeks to protect.

### III. INJURY TO SECURITIES MARKET SYSTEM

The organized securities markets provide a unique example of economic institutions which in some aspects approximate the theory of "pure competition."<sup>23</sup> This is true because securities are fungible, and the value of a security is determined by transactions between willing buyers and willing sellers at a price largely independent of the action

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<sup>22</sup> The ability of investors and insiders under certain circumstances to buy treasury shares does not necessarily prevent the purchase by insiders from decreasing the quantity of good securities owned by investors. In a sale by a corporation of treasury shares, which are about to increase in value, the corporation may be viewed as the "investor." No aggregate gain in the ownership of good securities by investors is achieved by an exchange between investors.

<sup>23</sup> But as in other areas of economic activity, this free competition operates within limits established by law. Securities regulations and antitrust law attempt to promote this competition by eliminating "cornering" and other manipulative devices.

of any one individual.<sup>24</sup> The price so established reflects the relative values the parties place on the securities sold in security transactions. These relative values are largely determined by financial analysis and perceptions as to the expected worth of the security at a later date, weighed by the probability of this expectancy materializing.<sup>25</sup> This analysis is encouraged as a matter of economic policy, as increased knowledge about various business enterprises will tend to allocate investment funds where they are most needed and will decrease the irrationality of investment behavior. The improper valuation of securities could lead to great financial injury to individual investors and thus the economy as a whole in times of general price adjustments or recessions. When the law permits a temporary period of nondisclosure a social decision has been made limiting for a time the establishment of a price which would reflect material aspects of a particular corporation. But if the insider is prohibited from trading during this period, analysis of the market will be encouraged by the prevention of trading by those acting on inside information rather than analysis.

One function of a stock market is to encourage investment in stock by the provision of a continuous market for securities;<sup>26</sup> a potential investor may buy securities with the assurance that he may sell at any time at a price reflecting current supply and demand. Material information would change the supply and demand for a class of securities.<sup>27</sup> Since social policy permits a corporation to temporarily withhold disclosure of material information for certain purposes, to that extent supply and demand at a given instant does not reflect the effect of investor analysis of the information. Allowing an insider to trade during this period of nondisclosure would exempt the insider from the current market supply and demand functions, while binding other investors.<sup>28</sup>

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<sup>24</sup> Leffler-Farwell. *See generally* V. Due & A. Clower, *Intermediate Economic Analysis* 47-48 (4th ed. 1961). Deviations from this pure model may be found in smaller subscriptions and in block trading.

<sup>25</sup> Other factors determining the value of an investment to a class of investors are the propensity to assume the risk of loss and psychological considerations with respect to the choice of investments among opportunities of the same probability of risk.

<sup>26</sup> Leffler-Farwell.

<sup>27</sup> "Material Information" has been defined as that which in "reasonable and objective contemplation might affect the value of the corporation's stock and securities." *Kohler v. Kohler*, 319 F.2d 634, 642 (7th Cir. 1963). *Cady, Roberts & Co.*, 40 S.E.C. 907, 911 (1961) called "material information" that which "would affect their investment judgment." *See* Fleisher, "Securities Trading and Corporate Information Practices," 51 *Va. L. Rev.* 1271, 1289 (1965).

<sup>28</sup> Of course, a rule prohibiting the insider from trading may "freeze in" the insider. However, this would only be for the temporary period of nondisclosure. Although the insider might suffer an economic loss during this period, he would suffer no greater loss than investors without the inside information.

Since to complete the transaction the insider must sell at or below the market, or buy at or above the market, it might appear as if the transaction discounts the expected effect of disclosure to the benefit of the trading parties. This price change is probably not significant as the price would likely be near the market price in the absence of the transaction, since the factors creating the supply and demand functions remain about the same both immediately before and after the sale. Furthermore, by allowing a policy of temporary nondisclosure in certain circumstances, a policy has been indicated which would permit delay in the effect of the information on market price.

