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# A New Market-Based Approach to Securities Law

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ARTICLES

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*Modern securities regulation has three main areas, each of which is plagued by a core problem. Mandatory disclosure law leaves society with suboptimal disclosure, as the government calls for too little of some information (for example, management analysis of company prospects) and too much of other information (for example, data about trivial executive perks). Securities fraud law (specifically, its central fraud-on-the-market theory of reliance) yields damages at odds with any reasonable theory of compensation and deterrence. And insider trading law fails to achieve its ends because incentives to police illegal trading and tipping by executives are currently weak.*

*In this Article, we propose fixing these fundamental flaws of securities law by shifting much of the regulatory focus from firms to information. In particular, we introduce the idea of building the law around a well-regulated market for the public-company information that sits at the center of each of the three main areas of securities law. Deploying this market, we argue, would trigger incentives for firms to disclose more information of value while also motivating them to more rigorously police illegal trading and tipping by their agents. Additionally, it would help regulators identify when the law requires disclosure that is not socially valuable and assist in the identification of a class of securities fraud plaintiffs that is more in line with the goals of the anti-fraud regime.*

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## INTRODUCTION

Many scholars have proposed market-based solutions to the well-known shortcomings of modern securities law. Most interestingly, it has been argued that there should be a market for the law itself—with securities law following corporate law by allowing firms to choose the best regime offered by states.[1] Also noteworthy are calls for leaving it to "the market" (namely, institutional investors) to penalize firms that fail to share information appropriately[2] and proposals to shift the focus of regulation from firms to investors.[3] None of these proposals has been adopted despite fervent support in some academic circles.

In this Article, we consider a new market-based approach that should have broader appeal across the political spectrum. We imagine a market for tiered access to the public-company information that sits at the center of securities law. A market for this information can play the lead role in fixing fundamental flaws of modern securities law.

The Great Depression–era securities laws on which much of modern capitalism is built are designed to get the optimal amount of information about public firms into the hands of investors. To some, the end goal is the protection of ordinary investors.[4] To others, it is the protection of savvy professionals.[5] Whatever the precise intent and dominant theoretical justifications, these interconnected laws are meant to enhance the accuracy of stock

1 See generally Roberta Romano, *The Advantage of Competitive Federalism for Securities Regulation* (AEI 2002); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 Yale L J 2359 (1998).

2 See Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* 276–314 (Harvard 1996); Frank H. Easterbrook and Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 Va L Rev 669, 709–13 (1984) (describing the potential advantages of a market regime but concluding that, based on the empirical research thus far, it is uncertain whether leaving the issue to the market is actually better than the status quo). The basic idea is that sophisticated investors will discount the value of companies in these instances, thereby changing company behavior by driving down stock prices in ways that matter for both firm owners and managers.

3 See Stephen Choi, *Regulating Investors Not Issuers: A Market-Based Proposal*, 88 Cal L Rev 279, 304–09 (2000).

4 See, for example, Easterbrook and Fischel, 70 Va L Rev at 693–94 (cited in note 2) (summarizing this view in the mandatory disclosure context, but labeling it "as unsophisticated as the investors it is supposed to protect").

5 See, for example, Zohar Goshen and Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 Duke L J 711, 713–14 (2006) ("Securities regulation is not a consumer protection law. Rather, scholarly analysis of securities regulation must proceed on the assumption that the ultimate goal of securities regulation is to attain efficient financial markets and thereby improve the allocation of resources in the economy," and for that reason, "the role of securities regulation is to create and promote a competitive market for information traders.").

prices,[6] thereby improving capital allocation and firm governance.[7]

The federal securities laws include a foundational aspect (securities disclosure law) along with two interrelated overlays (securities fraud law and insider trading law). The disclosure regime compels information sharing. The anti-fraud overlay makes disclosures more credible, while restrictions on trading and tipping by insiders encourage timely information release and create incentives for information production outside the firm.

Although critics have some objections to the fundamental theories behind these laws, to us and many others, the most damning objection is that their specific content and practical application are flawed. For those who look closely enough, it should be apparent that the disclosure regime compels too much sharing of some information and too little of other information.[8] It should likewise be clear that securities fraud case law creates class actions that have ballooned in size far beyond that which optimally compensates victims and deters perpetrators[9] and that insider trading law suffers from underenforcement that keeps it from achieving its ends.[10] Each of these problems has lingered for decades.

Enter our proposal: address these problems with a well-regulated market for tiered access to public-company information.[11] In this market, firms would be able to sell early access to their information to anyone who values it at at least the market price—so long as they did so transparently, on a nondiscriminatory basis, and with full public disclosure of the information coming soon after. For example, if a firm were going to release news to the public at noon, it would be allowed to sell private access to

6 See Merritt B. Fox, et al, *Law, Share Price Accuracy, and Economic Performance: The New Evidence*, 102 Mich L Rev 331, 368 (2003) (discussing empirical evidence showing that "mandatory disclosure can in fact increase the amount of meaningful information reflected in share prices and increase share price accuracy").

7 See Merritt B. Fox, *Shelf Registration, Integrated Disclosure, and Underwriter Due Diligence: An Economic Analysis*, 70 Va L Rev 1005, 1015–22 (1984) (discussing the main social benefits of enhanced stock-price accuracy). See also Marcel Kahan, *Securities Laws and the Social Costs of "Inaccurate" Stock Prices*, 41 Duke L J 977, 1028–34 (1992) (same); Merritt B. Fox, *Civil Liability and Mandatory Disclosure*, 109 Colum L Rev 237, 254–55 (2009) (discussing how disclosure improves corporate governance).

8 See Part II.A.

9 See Part II.B.

10 See Part II.C.

11 We limit our proposal to a market for the information that public firms provide post-IPO, including information that is now disclosed both on an ongoing, periodic basis and when secondary offerings of securities are made.

the news seconds, minutes, or even hours prior to noon. In this type of market for tiered access to information, stock market participants—such as high-speed traders and investment funds—would be able to purchase access to what would soon be public disclosures. So too would those with extramarket demand, such as corporate watchdogs and the media.

At first blush, this sounds like a scheme for the rich to get richer. If information is no longer "free," only wealthy investors that paid for it would receive it. They would then have an advantage that would build on itself in a vicious circle (from the standpoint of ordinary investors). We take up this objection in more detail later in this Article,[12] but we should say at the outset that it is exactly backward. The *current* system is perverse if protecting ordinary investors is the goal, and our proposal would *increase* ordinary investors' well-being. By making information traders—hedge funds, high-speed traders, and other similarly sophisticated professionals—bear the costs of corporate disclosures, the market we propose would act as a sort of Pigouvian tax on their trading. Because our proposed information releases would be announced in advance to everyone, the market would also help everyone else avoid the dangerous trading environment that arises whenever there are new releases of information.[13] Better yet, the new approach should also encourage ordinary investors to refrain from trying to beat the professionals, something finance theory has been urging for six decades.[14]

12 See Part IV.A.2.

13 In a 2016 article, we undertook a close examination of legal efforts geared at ensuring that market-moving information is made available to all at the exact same time when it is first shared beyond a small group of insiders or the like. See generally Kevin S. Haeberle and M. Todd Henderson, *Information-Dissemination Law: The Regulation of How Market-Moving Information Is Revealed*, 101 Cornell L Rev 1373 (2016). In that work, we criticized these legal efforts and noted in the conclusion that the relevant law could actually better meet its investor protection ends by allowing a market for tiered access to market-moving information so long as that market included basic regulatory protections to ensure transparency. See id at 1439–44. We discuss these points in more detail in Part III.A.

14 This is the central lesson arising out of Modern Portfolio Theory (MPT) and the efficient capital markets hypothesis. The idea is simple: extra-informational investors can earn higher returns with the same risk (or the same returns with lower risk) by following a buy-and-hold strategy—that is, buying a diverse portfolio of stocks and holding it for a long period. See Harry Markowitz, *Portfolio Selection*, 7 J Fin 77, 77–79 (1952). Trying to buy and sell based on changes in information is a losing strategy for the masses because markets incorporate new information based on the trading of sophisticated professionals with striking speed. For a popular account of MPT and these dynamics, see generally Burton G. Malkiel, *A Random Walk Down Wall Street* (Norton 1973). For a notable example of the speed at which information is incorporated into prices today, see Grace

The more compelling objection to our proposal may be that it would impede the incentives of trading professionals to generate information about stock prices. We do not know how much our proposed market will impact these incentives or how these "costs" should be traded off against the benefits of the market. But we take this up in detail below in laying out a framework for the debate our proposal should spark.[15]

The benefits of our proposal are potentially vast. The market could improve securities law as a whole by addressing each of the core problems mentioned above. First, the market could ameliorate the disclosure underproduction and overproduction problems.[16] Firms would have a revenue-based motivation to give investors and others what they want, give it to them in a form that is most valuable to them, and do it more often than under current law. We would then require that any enhanced early-release product be made available to the full public within a relatively short time frame, thereby ensuring that the improved disclosure is available to all. Prices would also reveal what investors value and what they don't. (Of course, if investors won't pay but the information is socially valuable, the government could still mandate its disclosure.[17])

Second, the market could lead to a much-needed reworking of private securities fraud litigation.[18] For almost three decades, federal courts have allowed essentially anyone who purchased a public company's stock to sue if the purchase was made during a period in which the stock price was inflated due to fraudulent corporate statements. Without this broad approach, the economics of this area of litigation are said to preclude viable private enforcement. But the approach permits suit by even those who, on an expected basis, are not harmed by these frauds. In addition, damages in these cases dwarf the gains of those committing the fraud.

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Xing Hu, Jun Pan, and Jiang Wang, *Early Peek Advantage? Efficient Price Discovery with Tiered Information Disclosure*, 126 J Fin Econ 399, 406–10 (2017) ("[T]he information content of the [University of Michigan Index of Consumer Sentiment] has been fully incorporated into the market price during the first second of trading within the early peek window.").

15 See Part IV.C.

16 We provide the relevant background to this argument in Part II.A, and we detail the argument in Part III.B.1.

17 In Part II.A.1, we discuss examples of recent prominent disclosure items with little (if any) financial value to firms and investors but—according to their proponents—much social value. See notes 68–78 and accompanying text.

18 We provide the relevant background to this argument in Part II.B and set forth the argument itself in Part III.B.2.

For these reasons, it is well established that society almost surely devotes more resources to these cases than can be justified by compensating victims and deterring fraud. Indeed, calls to scrap private litigation in the area altogether or to eliminate class actions through mandatory-arbitration clauses are common.[19]

Instead of a continuation of the unacceptable status quo or risk of throwing the baby out with the bathwater, courts could look to our proposed information market to identify the actual victims of securities fraud, certifying classes of those who purchased early-access rights to the information and then bought the stock while its price was still inflated. The end result would be a litigation device that allows class action suits yet avoids the current system's compensation of the unharmed and waste of scarce resources on cases of small marginal deterrence.

Third, the market would increase company incentives to police illegal trading by their executives.[20] Today, firms have much reason to turn a blind eye to this illegal trading.[21] For one thing, executives generally determine the approach the firm takes with respect to this issue. For another, even when shareholders get to decide, there is much reason to remain passive. This is because current law requires firms to give away their information for free. From the perspective of firm owners, the information might as well be used in a way that saves the enterprise from having to provide its executives with other compensation. Our market, however, changes that calculus for firms in a way that would make them more likely to crack down on illicit insider trading. This is because buyers would be less interested in information that might already be baked into stock market prices through trading and tipping by insiders. Buyers would adjust the prices they would be willing to pay for information based on how well companies police insider trading.

To the uninitiated, our proposal might seem like one of the several arguments calling for the legalization of insider trading itself.[22] But the proposal is for something very different and, as

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19 See, for example, A.C. Pritchard, Stoneridge Investment Partners v. Scientific-Atlanta*: The Political Economy of Securities Class Action Reform*, 2007–2008 Cato S Ct Rev 217, 248–55 (proposing arbitration of certain elements of securities fraud suits).

20 We lay out the background to this argument in Part II.C and present the argument itself in Part III.B.3.

21 Prosecutors also have incentives to ignore this trading. See Part II.C.

22 See generally, for example, Henry G. Manne, *Insider Trading and the Stock Market* (Free Press 1966).

we explain,[23] would in no way violate insider trading law or even trigger the social problems it targets. This statement is supported by the fact that legalizing insider trading would be unlikely to produce any of the key benefits summarized above. Instead, as we explain below,[24] the information market and these benefits are precluded by only a far less prominent administrative rule requiring firms to make disclosures in a simultaneous fashion and a more general regulatory attitude against tiered information revelation.

The remainder of this Article tells our full story. Part I describes the three-pronged legal response to the market failures that are thought to plague the sale of securities: modern securities law with its focus on compelling information sharing in an honest manner without predisclosure trading by insiders.[25] Part II then provides an overview of the core flaws of this area of law, focusing on suboptimal levels of disclosure, overinclusive private fraud actions, and underprosecution of insider trading. Next, Part III sets forth the specifics of our proposal to fix these flaws with our new market-based approach. Lastly, Part IV addresses a number of key objections—namely, ones relating to fairness, supply, demand, outside information production, and insider trading law. This final Part, when viewed along with what precedes it, thus presents a framework for the discussion we hope to spark about the desirability of addressing core shortcomings of modern securities law with a market for the information around which it centers.

## I. THREE MAIN ASPECTS OF MODERN SECURITIES LAW

Three especially notable market failures are said to be present when it comes to buying and selling the securities of public companies. First, left to their own devices, many firms will fall well short of the optimal level of information disclosure about their condition and prospects.[26] Second, even when firms share such information, there is the concern that it will be presented in

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23 See Part IV.A.1 (providing the full version of the points previewed in this paragraph).

24 See Part III.A.

25 Readers familiar with securities law can skip over this brief background Part, beginning instead with Part II.

26 We provide a detailed description of this disclosure underproduction problem in a recent work. See Kevin S. Haeberle and M. Todd Henderson, *Making a Market for Corporate Disclosure*, 35 Yale J Reg 383, 390–93 (2018).

a misleading—if not altogether untruthful—way.[27] Third, firm insiders may trade on company information before making it available to the market, thereby reducing both their incentive to release information in a timely manner[28] and outsiders' incentives to invest in information production of their own.[29]

The legal response to these three problems is the enormous body of law known as modern securities regulation.[30] At least at a general level, this area of law can be boiled down to a mandatory disclosure regime and its two main supports—one that prohibits fraud and another that restricts insider trading. Each, in turn, sets out to remedy the three market failure concerns. In brief, the disclosure regime addresses the information underproduction concern by requiring public companies to generate and release a wide array of information. The anti-fraud rules address the information integrity problem by trying to ensure that disclosures are in fact reliable, and the insider trading rules address the alleged social harm arising out of trading activity by insiders that predates full public disclosure. In this Part, we briefly introduce each of these three main aspects of securities law before critiquing them in Part II and showing how they can be improved by our proposal in Parts III and IV.

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27 See, for example, Dan Cable and Freek Vermeulen, *Stop Paying Executives for Performance*, (Harv Bus Rev, Feb 23, 2016), archived at http://perma.cc/6JQL-RMPU (noting the disconcerting incentives created by aligning management pay with company market performance).

28 See, for example, Frank H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 S Ct Rev 309, 333 (arguing that, if allowed to trade, insiders would hold onto material information for personal gain through quiet trading in the market over prolonged periods rather than sharing it with the public promptly). But see Dennis W. Carlton and Daniel R. Fischel, *The Regulation of Insider Trading*, 35 Stan L Rev 857, 879 (1982) ("[I]nsider trading in some cases may accelerate the speed of disclosure because the ability to profit is dependent on information reaching the market. Thus insiders, if allowed to trade, may have strong incentives to communicate information to the market."); id at 892.

29 See Zohar Goshen and Gideon Parchomovsky, *On Insider Trading, Markets, and "Negative" Property Rights in Information*, 87 Va L Rev 1229, 1257–58 (2001); id at 1261 (stating that "[p]ermitting insiders to trade on inside information will drive analysts out of the market").

30 To many, this response predated the identification of the underlying social problems. See generally, for example, Homer Kripke, *The SEC and Corporate Disclosure: Regulation in Search of a Purpose* (Law & Business 1979). But even if that is the case, the concerns we lay out above form the principal current theoretical justifications for the main parts of securities law.

### A. Securities Disclosure Law

The government has responded to the disclosure underproduction concern with a command-and-control approach that links company access to public markets with coerced disclosure. The mandatory disclosure regime constitutes the foundation of modern securities law.

The mandatory disclosure obligation arose following the stock market crash of 1929. At that time, there was a view that speculation in securities based on incomplete information caused the sudden market drop and, in turn, the argument went, the Depression.[31] The first major piece of modern federal securities regulation, found in the Securities Act of 1933[32] (Securities Act), was therefore a system of mandatory disclosure according to a detailed government recipe. The idea was to reduce informational asymmetries between firms and investors. Since the passage of the Securities Act, firms have been able to sell securities to the public only if they first share vast amounts of information about themselves according to detailed government requirements. The Securities Exchange Act of 1934[33] (Exchange Act) continued this same approach beyond the new-issuance context, imposing the United States' famous ongoing, periodic disclosure regime for public firms.

Over time, a vast complex has been erected on these New Deal–era foundations.[34] Public companies spend many tens of billions of dollars each year producing and disseminating information about themselves in compliance with the law. Today, hundreds of items must be disclosed in registration statements upon the new issuance of shares. In fact, the Securities and Exchange Commission (SEC) regulation known as Regulation S-K that guides companies through the core disclosure process takes up over two hundred pages, and it merely lists what information firms must share with the public.[35] Disclosure doesn't stop there.

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31 See Joel Seligman, *The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance* 14–38 (Houghton Mifflin 1982). But see Milton Friedman and Anna Jacobson Schwartz, *A Monetary History of the United States: 1867–1960* 305–08 (Princeton 1971) ("[The crash's] direct financial effect was confined to the stock market and did not arouse any distrust of banks by their depositors.").

32 48 Stat 74, codified as amended at 15 USC § 77a et seq.

33 48 Stat 881, codified as amended at 15 USC § 78a et seq.

34 See Fox, 109 Colum L Rev at 241–49 (cited in note 7) (discussing the evolution of mandatory disclosure laws in the United States).

35 See SEC, Regulation S-K, 17 CFR § 229.

Public companies must disclose large amounts of information in 10-Qs (quarterly) and 10-Ks (annually). They also are required to share news of certain significant firm events by filing an 8-K within four days of their occurrence.[36]

The resulting disclosure is voluminous. When Facebook went public, it filed a Form S-1 with the SEC that ran nearly three hundred pages, describing in exact detail essentially every aspect of its business operations, results, management, and forecasts.[37] Every year, Facebook discloses many times this amount of information in its ongoing, periodic disclosures. In 2016, for instance, its disclosures ran about eleven hundred normal pages of twelve-point font.[38]

## B. Securities Fraud Law

Anti-fraud law buttresses mandatory disclosure law. The latter compels corporate statements, while the former helps ensure that those statements are credible.

Of course, fraud—or at least "deceit"—has long been outlawed under the common law in all fifty states.[39] But a special place in federal law has been reserved for deceptive statements made in the securities context: § 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.[40] Rule 10b-5 makes most deceptions in securities transactions illegal by outlawing both false statements as well as those that are technically true yet misleading.[41] Related provisions do the same, albeit in a more limited set

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36 See SEC, *Form 8-K* *2, archived at http://perma.cc/WS7R-M75W.

37 See Facebook, Inc, *Form S-1 Registration Statement under the Securities Act of 1933* (SEC, Feb 1, 2012), archived at http://perma.cc/GQC5-ER7S.

38 To estimate this in at least a rough manner, we downloaded each Facebook disclosure on the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) database, cut and pasted it into Microsoft Word, converted the font to Times twelve-point font, and did a page count.

39 See, for example, *Chiarella v United States*, 445 US 222, 227–28 (1980) ("At common law, misrepresentation made for the purpose of inducing reliance upon the false statement is fraudulent.").

40 Section 10(b) is codified at 15 USC § 78j(b), and Rule 10b-5 at 17 CFR § 240.10b-5. Section 10(b) and Rule 10b-5 operate as a set, as the former is not self-executing. More technically, a violation of Rule 10b-5 constitutes a violation of § 10(b).

41 See Rule 10b-5(b), 17 CFR § 240.10b-5(b) (making it illegal "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading").

of circumstances.[42] More generally, the robust, nationwide prohibition on fraud found in these interconnected provisions essentially federalizes the tort of deceit when it is committed in the securities context.[43]

Notably, nothing in § 10(b) or Rule 10b-5 limits their application to required statements. For that reason, corporate speech beyond that which is required is also policed for fraud. Accordingly, the provisions increase the reliability of corporate representations well beyond those made in public filings with the SEC.

In the end, this second main area of modern securities law reduces the extent to which firms and their agents lie and mislead—thereby mitigating the information integrity problem noted at the outset of both this Article and this Part.