Although there would appear to be no injury to a particular investor, since the insider's transaction does not substantially affect the price for stock, still there would seem to be an abuse of the system, as the fact of nondisclosure permits the insider to trade upon a more realistic set of probabilities of gain, while at the same time it exempts the insider from the operations of supply and demand that ordinarily characterize stock transactions. There will be a change in the price of securities when the extraordinary undisclosed corporate business is revealed. This change of price is caused by the nature of the underlying undisclosed business. The fact of trading without disclosure only shifts the loss, it does not cause the change of price. The investor who loses is presumed to have anticipated the probabilities of this corporate business and assumed the risk. The fact remains, however, that in the absence of a rule prohibiting nondisclosure the risk will be shifted and the insider is given a preferred position enabling him to avoid a highly probable loss or to gain an assured profit. While the insider is free to trade with less uncertainty, the knowledge of a non-insider investor that he must calculate the probabilities and sustain his loss may tend to discourage investment.

The economic laws of supply and demand just analyzed with respect to transactions on the organized securities markets also apply in private securities transactions. The analysis is conceptually easier to understand in terms of an organized market such as the New York Stock Exchange, since it is more realistic in such a market to comprehend the immediate effect of a disclosure, the existence of innocent investors without notice, the ease of shifting a loss, and the high liquidity of a continuing market. To the extent a private market approximates these qualities there is a similar effect.

#### IV. THEORIES OF LIABILITY

The doctrine of fiduciary duty has often been used to explain the imposition of liability in insider nondisclosure cases.<sup>29</sup> In the stock-

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<sup>29</sup> *Brophy v. Cities Service Co.*, 31 Del. Ch. 241, 70 A.2d 5 (1949).



option transactions this doctrine would be appropriate. Where a corporation is bound by a contract with its directors or officers to issue stock to them at a percentage discount from market, it would be a violation of such officer's duty to the corporation to exercise this option at a time when the market had not received the material information affecting the price. In this situation the duty of the director or officer runs to the corporation. The ordinary rule is that the duties of the corporate officers and directors run only to the corporation, and thus to all stockholders, but not directly to individual stockholders.<sup>30</sup> At common law the courts split as to the rule applicable in the situation of insiders trading without disclosure of material information to the public; the majority of jurisdictions, including the United States under pre-*Erie* common law imposed a duty only under special circumstances.<sup>31</sup> Since this duty bears no relation to other corporate responsibilities, and since it is an exception to the general rule of no duty to stockholders, the doctrine is a mere fiction used to impose a legal obligation. This fiction has been extended by applying agency principles. Thus brokers and experts hired by the corporation have been held to a fiduciary duty.<sup>32</sup> The federal securities acts nowhere speak of fiduciary duties. They make unfair and deceptive practices in securities transactions illegal. It would be incorrect to say the goal of these acts was to establish fiduciary duties and thus indirectly make illegal certain conduct. Such a view would improperly interpret the statutes as establishing a body of federal corporation law, the content of which was left to the courts.

Three closely allied doctrines of the common law have been given relevance by the courts in explaining the basis of liability of insiders for trading without disclosure: agency, trade secret, and misappropriation. An agency doctrine holds an agent accountable to his principals for profits made "incidentally to his employment."<sup>33</sup> The utility of this doctrine is questionable in a securities transaction by a corporate officer or director, since the corporate function of such an insider would ordinarily bear no relation to the sale or purchase of securities.

The trade secret doctrine attempts to preserve certain business secrets which give a competitive advantage to a corporation.<sup>34</sup> Because

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<sup>30</sup> See A. Berle and G. Means, *The Modern Corporation and Private Property* (1932), wherein the authors lament the separation of control from ownership in the corporate system.

<sup>31</sup> Comment, "Insider Liability under Securities Exchange Act, Rule 10b-5: The Cady, Roberts Doctrine," 30 U. Chi. L. Rev. 121, 123 (1962). The article collects the "special facts" which have led to liability.

<sup>32</sup> Cady, Roberts & Co., 40 S.E.C. 907 (1961).

<sup>33</sup> M. Ferson, *Principles of Agency* 415 (1954).

<sup>34</sup> 4 Restatement of Torts § 757, comment (b) (1939).

the insider releases no corporate secrets when he trades without disclosure, the doctrine would appear to have no application in such a securities transaction. In addition, an element of the cause of action in a trade secret case is a breach of confidence or other misconduct in the obtaining or disclosure of the secret.<sup>35</sup> To call trading without disclosure a wrong is to avoid the necessity of using a trade secret analogy.