## C. Insider Trading Law

The third pillar of modern securities law—insider trading law—is on par with the legal responses embodied in securities disclosure and securities fraud law. But here the approach of the law is less straightforward. In fact, even those who are sympathetic to its ends are often flummoxed by the doctrine.[44]

Aspects of state law have restricted insider trading to some degree since at least the early twentieth century.[45] Specifically, expansive interpretations of the common law of deceit as well as

[42] See § 17(a) of the Securities Act, 15 USC § 77q(a) (making the same basic conduct illegal when it occurs with respect to the "offer or sale of any securities"); § 8(b) of the Securities Act, 15 USC § 77h(b) (targeting securities registration statements that are either "incomplete or inaccurate in any material respect"); § 12(a)(2) of the Securities Act, 15 USC § 77l(a)(2) (outlawing offers and sales of securities made "by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading").

[43] These provisions also target silent deceptions when the alleged fraudster owes the putative victim a duty to speak, yet fails to do so. See, for example, *Chiarella*, 445 US at 230 (noting that "silence in connection with the purchase or sale of securities may operate as a fraud actionable under § 10(b) . . . [b]ut such liability is premised upon a duty to disclose arising from a relationship of trust and confidence"). This exception to the general rule of caveat emptor is relevant to our discussion of insider trading law in the next Section, but not to our discussion of affirmative misrepresentations in this one.

[44] For a comprehensive review of insider trading law, see Stephen M. Bainbridge, *An Overview of Insider Trading Law and Policy: An Introduction to the* Research Handbook on Insider Trading, in Stephen M. Bainbridge, ed, *Research Handbook on Insider Trading* 1–30 (Elgar 2013). For a recent critique of insider trading law's form, see generally Richard A. Epstein, *Returning to Common-Law Principles of Insider Trading after* United States v. Newman, 125 Yale L J 1482 (2016).

[45] For a seminal look at how the common law of deceit was said to restrict insider trading in limited circumstances, see *Strong v Repide*, 213 US 419, 433–35 (1909).

the fiduciary duties at the heart of corporate law have long combined to stop some instances of insider buying from existing shareholders.[46] But even then, this "special facts" doctrine held that the prohibition applied only when there were, well, special facts, such as those involving face-to-face transactions by paradigmatic insiders.[47] Whatever the direction of that law throughout the earlier and middle parts of the twentieth century, it is clear that courts have for some time been reluctant to expand it.[48] One large determinant of this direction has been the existence of federal law on point since the passage of the foundational federal securities acts in the 1930s.[49]

Two federal securities laws that explicitly target insider trading are worth mentioning. The main one merely requires members of a small group of corporate executives at each public company to disclose their trades in company stock and to disgorge any profits they make on relatively quick purchases and then sales (or short sales and later purchases).[50] The other one relates to damages in private suits under the much more relevant federal laws that are interpreted as restrictions on insider trading.[51]

But most insider trading law is judge made. According to long-standing Supreme Court precedent, § 10(b) and Rule 10b-5, which do not mention insider trading, prohibit the fraud that is said to occur in two situations that involve insider trading.

First, under the "classical theory" of insider trading, firm officers and directors who buy or sell stock in their own company on the basis of material, nonpublic information are said to defraud their trading counterparties.[52] The theory is that these "classical insiders" owe a fiduciary duty to existing shareholders.[53] This duty is not one of the three main corporate law duties

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46 See id.

47 See id; *Goodwin v Agassiz*, 186 NE 659, 660–61 (Mass 1933).

48 See, for example, *Freeman v Decio*, 584 F2d 186, 188–96 (7th Cir 1978) (declining to adopt an expansive ruling on the fiduciary duty owed by corporate officers and directors to stock purchasers).

49 See id at 195 (reading the state law restriction narrowly because, among other reasons, "the 10b-5 class action has made substantial advances toward becoming the kind of effective remedy for insider trading that the [New York State] court of appeals [had previously] hoped that it might become").

50 The disclosure obligation is found in § 16(a) of the Exchange Act, and the disgorgement provision in § 16(b). See 15 USC § 78p.

51 See Insider Trading and Securities Fraud Enforcement Act of 1988, Pub L No 100-704, 102 Stat 4677, codified in various sections of Title 15.

52 See *Chiarella*, 445 US at 226–28.

53 See id at 227–28. See also id at 228 (noting that the SEC had previously "recognized a relationship of trust and confidence between the shareholders of a corporation and

relating to obedience, care, and loyalty. Rather, it is a specialized duty to disclose information to counterparties or abstain from trading with them[54] (or tipping others with an eye toward doing the same[55]). And unlike under common law deceit, the duty is owed to even nonexisting shareholders, as an instantaneous fiduciary relationship is said to form upon entering into the transaction with new shareholders.[56] Accordingly, § 10(b) and Rule 10b-5 generally prohibit the top corporate brass (and their tippees) from using the company's material, nonpublic information to profit by purchasing or selling company stock.

Second, under the "misappropriation theory," a firm director, officer, or indeed anyone else inside or outside the firm, is said to engage in fraud when she deceptively trades based on material, nonpublic information in violation of a fiduciary duty *to the source* of that information.[57] Everyone who owes a duty of confidentiality amounting to a fiduciary duty to a firm yet secretly uses the information for trading profits is said to have deceived the firm in a way that constitutes federal securities fraud.[58] This theory thus covers conduct that can also violate the classical theory of insider trading. After all, if the CEO takes company information and uses it with respect to a trade in company stock without the firm's permission, she has likely both violated her "disclose or abstain" duty to counterparties as well as her fiduciary duty to the firm. But the theory also encompasses "insider" trading by *outsiders*.[59] This holds even when the trading at issue is based on information that does not come directly from inside a firm whose stock is being traded. In fact, it can apply when the information is that generated by people or entities with no connection to the firm.[60] All that

those insiders who have obtained confidential information by reason of their position with that corporation"), citing *In re Cady, Roberts & Co*, 40 SEC 907, 911–13 (1961).

54 See *Chiarella*, 445 US at 226–28.

55 See *Dirks v Securities and Exchange Commission*, 463 US 646, 659–60 (1983).

56 See *Chiarella*, 445 US at 227.

57 See *United States v O'Hagan*, 521 US 642, 652 (1997).

58 See id at 665–66.

59 For a seminal article on this issue years before the misappropriation theory was adopted by the federal courts, see Victor Brudney, *Insiders, Outsiders, and Informational Advantages under the Federal Securities Laws*, 93 Harv L Rev 322, 363–67 (1979) ("If a person acquires nonpublic information which he is forbidden by loyalty to his source from disclosing, that prohibition alone should be enough to suggest to him that his information is exclusive, and to subject him to liability for violating the disclose-or-refrain rule.").

60 For an interesting application of this point, see the Stop Trading on Congressional Knowledge Act of 2012 (STOCK Act), Pub L No 112-105, 126 Stat 291 (prohibiting members of Congress from trading on nonpublic information learned through their official roles). See also Jeanne L. Schroeder, *Taking Stock: Insider and Outsider Trading by*

is required is trading-focused misappropriation of information from its source in violation of some fiduciary duty.[61] A lawyer who trades based on confidential information obtained from even a client (including a noncorporate one) can find herself on the wrong side of the law.

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As this Part shows, modern securities law is centered on the famous Depression-era disclosure laws and their progeny, along with two related overlays. These interconnected laws get credible information out of firms and into the hands of investors in a timely fashion. In so doing, they address the perceived market failures we note at the outset of this Part. But as we discuss in the next Part, in their current forms, these three main aspects of securities law are flawed in ways that prevent them from optimally achieving their ends.

## II. FUNDAMENTAL FLAWS OF THE LAW

Each of the three pillars of securities law overviewed above falls significantly short today. As we explain in this Part, the government-run disclosure regime likely results in too much disclosure of some information, while still producing too little of other information. The securities fraud regime also contains a central imperfection: overinclusive private class actions that have strayed far from any reasonable understanding of the victim-compensation and perpetrator-deterrence goals that motivate them. Lastly, whatever might be admired in the substance of insider trading law, the enforcement of that body of law against actual corporate executives is weak, thereby keeping it from achieving its ends.

### A. Overdisclosure, Underdisclosure

Although a mandatory disclosure regime may be a logical enough way to address underproduction incentives for corporate information, government agents are not the main consumers of corporate information and therefore do not have ideal incentives to optimize disclosures. Investors are the intended beneficiaries

*Congress*, 5 Wm & Mary Bus L Rev 159, 165–66 (2014) (detailing the STOCK Act's framework).

61 See *O'Hagan*, 521 US at 652; Brudney, 93 Harv L Rev at 367 (cited in note 59).

of this information, and the government is merely guessing about what information they want. Even when the government is aided through public comment and private dialogue with information consumers, this creates two significant problems. As this Section explains, the disclosure rules and requirements that have amassed since 1933 present obvious overproduction concerns. At the same time, the opposite often is true with respect to other information, as the regime—especially when viewed along with its speech-chilling anti-fraud overlay—does not catch all information of value.

1. The overproduction flaw.

Even if one believes, as we do, that there are instances when compelling disclosure has value for investors or society as a whole, there are several reasons to be concerned that government mandates will call for companies to disclose information when the social benefits of the disclosure are outweighed by its production costs.[62]

Government officials operate subject to various political pressures and outside influences that often favor more information rather than less.[63] They will therefore reap benefits from disclosure that is not of value to shareholders, traders, and society more generally. All the while, these officials do not bear anywhere near the full costs of disclosure requirements, making them more inclined to impose those requirements even when society would not benefit.

These points can be seen by thinking about two of the biggest interest groups with sway at the SEC: lawyers and accountants. Members of each profit tremendously in direct proportion to the volume and complexity of corporate disclosures.[64] Securities lawyers are the ones who prepare corporate disclosures. They are

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62 For a look at disclosure overproduction more generally, see Omri Ben-Shahar and Carl E. Schneider, *More than You Wanted to Know: The Failure of Mandated Disclosure* (Princeton 2014).

63 See notes 68–74 and accompanying text.

64 See Easterbrook and Fischel, 70 Va L Rev at 671–72 (cited in note 2):

> The securities laws may be designed to protect special interests at the expense of investors. . . . Many lawyers are specialized in securities work, and other market professionals depend on the intricacies of the law for much revenue. . . . [They] would suffer windfall losses if existing regulations were repealed. Thus they have every incentive to support the status quo on an interest-group basis.

likewise the ones who file and defend suits when those informational products are defective. Auditing firms also play integral roles with respect to both the provision of disclosure and litigation surrounding the same.[65] Moreover, each group of professionals moves in and out of government.[66] The more that the law they help shape requires firms to generate and share information, the larger the private sector award waiting for them when their tour of duty is complete.[67]

Bureaucrats also face pressure to stray from pure securities-based disclosures into corporate governance and even politics. Corporate governance is traditionally an area of state law dominion. Nevertheless, Congress and the SEC frequently add governance goodies to the basket of disclosure items without clear evidence that state law is insufficient. This is perhaps because new disclosure requirements are salient evidence of regulatory action and easy to justify—how many government officials are against more information?

Further, these federal-level disclosure requirements also generally represent regulation with diffuse costs. One recent example is the Dodd-Frank Act's provision relating to the disclosure of the ratio between the CEO's pay and that of the median worker at the company.[68] This information has obvious political value to those who are dissatisfied with the current distribution of wealth

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65 See Lisa H. Nicholson, *A Hobson's Choice for Securities Lawyers in the Post-Enron Environment: Striking a Balance between the Obligation of Client Loyalty and Market Gatekeeper*, 16 Georgetown J Legal Ethics 91, 100–01 (2002):

> In fact, several SEC commissioners have individually, and the SEC has collectively, remarked from time to time that the SEC would be unable to administer the federal securities laws effectively without the assistance of market professionals such as lawyers, accountants and underwriters, whose integrity and competence serve to protect the investing public.

66 See *Highlights of GAO-11-654, Securities and Exchange Commission: Existing Post-Employment Controls Could Be Further Strengthened* (Government Accountability Office, July 2011), archived at http://perma.cc/6RZX-QXHU.

67 For an interesting empirical study on this point, see Ed deHaan, et al, *The Revolving Door and the SEC's Enforcement Outcomes: Initial Evidence from Civil Litigation*, 60 J Accounting & Econ 65, 91 (2015).

68 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub L No 111-203, 124 Stat 1376 (2010), codified at 12 USC § 5301 et seq.

in society,[69] yet no financial value to firms and investors.[70] In fact, the information might be of negative value to them, for example by restricting them from attracting the best talent to take the helm.[71]

The problem can even be seen with the base of the mandatory disclosure regime itself. Professors Paul Mahoney, George Benston, and others have argued that the passage of the Securities Act and the Exchange Act did not provide shareholders of any firm with information they valued as shareholders at a level higher than the costs its generation and sharing imposed on the company—and therefore themselves.[72] Even if they were wrong about the 1930s, their arguments are likely much more powerful today with respect to a number of specific disclosure items—especially given the massive expansion of private securities fraud suits[73] and its implications for the cost of additional statements.[74] For example, it is estimated that post–Financial Crisis rules requiring the disclosure of "conflict minerals" in firms' supply chains have imposed $700 million in added disclosure work each year.[75] Few, if any, believe in the existence of investor benefits from this requirement that offset these costs. Even

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69 For a news article reporting on the first set of public-company disclosures made pursuant to this new disclosure requirement and demonstrating the political power of this information, see Theo Francis and Vanessa Fuhrmans, *In a First, US Firms Reveal Workers' Pay Gap with CEO*, Wall St J A1 (Mar 12, 2018).

70 For a critique of the financial value of a Dodd-Frank Act disclosure requirement of the same vintage, see Jeff Schwartz, *The Conflict Minerals Experiment*, 6 Harv Bus L Rev 129, 158–61 (2016).

71 For the CEO perspective on these rules, see *The Materiality Standard for Public Company Disclosure: Maintain What Works* *9–10 (Business Roundtable, Oct 2015), archived at http://perma.cc/8R3R-68HV (asserting that the CEO pay ratio rule fails to convey material information to investors while also harming firms).

72 See Paul G. Mahoney, *Wasting a Crisis: Why Securities Regulation Fails* 77–99 (Chicago 2015) (discussing how the Exchange Act did not improve disclosure practices, especially compared to the New York Stock Exchange's disclosure standards); George J. Benston, *Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934*, 63 Am Econ Rev 132, 153 (1973) (concluding that "the disclosure requirements of the Securities Exchange Act of 1934 had no measurable positive effect on the securities traded on the [New York Stock Exchange]," that "[t]here appears to have been little basis for the legislation and no evidence that it was needed or desirable," and that "there is doubt that more required disclosure is warranted").

73 See Part II.B (explaining the fraud-on-the-market expansion to securities fraud law).

74 See Part II.A.2 (discussing the connection between these suits and disclosure underproduction).

75 The Dodd-Frank Act added § 13(p) to the Exchange Act of 1934, requiring the SEC to issue rules mandating disclosure of the presence or absence of some "conflict minerals" in their supply chains. See Dodd-Frank Act § 1502, 124 Stat at 2213–18. At the time of its

when factoring in the larger social benefits of public outing of this information, most commentators are likewise dubious of the welfare outcome.[76] And even assuming it is in society's interest to know more about blood diamonds, we see no reason why the interest should be bundled into securities law disclosures as opposed to disclosures compelled by Congress or an agency other than the one whose mission is to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[77]

2. The underproduction flaw.

The mandatory disclosure regime is also likely underinclusive at the same time, leaving the failure of market forces to produce enough corporate disclosure underaddressed in many instances.[78]

At the most basic level, it is doubtful that the government is able to identify and compel all of the information production that users (and potential users) of corporate information would find valuable beyond its cost of production. This conclusion should come as little surprise. We wouldn't think a government ministry of the internet would be able to accurately predict consumer demand for social media application features, so why would the SEC do better with respect to demand for corporate information? The room for miscalculation is simply too great, at least with respect to the demand for company information. This is especially true because there is significant heterogeneity of preferences across investors for a bureaucratic agency to satisfy investor demand optimally—let alone the demand of a broader range of information consumers. This remains true as a general matter even if interaction between regulators and information consumers reduces some degree of the problem.

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adoption, the SEC estimated that this rule would cost $3 billion to $4 billion when implemented, and then $207 million to $609 million each year thereafter. SEC, Conflict Minerals Final Rule, 77 Fed Reg 56274, 56334 (2012), codified at 17 CFR §§ 240, 249b. One report estimated that compliance with the requirement would actually cost US investors over $700 million per year. See Chris N. Bayer, *Dodd-Frank Section 1502: Post-Filing Survey 2014* *26 (Payson Center for International Development), archived at http://perma.cc/SC2Z-UDEV.

[76] See, for example, Schwartz, 6 Harv Bus L Rev at 158–61 (cited in note 70); Lauren Wolfe, *How Dodd-Frank Is Failing Congo* (Foreign Policy, Feb 2, 2015), archived at http://perma.cc/UY8K-YENL (reporting that, according to critics of the rule, "the conflict minerals movement has yet to lead to meaningful improvement on the ground, and has had a number of unintended and damaging consequences").

[77] *What We Do* (SEC, June 10, 2013), archived at http://perma.cc/ZNR5-8LCX.

[78] In our recent work, we provided an in-depth look at this disclosure underproduction problem. See generally Haeberle and Henderson, 35 Yale J Reg 383 (cited in note 26).

On this note, the problems of bureaucracies and public-choice economics also frustrate the command-and-control approach to disclosure in a way that matters for the underproduction concern.[79] Whether to satisfy political masters or because of regulatory capture, the SEC may resist requiring disclosure of things investors care about, or simply underestimate the benefits of certain disclosures. While the SEC is tasked with serving the public interest, it may deviate from that goal for a number of other well-known reasons. For example, the best and the brightest will not always run and staff the agency.[80] Government agents may have incentives to work on projects that receive the most attention in the news rather than the ones that serve the public interest.[81] All the while, the forces of competition that might otherwise keep the agency from losing touch with information demands are not present. For example, instead of spending time optimizing the type of information that investors demand, the SEC may focus on topics that garner more headlines, such as corporate governance goodies, illicit trading by rich people, or political contributions by firms.[82]

The same principles apply with respect to the broader audience of individuals and entities that value information about public companies. Other types of investors and a large universe of noninvestors who consume corporate information may not be best served by disclosure laws set forth by a government agency with the investor-protection, market-efficiency, and capital-formation mission recited above as opposed to their broader needs. The government officials determining what firms must disclose would need to be dialed in to the optimal level that encompasses not just the well-being of investors, but that of these groups as well. And significantly, they would also have to weigh the tradeoffs among the various groups when their demands are in conflict or point in opposite directions. The officials promulgating the relevant rules would presumably need to hold more power than what Congress

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79 See notes 64–67 and accompanying text.

80 For a critique of SEC competence in certain matters, see generally Robert J. Rhee, *The Madoff Scandal, Market Regulatory Failure, and the Business Education of Lawyers*, 35 J Corp L 363 (2009).

81 See James D. Cox, Randall S. Thomas, and Dana Kiku, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 Duke L J 737, 777–78 (2003) (discussing evidence suggesting that the SEC may prefer prosecuting weak opponents to maximize its chances of winning suits—in contrast to its stated practice of focusing on cases with significant investor losses).

82 See text accompanying notes 75–77.

has delegated to the SEC with respect to securities-focused disclosure.[83]

Lastly, and crucially, the fundamental flaws of the current anti-fraud regime supply an additional antidisclosure force. We discuss those flaws in detail in the next Section. But it is worth noting the intersection of these two regimes at this point. The cost of the disclosure integrity provided by the anti-fraud regime[84] comes in the form of considerable legal risk imposed on information revelation.[85] Additional statements mean additional exposure to lawsuits based on the allegation that those statements are false or misleading.[86] If these suits were costless and perfect at targeting actual fraud, this would not deter valuable disclosure. But no educated commentator believes the system is either of these things. Quite the contrary, these lawsuits are notoriously expensive to defend, thus opening up corporate speakers to strike

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83 The main delegation of rulemaking authority with respect to disclosure for already public firms is found in § 13 of the Exchange Act, codified at 15 USC § 78m. Although its language is quite broad, the preamble to § 13(a) states that whatever disclosure the SEC prescribes under the section must be "necessary or appropriate for the proper protection of investors and to insure fair dealing in the security."

84 See Part I.B.

85 See Edmund W. Kitch, *The Theory and Practice of Securities Disclosure*, 61 Brooklyn L Rev 763, 770–72 (1995):

> [T]he securities laws themselves reduce the amount of information that is provided by issuers because they impose significant liability for the production of misinformation. . . . This strategy of requiring that information be produced to a "gold standard" is at the heart of the disclosure program as it is traditionally understood. The insight, so accepted in the free speech area, that high standards of liability for the production of erroneous information will, as one of its effects, reduce the production of any information, is unacknowledged in the securities area. But unacknowledged or not, the liability structure of the securities laws reduces the production of information.