The misappropriation doctrine of unfair trade is used to impose liability for the appropriation by one of the work product of another to the prejudice of that other.<sup>36</sup> The purpose of the doctrine is to allow the corporation itself to reap the benefits of its efforts. The corporation is not prevented from benefiting from its efforts by the insider's security transaction, since the ownership of its stock is ordinarily irrelevant to the corporate advantage derived from the underlying business event which has not been disclosed. Another view is that "information developed within the corporate sphere belongs, of right, to all shareholders equally."<sup>37</sup> By selling before the disclosure an investor may lose the expected gain in the value of a security resulting from the information. Thus, the investor has no "right" to the gain which has been misappropriated.

The common law theory of misrepresentation applies only to affirmative declarations. In certain cases, however, an action for fraud exists at common law for nondisclosure.<sup>38</sup> Recent cases have declared that actual fraud is not necessary under rule 10b-5.<sup>39</sup> Discussion of the significance of the doctrine of common law fraud has been lively and needs no repetition here. There would appear to be no satisfactory statutory base for retention of any of the elements of common law fraud.

The appropriate theory of liability is a social determination that

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<sup>35</sup> *E. I. Du Pont De Nemours Powder Co. v. Massland*, 244 U.S. 100 (1917).

<sup>36</sup> *International News Service v. Associated Press*, 248 U.S. 215 (1918). This case was brought in the federal courts before *Erie*. *Contra*, *Metropolitan Opera Ass'n. Inc. v. Wagner-Nichols Recorder Corporation*, 199 Misc. 786, 101 N.Y.S.2d 483 (1950), where the court applied the misappropriation doctrine although the parties were not competitors.

<sup>37</sup> Manne, "What's So Bad About Insider Trading?" 15 *Challenge* 14, 15 (Jan.-Feb. 1967). Professor Manne apparently does not advocate this position. On the contrary, in an earlier article he has asserted that insider trading is a proper and necessary means to compensate insiders and stimulate innovation within the corporate system. Manne, "In Defense of Insider Trading," 44 *Harv. Bus. Rev.* 113, 116-19 (Nov.-Dec. 1966).

<sup>38</sup> See *W. Prosser, Torts* § 101 (3d ed. 1964).

<sup>39</sup> *SEC v. Texas Gulf Sulphur*, 258 F. Supp. 262, 277-78 (1966). The court cited the recent decisions on this question. This case should be consulted for citations to the cases declaring various elements of common law fraud irrelevant to a rule 10b-5 cause of action. The case further directs attention to the lively discussion of commentators on the utility of the doctrine. Older cases asserting the need for common law fraud are also cited.

it is unfair to allow securities trading where the parties do not have *equal access* to information. This rule applies only to material information, and thus would not punish the insider because of his diligent analysis, but only to prevent his shifting a certain loss in extraordinary situations. This theory applies equally to all possessing the inside information, and considers irrelevant the relation of the insider to the corporation. Likewise, there is no need for privity or reliance by the investor. This rule was suggested as an alternate theory of liability in *Cady, Roberts*.<sup>40</sup>

Equal access to information exists only after disclosure. But in finding whether "disclosure" is present the courts have usually adopted technical rules which have no relevance to the determination of equal access. For example, in *Texas Gulf Sulphur* the court selected the instant of the announcement as the time of disclosure even though the information had not yet been reported on the stock tickers or in the newspapers.<sup>41</sup> Certainly the complicated mining reports could not so readily be absorbed and evaluated even if immediately reported. This theory of equal access would be consistent with the language of the federal securities regulations. It is a rule intended for maintenance of "fair and honest markets," is a means of preventing "deception," and prevents acts that would have the effect of "deception or fraud."

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<sup>40</sup> *Cady, Roberts & Co.*, 40 S.E.C. 907, 912 (1961).

<sup>41</sup> *SEC v. Texas Gulf Sulphur*, 258 F. Supp. 262, 288-89 (1966).