See also id at 840–41:

> One way for issuers to respond to this [litigation] risk is to reduce the number of statements they make, and the definiteness of those they do make. Issuers are likely to respond in this way as their ability to predict whether any given statement will lead to litigation or liability decreases. Their difficulty in prediction may result from their own inability to determine whether the statement is misleading or incomplete, their inability to predict when litigation will occur, or their inability to predict the outcome of litigation when it does occur. Saying less means litigating less and being held liable less often. Liability is a cost of the activity of making statements, and will reduce the level of that activity.

86 Id at 840–41.

suits.[87] Even a truthful statement may be worth a sizeable settlement if the company can settle for less than the costs of fighting.[88] Given the large error costs with respect to the ultimate outcome of each stage of these suits (including the stage when the jury reads the verdict), that risk hangs like a dark cloud over a firm, thereby increasing the expected costs of disclosure. That securities fraud cases often turn on the meaning of complex corporate statements targeted at specialized audiences only increases this risk (and those costs) given that the statements will be evaluated by judges and jurors.

This final point on the impact of securities fraud law on the disclosure underproduction concern is underscored by the realities of practice today. Wall Street lawyers frequently advise corporate clients that the best legal strategy is to disclose only what is mandated by law, as there is often legal uncertainty regarding what statements can be pursued as misleading under securities fraud law and little upside for the company itself from disclosing more than that which is required.[89] Commentators have echoed

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[87] See A. C. Pritchard, Stoneridge Investment Partners v. Scientific-Atlanta*: The Political Economy of Securities Class Action Reform*, 2007–2008 Cato S Ct Rev at 227 (cited in note 19) (noting that "[the] possibility of extracting multimillion dollar settlements from strike suits has driven post-*Basic* efforts to rein in securities class actions"). See also Hillary A. Sale, *Heightened Pleading and Discovery Stays: An Analysis of the Effect of the PSLRA's Internal-Information Standard on '33 and '34 Act Claims*, 76 Wash U L Q 537, 552–54 (1998) (describing pre–Private Securities Litigation Reform Act practices cited by proponents of that Act).

[88] The Private Securities Litigation Reform Act of 1995 (PSLRA), Pub L No 104-67, 109 Stat 737, codified in various sections of Title 15, is evidence Congress believed the system created these troubling settlement incentives. For a discussion of these problems and the impact of the PSLRA, see generally Stephen J. Choi and Robert B. Thompson, *Securities Litigation and Its Lawyers: Changes during the First Decade after the PSLRA*, 106 Colum L Rev 1489 (2006); James D. Cox, Randall S. Thomas, and Dana Kiku, *Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 Colum L Rev 1587 (2006).

[89] See, for example, *Practical Guidance for Living with Regulation FD* (WilmerHale, Sept 1, 2000), archived at http://perma.cc/2A7S-JESW:

> Follow a "no comment" policy which prohibits the company from responding to inquiries or commenting upon rumors concerning prospective developments or transactions, such as acquisitions. Adherence to this policy requires that the company respond with a statement to the effect that it is the company's policy not to comment upon or respond to such inquiry or rumor. A statement that the company does not know of any basis for such a rumor, or is not aware of any pending transaction, is not consistent with this policy and, if inaccurate, could subject the company to liability.

this view, noting the perverse disclosure incentives to which it leads.[90]

For the corporate agents who retain counsel on behalf of the firm, the personal cost-benefit ratio is often even worse than the firm-level one that leads to this sheepish disclosure advice and the accompanying "neither confirm nor deny" corporate approach. There is thus a widely held view among the securities bar that many mandatory disclosure requirements designed to be floors become ceilings. A leading commentator has summed up these disconcerting realities, essentially describing the securities laws centered on the disclosure regime as antidisclosure laws.[91]

## B. Overinclusive Fraud Class Actions

The flaw of the securities fraud law regime arises due to problems with its implied private enforcement mechanism under § 10(b) and Rule 10b-5. For decades, that mechanism has allowed misstatement suits with class sizes that have ballooned in a manner that makes them susceptible to critique. To some, they present an altogether negative cost-benefit picture.[92] But even those who think the current system is justified on a cost-benefit basis nevertheless recognize that there are almost surely more efficient ways of achieving the benefits.[93] In fact, it is almost universally thought that these suits can be tailored in a way that

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[90] See, for example, Donald C. Langevoort, *From* Texas Gulf Sulphur *to* Chiarella*: A Tale of Two Duties* (CLS Blue Sky Blog, Jan 8, 2018), archived at http://perma.cc/QJ6A-WFKV:

> The law of corporate disclosure promptly went adrift [after the Second Circuit's decision in *SEC v Texas Gulf Sulphur*, 401 F2d 833 (2d Cir 1968) (en banc)], making concealment cases turn on silly distinctions so that true silence about even the most material facts is rewarded with legal absolution, while saying a bit too much about the subject triggers large potential liability.

See also Kitch, 61 Brooklyn L Rev at 770–72 (cited in note 85).

[91] See Paul G. Mahoney, *The Exchange as Regulator*, 83 Va L Rev 1453, 1467 (1997) ("In general, there is substantial evidence that the mandatory disclosure system does not produce information."). See also Mahoney, *Wasting a Crisis* at 38 (cited in note 72) ("[A]lthough described as a 'full disclosure' statute, the Securities Act as initially enacted was at least as much a secrecy statute.").

[92] See Joseph A. Grundfest, *Damages and Reliance under Section 10(b) of the Exchange Act*, 69 Bus Law 307, 309 (2014) (stating that securities fraud class action litigation has generated "significant controversy" and that "[c]ritics respond that these same lawsuits fail to promote either deterrence or compensation, and that they impose costs in excess of benefits").

[93] See, for example, Merritt B. Fox, *Why Civil Liability for Disclosure Violations When Issuers Do Not Trade?*, 2009 Wisc L Rev 297, 320–21 (describing a proposed "transformation" of the civil liability imposed on issuers that would eliminate overenforcement).

would present much more bang for their buck. And the issue of how to address this flaw has thus been one of the most prominent issues in the field for some time now—if not the most prominent altogether.[94]

The problem is rooted in the federal court approach to reliance in these suits. Reliance is a core element of a traditional common law claim targeting a deceitful representation: for one to be liable for using a false or misleading statement to induce another into some detrimental action, the latter must have relied on the former's statement.[95] But for decades now, federal courts have held that actual reliance on the federal, securities-specific version of those common law claims embodied in § 10(b) and Rule 10b-5 need not be pleaded in the complaint or proven at trial. Instead, all plaintiffs receive a presumption of reliance, so long as they can show that the security they purchased[96] traded in an informationally efficient market.[97] In this type of market, material statements—by definition—move market prices, meaning that false or misleading ones will generally distort the price.[98] The presumption is thus referred to as the fraud-on-the-market presumption (the "FOTM presumption"), as it is the misrepresentation's impact on the market price that is held front and center. It is this presumption (specifically, the floodgates it opens for market participants to join a plaintiff class) that results in these securities fraud suits having a far lower benefit-to-cost ratio than they otherwise might.

94 See text accompanying notes 162–64.

95 See *List v Fashion Park, Inc*, 340 F2d 457, 462 (2d Cir 1965) ("[T]he test of 'reliance' is whether 'the misrepresentation is a substantial factor in determining the course of conduct which results in [the recipient's] loss.'"), quoting Restatement (First) of Torts § 546 (1938).

96 For ease of exposition, and consistent with the vast majority of real-world public-company misstatement cases, we use only examples involving purchases that take place after a material misrepresentation has been made. Consequently, only those who *purchased* securities will be considered in the text even though many cases center on negative misrepresentations and sellers.

97 The Supreme Court endorsed this thinking in *Basic Inc v Levinson*, which held that plaintiffs in these suits did not have to show individual reliance on alleged misrepresentations in order to proceed under the anti-fraud laws and instead were entitled to the presumption that they had satisfied the reliance requirement. 485 US 224, 245–47 (1988). See also *Halliburton Co v Erica P. John Fund, Inc*, 134 S Ct 2398, 2414 (2014).

98 See *Basic*, 485 US at 249–50 (adopting the *TSC Industries, Inc v Northway, Inc*, 425 US 438 (1976), standard in the Section 10(b) context and holding that a fact is material if a reasonable investor would consider it important in deciding whether to buy or sell).

To see why, think about the two main benefits of private securities fraud suits: victim compensation and perpetrator deterrence.[99] With respect to the former, it is thought that without the presumption of reliance there is not enough commonality among the plaintiffs to allow for aggregation under Rule 23 of the Federal Rules of Civil Procedure. The inquiry into whether or not any given plaintiff actually relied on the misstatement is too individualistic.[100] The class action vehicle is thus unavailable in these suits so long as actual reliance is required.[101] But when reliance is not required thanks to the FOTM presumption, the class action vehicle is available to aggregate claims that would be too small to bring individually.

This judicial creation no doubt helps real victims receive real compensation for real losses caused by real fraud. Critically, it facilitates viable suits for investors who actually relied on corporate misstatements in making their purchasing decisions.

But a natural consequence of this doctrine is that once a lead plaintiff shows that the security traded in an efficient market, *any* investor who bought at the inflated market price can join the class of aggrieved individuals. And much of the universe of the investing community that buys stock during any substantial period does so for reasons that have nothing to do to with the false or misleading statement at issue. Instead, they are buying based on other information—or for extra-informational purposes altogether (such as mere portfolio accumulation or diversification reasons[102]). For that reason, nothing about the statement or price caused them to enter into the transaction; they would have bought even if the misstatement had never been made—and even if the price were far higher. But to the extent they have bought at an inflated price after a corporate misstatement, they too can join the class.

To be sure, in this situation, portfolio investors who purchased the stock would have paid more for it as a result of the

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99 See Christopher R. Leslie, Comment, *Den of Inequity: The Case for Equitable Doctrines in Rule 10b-5 Cases*, 81 Cal L Rev 1587, 1613 (1993) (noting the two main goals of these actions).

100 See *Basic*, 485 US at 230 (recognizing that "without the presumption it would be impractical to certify a class under Federal Rule of Civil Procedure 23(b)(3)"); id at 242 ("Requiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented respondents from proceeding with a class action, since individual issues then would have overwhelmed the common ones.").

101 See id at 242.

102 See note 14 and accompanying text.

misstatement and its impact on the stock's market price. But ex ante, these "fraud victims" were just as likely to sell stock of companies with misrepresentation-based inflated prices during the inflationary window as they were to buy it. And no law requires them to disgorge their gains based on sales at inflated prices. Consequently, from a trading perspective for these investors, so long as the company and its insiders are not selling in the market based on their knowledge of the misrepresentation, the prospect of a misrepresentation that inflates price is just as likely to be good as bad. Yet the FOTM presumption allows the investors into the private-damages litigation every time they purchase a stock at a price that is inflated by a corporate misrepresentation. It follows that allowing legions of traders from these ranks to join a plaintiff class in this manner leads to overcompensation.[103]

These overcompensating securities fraud class actions are not free. In fact, the hefty resources they suck up are well documented.[104] Mostly, these scarce resources end up being drained from firm coffers in the form of lost opportunities due to management and employee distraction, legal fees, and the settlement amount itself.[105] Still more comes at the expense of the judicial system, including the opportunity costs of everyone from judges to stenographers. As welcome as fees might be to lawyers and the legislators they support, these fees eat up significant social resources relative to whatever gain they provide to actual victims of securities fraud.[106]

For these reasons, at least from a victim compensation perspective, there has been practically universal resistance to FOTM suits.[107] That conclusion holds even if the suits do serve an important compensatory function with respect to one group

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103 Since 1996, over thirty-five thousand defendants have been sued, with the settlements totaling over $95 billion. See Securities Class Action Clearinghouse, *Box Scores or Key Statistics from 1996 to YTD* (Stanford Law School), archived at http://perma.cc/E9AS-M5JL.

104 See id.

105 Even plaintiff-side legal fees are generally borne by the firm, whether directly as part of the settlement costs or indirectly in the form of an increased cost of capital attributable to discounting of company value in the market.

106 One particular cost of this overinclusiveness bears special mention: disclosure underproduction. With larger class actions, there are larger damages on the line—thereby exacerbating the problem of excessive secrecy among corporate executives. See Part II.A.2.

107 See, for example, *Interim Report of the Committee on Capital Markets Regulation* *79, (Nov 30, 2006), archived at http://perma.cc/Y23F-MD8H ("[C]ontemporary securities class action litigation is still suffering from a problem of circularity. [Securities class action] recovery is largely paid by diversified shareholders to diversified shareholders and thus represents a pocket shifting wealth transfer that compensates no one in any meaningful sense and incurs substantial wasteful transaction costs in the process.").

of investors (that composed of information-based traders who actually relied on the misrepresentation, but who would not have had an economically viable path toward recovery absent the FOTM presumption).

Still, all of these costs may be worth spending if they result in other social benefits in addition to whatever victim compensation ones they provide. But there is only one other main aim of the suits to consider—deterrence[108]—and here too the story isn't pretty.

On this front, securities fraud law aims to limit fraud to its optimal level: spending an additional dollar on the deterrence of misrepresentations only when the corresponding social gain from the reduction in misrepresentations is worth at least the same amount. There are considerable social benefits to having fraud suits. Not least among them is that the suits make disclosures credible and thus improve capital allocation and corporate governance.[109] We, like all other securities law scholars we know, are in favor of strict anti-fraud rules.

But here too the size of the typical plaintiff class, rooted in the FOTM presumption, creates damages from fraud that no doubt dwarf the deterrence gains it generates.[110] To see just how out of whack these class sizes are with their deterrence function, it is important to remember that disclosure decisions are made by individuals (not firms) and that these individuals' incentives are what the law is trying to change through the fraud suits. For example, imagine that the CEO and other insiders lied to inflate the company's market value and that they actually did so not just to inflate the stock price, but also to earn trading profits by selling stock for gains of $20 million before the truth is revealed weeks

108 See Leslie, Comment, 81 Cal L Rev at 1613 (cited in note 99) ("Deterrence prevents fraud and is thus the primary goal of Rule 10b-5 and other securities fraud laws. When deterrence fails, the focus shifts to compensating victims and disgorging ill-gotten gains from wrongdoers.").

109 See notes 6–7.

110 See Pritchard, 2007–2008 Cato S Ct Rev at 223–25 (cited in note 19) (describing how the measure of damages typically used in such cases "exaggerates the social harm" caused by the fraud); A.C. Pritchard, *Markets as Monitors: A Proposal to Replace Class Actions with Exchanges as Securities Fraud Enforcers*, 85 Va L Rev 925, 947 (1999) (arguing that, because the law favors compensation over deterrence, "securities class actions are an expensive way to reduce the social costs of fraud on the market"); Fox, 109 Colum L Rev at 246–48 (cited in note 7) ("The rise of the fraud-on-the-market class action [ ] created strong new incentives for an issuer to comply with its periodic disclosure obligations. . . . There is a widespread feeling, however, that the incentives come at great social expense.").

or even months later. Putting aside other benefits and costs (namely, whatever indirect benefits the executives would receive from the higher stock price and indirect costs they would incur from the revelation of the truth), if the probability of detection is 50 percent, then, even if we assumed risk neutrality on behalf of the insiders, they as a group would be deterred by personal damages of only $40 million plus a dollar. Those damages alone would result in negative expected gains from their planned conduct. Yet under these facts, a 10b-5 class action could easily generate hundreds of millions of dollars in damages or more as traders purchased and sold the stock in the market during the inflationary period.[111]

Ultimately, these types of potential damages offer questionable marginal returns in terms of deterrence. The threat of an additional $200 million in damages and litigation costs for a medium-sized public company would likely do little more to deter fraud than the threat of the initial $100 million. This conclusion is bolstered by thinking about the career implications of sanctions for executives and the fact that the truth can generally be suppressed for only so long before the day of corporate reckoning. The benefit-to-cost ratio relating to additional millions or even tens of millions in damages generated by the FOTM presumption is therefore likely quite low. The same principles apply—albeit with different numbers—to smaller and larger firms that typically have, respectively, smaller and larger trading volume and market capitalizations.

Stepping back, the almost universal view that these suits could be tailored to produce a far higher benefit-to-cost ratio is easy enough to see. That statement holds even when that ratio takes into consideration FOTM suits' victim-compensation benefits, which, as explained above, are limited in scope and come with all of the aforementioned costs.

111 See note 119 and accompanying text.

### C. Underprosecution of Illegal Trading and Tipping by Executives

Lastly, the restriction on insider trading is thought to be suboptimally enforced. In fact, there is evidence that illegal trading and tipping by those with informational advantages based on their position inside public companies remains rampant.[112]

Either of the two main bars on insider trading could be used to stop corporate management and directors from trading (and tipping) in their own firm's stock based on material, nonpublic information.[113] However, consistent with this story of widespread trading by actual corporate insiders, classical insider trading appears to have taken a back seat to misappropriation insider trading, with the lion's share of the government's efforts at cracking down on improper trading appearing to fall on outsiders at hedge funds who misappropriate information from any one of a variety of sources.[114] To the extent that focus has in fact shifted in this way, there may be much room for illegal trading by actual corporate insiders.[115]

There's a troubling political economy embodied in this approach of, on the one hand, allowing America's corporate executives more breathing room while, on the other, targeting hedge-fund managers and the henchmen those investors deploy to do their dirty work. The most prominent debate in the corporate governance arena today is whether the investment activity of activist hedge funds disrupts the execution of long-term corporate strategies or whether this activity actually improves corporate perfor-

112 See, for example, M. Todd Henderson, *Insider Trading and CEO Pay*, 64 Vand L Rev 505, 541–42 (2011) (showing large and significant abnormal returns for insiders using so-called Rule 10b5-1 trading plans); Alma Cohen, Robert J. Jackson Jr, and Joshua R. Mitts, *The 8-K Trading Gap* *30–31 (Columbia Center for Law and Economic Studies Working Paper No 524, Sept 7, 2015), archived at http://perma.cc/7GE7-UJPM (demonstrating the existence of increased trading by corporate executives in the days *before* their firms release 8-K disclosures on significant firm events, with buying (selling) far more often than not coming before the good (bad) news).

113 See Part I.C.

114 See M. Todd Henderson, *The Changing Demand for Insider Trading Regulation*, in Bainbridge, ed, *Research Handbook* 230, 242–44 (cited in note 44) (noting the move from classical insider trading to the misappropriation theory and an increase in prosecutions of outsiders, such as hedge funds, over the past several decades).

115 See Henderson, 64 Vand L Rev at 526–37 (cited in note 112) (examining empirical evidence suggesting a connection between the lack of insider trading prosecution and trading by true insiders).

mance by reining in massive agency costs associated with the separation of ownership and control in public companies.[116] You can guess where corporate executives come down on this issue.[117] And although hedge funds have a good deal of campaign finance power beyond even select New York and California congressional districts,[118] the political influence and resources of the types of funds usually targeted by the government pale in comparison to those of America's CEOs, who stand at the helms of ships that together make up a $32 trillion armada.[119] Although there is some intersection between fund and executive control of the fleet, it is clear that America's top executives wield wealth and power that is enormous relative to even that in the hands of hedge fund managers.[120] Accordingly, when we see strong insider trading enforcement under the misappropriation theory against fund managers by the executive branch yet indications of weak enforcement against C-suite executives, we further worry about suboptimal levels of enforcement, at least with respect to the latter.

Further, there are other forces at play behind this apparently lax effort to crack down on executives trading on nonpublic information. Even though they are disproportionately registered in a select few jurisdictions and trading on exchanges associated with similarly circumscribed geographical areas, America's public

116 Compare Stephen M. Bainbridge, *Preserving Director Primacy by Managing Shareholder Interventions* *11–14 (UCLA Law-Econ Research Paper No 13-09, Aug 27, 2013), archived at http://perma.cc/Z8XM-3Y58 (discussing various studies on the topic and noting that "one ought to be especially dubious of hedge fund interventions . . . aimed at changing corporate business strategy"), with Lucian A. Bebchuk, Alon Brav, and Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 Colum L Rev 1085, 1117–20 (2015) (finding that the claim that "activist interventions are followed by declines in long-term operating performance" is "not supported by the data").

117 For notable articles supporting their view in addition to Bainbridge, cited in note 116, see generally K.J. Martijn Cremers, Saura Masconale, and Simone M. Sepe, *Commitment and Entrenchment in Corporate Governance*, 110 Nw U L Rev 727 (2016); Leo E. Strine Jr, *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 116 Yale L J 1870 (2017); Martin Lipton and Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U Chi L Rev 187 (1991).

118 For more detail on campaign contributions by the hedge fund industry, see Center for Responsive Politics, *Hedge Funds* (OpenSecrets.org, Mar 12, 2018), archived at http://perma.cc/4UFC-WT9V.

119 Public companies in the United States are now worth an aggregate of more than $32 trillion. See *Market Capitalization of Listed Domestic Companies (Current US$)* (World Bank, 2017), archived at http://perma.cc/5R87-5GAQ.

120 See Henderson, *The Changing Demand for Insider Trading Regulation* at 234–36 (cited in note 114) (noting the change in prosecution and describing the political economy of the interplay among traders, CEOs, and the SEC).

companies have headquarters dispersed throughout the country. Federal prosecutors in most jurisdictions may be reluctant to bring criminal charges against the directors and officers of the large employers and philanthropists headquartered in their jurisdictions. To go after them for trading on not-yet-public information may be bad for the automobile plant, let alone the local opera house.

Even if they had the will, federal prosecutors and the SEC Division of Enforcement attorneys located in New York, Washington, or anywhere else in the country face an uphill battle in policing classical insider trading on their own given the large number of public firms dispersed throughout the nation—each of which generally has at least one or two dozen top insiders.[121] The government has limited resources with which to police the vast amounts of trading and tipping by tens of thousands of insiders. Consistent with this story, the SEC has brought only about fifty insider trading cases per year for over a decade[122] despite the earlier-cited evidence about the scope of illegal insider trading today.[123] The result is to leave the primary role in prosecuting insider trading to the Department of Justice (DOJ). Because this means the suits will be criminal, not civil, a higher burden of proof will apply to the prosecutions, dictating that cases will be harder to win—which of course has an effect on charging decisions in the first place. It also means that those with a more general focus than just securities law will often be making those decisions and presenting those cases, even if federal prosecutors in New York and select other jurisdictions have many securities-focused lawyers.

Ultimately, then, the existing insider trading regime, enforced by members of an elected branch of government who may in many instances be unwilling and/or unable to curb this activity that is said to be so socially harmful, reveals the strong possibility that illegal trading and tipping by insiders are significantly underprosecuted. Knowing that insider trading often gives rise to supernormal profits for executives and that they face a low likelihood of actually getting their mug shots taken, trading by these insiders may remain as rampant as the evidence we cite suggests.

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121 For a sense of the aggregate number of corporate board seats at these companies, see *2016 Spencer Stuart Board Index* *14 (Spencer Stuart, 2016), archived at http://perma.cc/9NMM-NUQN.

122 See *Year-by-Year SEC Enforcement Statistics* (SEC), archived at http://perma.cc/M3SP-8TJG.

123 See note 112.

That it is these corporate agents themselves who have much power over the extent to which their principal (the firm) will monitor and report illegal trading by them should underscore the concern. That a light-touch approach at the enterprise level allows shareholders to pay their executives less compensation out of the company coffers should do the same.[124]

* * *

This Part presents our version of a well-known story revolving around established facts. Although perhaps an improvement over the status quo ante, the mandatory disclosure regime rooted in the major New Deal–era securities acts is unlikely to have landed on the optimal level of public-company information production and sharing. In sum, that regime introduces an overproduction problem while at the same time leaving much to be desired when it comes to addressing the original underproduction one. Moreover, one of the two main overlays on the disclosure regime (securities fraud law) facilitates private class actions with benefit-to-cost ratios that are almost surely far lower than they could be while also exacerbating the disclosure underproduction concern. Likewise, an apparent disconcerting lack of enforcement against a key group of insider trading perpetrators (actual corporate insiders) with respect to the other main legal overlay (insider trading law) keeps that effort from attaining its goals. The three main aspects of modern securities law, along with their key flaws, should now be apparent.

## III. Fixing the Flaws with a New Market-Based Approach

In this penultimate Part, we set forth the specifics of our market-based approach to securities law. In a way, our proposal is relatively small: we call only for the amendment of an SEC rule relating to the precise timing and manner of information releases by firms, and a more general attitude change among regulators regarding the same. The rule, Regulation Fair Disclosure ("Reg FD"), requires the simultaneous release of material public-company information when it is first revealed beyond the firm, and the accompanying regulatory mood is one that strongly encourages a more general adherence to a simultaneous-disclosure standard.[125] Changing this rule (in admittedly core ways) and the

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124 See notes 7 and 28 and accompanying text.

125 See notes 127–31 and accompanying text.

related regulatory attitudes would allow a well-regulated market for early access to public-company information to arise. The impact of this information market could be profound—specifically, it could ameliorate each of the fundamental flaws of modern securities law discussed in Part II. We explain why in detail below, focusing on these benefits before turning to consider reasonable objections to this approach in Part IV. Thus, this Part lays out the main benefits of our new market-based approach to securities law, while the final one then considers whether that approach would in fact further the law's attempt to improve social welfare through securities regulation.

## A. The Approach

Our basic idea has two pillars: first, permit companies to release new-to-market information to information consumers at different times; and second, permit those companies to charge those consumers in return for the earlier releases.

Enabling these interconnected changes requires an amendment to Reg FD. Promulgated in 2000, that SEC regulation requires public companies that are disclosing any material information to the market to make the information available to all potential investors at the same exact time.[126] This simultaneous-dissemination requirement applies to the disclosure of all material corporate information—whether or not that disclosure was compelled by law in the first place. For these reasons, firms must make everything from a mandated formal quarterly 10-Q report with earnings information, on the one hand, to a voluntary press release on the CEO's health considered to be material (which may or may not be required by the law), on the other, available to all members of the public at the exact same time.

Reg FD is designed to increase fairness for ordinary long-term investors—and to address closely related concerns for those investors' confidence in the market.[127] In the days before Reg FD

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[126] See 17 CFR § 243.100(a) ("Whenever . . . [a public firm] discloses any material nonpublic information regarding [itself] or its securities . . . [it] shall make public disclosure of that information . . . [s]imultaneously."); SEC, *Selective Disclosure and Insider Trading*, 65 Fed Reg 51716, 51719 (2000) ("As a whole, the regulation requires that when an issuer makes an intentional disclosure of material nonpublic information . . . it must do so in a manner that provides general public disclosure, rather than through a selective disclosure.").

[127] See SEC, *Selective Disclosure and Insider Trading*, 64 Fed Reg 72590, 72592 (1999) (stating that the main goal of Reg FD is to help increase "fundamental fairness to all investors").

was implemented, the Commission thought it was unfair that firms handed out valuable information through backchannels to securities analysts before making that information available to everyday investors. The underlying assumption, whether right or wrong, is that equal access to new information puts these investors on an even playing field with sophisticated professionals, thereby allowing the former to participate in the market in a "fair" way and to have confidence in its integrity.[128]

The regulation is also accompanied by a general disdain among policymakers, which goes back decades, for unequal access to market-moving information.[129] It isn't hard to find examples of this regulatory animus toward tiered information release. Three prominent recent examples are noteworthy.

First, the government made parity-of-information arguments in the most recent Supreme Court case on the appropriate scope of insider trading law. In *Salman v United States*,[130] the government focused on "the unfairness of allowing a corporate insider to take advantage of [inside] information" unavailable to outsiders.[131] The Supreme Court rejected those arguments, stating that "a tippee is exposed to liability for trading on inside information only if the tippee participates in a breach of the tipper's fiduciary duty" and "[t]hus, the disclosure of confidential information without personal benefit is not enough."[132]

Second, in late 2014, academic studies showed that the SEC itself (specifically, its Electronic Data Gathering, Analysis and Retrieval (EDGAR) website) was routinely allowing traders to

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128 In adopting the rule, the SEC emphasized that "[t]he vast majority of [those who submitted comment letters in response to the SEC's Reg FD proposal] consisted of individual investors" and that those investors urged the adoption of the regulation because nonsimultaneous dissemination of corporate disclosures "places them at a severe disadvantage in the market." 65 Fed Reg at 51717 (cited in note 126).

129 The SEC's march to Reg FD began at least seventeen years prior to its adoption. In the seminal *Dirks v Securities and Exchange Commission* insider trading case, the agency argued for a broader insider trading restriction on tipping so that all investors would be more likely to have equal access to material public-company information. 463 US 646 (1982). The Supreme Court rejected those arguments in that case, as it did earlier in *Chiarella*. See *Chiarella v United States*, 445 US 222, 233 (1980) ("[N]either the Congress nor the Commission ever has adopted a parity-of-information rule. Instead the problems caused by misuse of market information have been addressed by detailed and sophisticated regulation that recognizes when use of market information may not harm operation of the securities markets.").

130 137 S Ct 420 (2016).

131 Brief for the United States, *Salman v United States*, No 15-628, *18 (US filed Aug 1, 2016) (available on Westlaw at 2016 WL 4088380), quoting *Dirks*, 463 US at 653–54.

132 *Salman*, 137 S Ct at 427.

gain seconds-early and even minutes-early access to corporate filings.[133] Even though there was no technical violation of Reg FD (the rule applies to public companies, not to the SEC), the SEC unsurprisingly took immediate aim at the unintentional tiered releases,[134] noting its commitment "to help ensure that the equity markets remain the deepest and fairest in the world."[135]

Third, around the same time, the New York State Attorney General (NYSAG) began using state-level fraud law to target seconds-early releases of market-moving information by noncorporate information producers, such as research universities and trade associations.[136] Labeling these tiered information releases and related market activity "Insider Trading 2.0," the NYSAG effectively stopped seconds-early information releases nationwide via consent decree alone.[137] No firm appears to have been interested in challenging the merits of these claims despite strong arguments against them.[138]

All of these recent examples of opposition among regulators to tiered information release occurred at the same time as more general skepticism about other examples of uneven information release, such as those relating to direct feeds of transaction and

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133 See Robert J. Jackson Jr and Joshua R. Mitts, *How the SEC Helps Speedy Traders* *8–9 (Columbia Center for Law and Economic Studies Working Paper No 501, Nov 6, 2014), archived at http://perma.cc/US7C-D4XG. See also Jonathan L. Rogers, Douglas J. Skinner, and Sarah L.C. Zechman, *Run EDGAR Run: SEC Dissemination in a High-Frequency World* *35–36 (Chicago Booth Paper No 14-36, Jan 2017), archived at http://perma.cc/R4LL-45B9 (finding that certain firms, who "pay for direct access to EDGAR, receive filings before they are available on the SEC website more than half of the time").

134 See Scott Patterson, *SEC to Close Gap in Filings' Release—Lawmakers Expressed Concern after Studies Showed Rapid-Fire Traders Were Given an Edge on Data*, Wall St J B1 (Dec 27, 2014).

135 *Examining Recent Efforts by the SEC and FINRA in Aiding the Functioning and Stability of the Equity Markets, and Identifying Key Issues under Consideration to Reduce Market Complexity, Increase Operational Stability, and Promote Efficiency, Competition, and Capital Formation*, 114th Cong, 2d Sess 43 (2016) (Letter from SEC Chair Mary Jo White to Senators Johnson and Crapo, Dec 23, 2014).

136 See *A.G. Schneiderman Announces Marketwired Agreement to End Sales of News Feeds to High-Frequency Traders* (NYSAG, Mar 19, 2014), archived at http://perma.cc/9XKS-VZ6C; *A.G. Schneiderman Secures Agreement by Thomson Reuters to Stop Offering Early Access to Market-Moving Information* (NYSAG, July 8, 2013), archived at http://perma.cc/DB22-WL9L.

137 See Haeberle and Henderson, 101 Cornell L Rev at 1375–76, 1391–92 (cited in note 13). See also *A.G. Schneiderman Announces Marketwired Agreement* (cited in note 136) (discussing former Attorney General Eric T. Schneiderman's "efforts to end Insider Trading 2.0").

138 See Haeberle and Henderson, 101 Cornell L Rev at 1430 (cited in note 13) (explaining why the underlying conduct that the NYSAG stopped was likely desirable from a public policy perspective).

quote information from trading platforms to high-speed traders and "colocation" arrangements[139] by those traders.[140]

The tiered information releases involving payment for premier access that we contemplate would thus require both changes to Reg FD as well as a more general reformation in regulatory attitude regarding tiered information revelation. Notably, however, these releases would not require any change to insider trading law.[141]

Without Reg FD's simultaneity requirement and this related regulatory mood, yet with existing insider trading law operating in full force, firms could offer to sell early access to information that must—under our proposal,[142] if not existing law—soon be made available to all. For example, if a firm wanted to release new material information to the public at noon, it would be permitted to sell private access to the news seconds, minutes, or even hours prior to noon—so long as the firm did so openly and on a nondiscriminatory basis, that is, by making it available to anyone willing to pay the market price for it.

The immediate effect of this reform would be to unleash forces of information supply and demand that are now suppressed by the law. We detailed this now-suppressed supply and demand for early access to corporate information in other work.[143] More specifically, we focused on the demand that information traders, noise traders, and even those beyond securities markets would have if the law permitted the purchase and sale of early-access disclosure products today.[144] We then also detailed the supply of such products that this demand would trigger.[145]

With this supply and demand able to interact out in the open, a market for corporate information would form. Our recent work carefully considers the likely broad contours of this market, providing an example of such a market by focusing on one in which there are at least two early releases before the ultimate

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139 "Colocation" in this context refers to the situation in which market participants pay trading platforms for the right to place their servers next to the trading platforms' servers, thereby reducing the time it takes for communications to travel between the two.

140 See, for example, SEC, *Release No. 34-61358, Concept Release on Equity Market Structure* 45–46, 58 (2010) (discussing both the direct-feed and colocation issues).

141 We discuss why that is so in the context of addressing general objections to our approach in Part IV.A.1.

142 See text accompanying notes 11–13 (discussing our full-release requirement); notes 169–75 and accompanying text (same).

143 See Haeberle and Henderson, 35 Yale J Reg 401–10 (cited in note 26).

144 See id at 401–08.

145 See id 409–10.

public release (one initial release to high-speed traders, followed by a second one to fundamental-value traders and more general users of corporate information seconds later, and then a full public release perhaps a couple of hours later).[146] But as we make clear in that same work, ultimately only the market itself can provide us with those exact contours.[147]

Although important to note generally, the precise early-access supply and demand are unimportant here. The same can be said with respect to the exact contours of this market. What is important, however, is to recognize our new market-based approach to securities law: to set these market forces free in this type of transparent information market, thereby allowing those forces and that market to play the leading role in ameliorating the fundamental flaws of this area of law in the ways we describe next.

## B. Potential to Ameliorate the Flaws

Reforming the law to allow the information market discussed above could benefit securities law as a whole by ameliorating each of the fundamental flaws detailed earlier.[148]

### 1. Effect on securities disclosure law.

The market for corporate information could lead to increases in the production of information where there is too little today, all the while leading to a taming of the same where there is now too much.

*a) Effect on the undersupply of corporate information.* At the threshold, allowing bargaining between the public companies that produce disclosures and the consumers who actually use them is a straightforward remedy for the disclosure underproduction problem. We made this assertion and explained our reasoning in great detail in our recent article.[149] That work focused entirely on the claim we repeat here: that firms would provide more corporate information more frequently in better formats if they could earn revenue in return for it thanks to a market for tiered access to corporate information.

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[146] See id at 414–16.

[147] See Haeberle and Henderson, 35 Yale J Reg at 414–16 (cited in note 26).

[148] See Part II.

[149] For a detailed description of our argument, see Haeberle and Henderson, 35 Yale J Reg at 416–25 (cited in note 26).

Still, it is important to point out the connection between our reforms and these improvements. Reg FD and accompanying regulatory attitudes prevent such a market from arising.[150] But they also prevent a more general market for corporate information from arising. Today, firms cannot earn revenue in return for enhanced disclosure products. This is because no information consumer would pay for such enhancements knowing that the enhanced product must be delivered to all (including the competition) at the exact same time thanks to Reg FD and the related general regulatory mood.[151] Large groups of information consumers could, at least in theory, get together to pay firms to provide more information sooner, in better formats. But collective action among, for example, information-trading hedge funds on this front is unlikely.[152] That is especially true because these traders have more room to earn trading profits when the rest of the market is in the dark. In that situation, they are able to generate their own information and trade on it profitably in an under-the-radar fashion. If traders instead got together with the competition to induce firms to sell enhanced informational products, then they, their friendly competition, *and the entire market more generally* would all receive the information at the same time. After all, Reg FD and the related attitudes prevent any delay between initial and public disclosure. The end result would be markedly smaller opportunities for information-based trading profits.

A more specific example helps make these points clear. Take risk factors for the business that must be disclosed in 10-K annual reports today. Under the law as it stands, it is highly unlikely that a hedge fund would pay a public company for additional information about, for example, the company's not-yet-disclosed view on the probability and magnitude of the harm associated with a labor strike at one of its key suppliers. For the fund, mystery with respect to this information would likely provide more room for research and informed analysis—and ultimately serious profits from quiet piecemeal trading over a sustained period. Highlighting the information would likely do the opposite, precluding profitable investing based on the information. This is especially true because all competing hedge funds would get the information at the same exact time and because the market more generally would know of the new information.

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150 See notes 128–43 and accompanying text.

151 See Haeberle and Henderson, 35 Yale J Reg at 399–400 (cited in note 26).

152 See id at 406.

A reformation in the law to allow for a tiered-access market changes this status quo in a way that allows firms to earn revenue in return for sharing improved disclosure. For that reason, it provides firms with an incentive to generate and share more valuable content, with greater frequency, in better formats—all to meet information consumer demand. And because we require the full public release of any enhanced disclosure product within a relatively short timeframe,[153] the information would be made available to all soon enough, dictating an improvement to public disclosure and not just to the earlier-released selective disclosure.

In sum, the reforms to allow our tiered-access market would bring market forces to the world of corporate disclosure, and those market forces would provide firms with a revenue incentive to produce better quality disclosure for the actual users of public-company information.

*b) The oversupply of public-company information.* The same basic logic also applies to the tailoring of disclosure where too much is provided today. Here, the proposed information market would tell regulators much about the value of existing disclosure requirements. They could then use that information to better tailor the disclosure regime.

In our market, companies would earn revenue in return for providing information to traders and others. But that is only the case if those users of corporate information in fact value early access to the information at issue. When traders and more general information consumers do not value information, they will not pay for early access to it. For that reason, the market will not add a revenue incentive to include that information. But the firms will still share that information in the way they must today, as the law requires it.

How then would the market help identify areas of information underproduction? Firms, as influenced by actual users of their information, could use the market to convey their views on the value of the disclosure requirement at issue. They could do so by leaving the information at issue (for example, executive-to-median-worker pay ratio) out of their enhanced products that they release on a tiered basis before making it available to all, continuing to disclose it to the public in only their full public release of that information as they do today. To the extent such

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[153] See text accompanying notes 11–13, 168–74. In Part IV.A, we discuss the implications of this full-disclosure requirement for ordinary investors.

exclusions of specific items of required information in the selective disclosures appear across firms, a strong signal as to the lack of information consumer value—and thus often the lack of overall value—would be present.[154]

Of course, if regulators listened to this signal, firms could attempt to game the system by omitting key information from early-release products (for example, management discussion and analysis of the firm's financial condition) and disclosing it only in the same way in which it is disclosed today. But regulators would have a variety of clues that would help them identify such gaming. For one thing, many firms would have to coordinate on such omissions. This is because only signals as to the lack of value of a disclosure requirement across a number of firms would be valuable. For another, event studies by SEC and academic and professional economists could help regulators determine when there is information of value being released only in this way. This is especially true in the world we envision, as market movements should happen immediately after material information is first released.[155] Price movements in the market that begin immediately after the full public disclosure, and not earlier during the tiered information-release period, would therefore help reveal instances in which firms were holding material information out from the early-access market. Information consumers could aid those studies by informing regulators of information they want in the early-access market that is not being provided in that market.

Still, there is an additional, even more important reason for concluding that such gaming would not be problematic. Our changes to the securities fraud regime provide firms with powerful incentives to include all material information in early-release products. This point becomes clearer after the next Section, where we discuss how we envision the information market changing securities fraud law. But it is sufficient to say here that those changes result in a situation in which firms would lose out on notable cost savings if they failed to disclose material information in the early-access market.

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154 The converse is also true: inclusion of required disclosure information in early-release products could provide the basis for an inference that the requirement correctly identifies material information. This could be helpful in proving materiality in securities fraud litigation, including those relating to the "fraud" that is said to occur in classical and misappropriation insider trading.

155 See note 14 and accompanying text.

Stepping back, it becomes clear that market feedback indicating a lack of interest in information would often help firms hone their early-release products. Over time, information that is irrelevant to information consumers would likely fall out of early-release products. The SEC and Congress could then look to those products for signals as to what information consumers do and do not value. When they see information that must be disclosed pursuant to a mandatory disclosure requirement being released only in public disclosures and not in any early-release product, the regulators should question the value of the information to information consumers—and therefore the overall value of the requirement itself.

2. Effect on securities fraud law.

The information market could also improve securities fraud litigation. Here, the contribution of the market comes in the form of its potential as a powerful reference point for courts seeking to reduce the problematic breadth of private securities litigation.[156]

A market for public-company information gives courts a far better way of identifying the appropriate class members in private 10(b) and 10b-5 suits. In determining who gets a presumption of reliance, courts could look to who participated in the information market *and* then traded during the inflationary period rather than just the latter, as they do today. In other words, with such a market in operation, courts could replace the FOTM presumption with a "Participated in the Information Market" (PIM) one. Under this new reliance presumption, anyone who purchased early-access rights to a corporate disclosure that included a false or misleading statement could join a class action suit against the corporate fraudsters—so long as, like today, they also purchased the stock while its price was still inflated by the statement.

From the victim-compensation perspective, this novel reliance presumption is eminently more reasonable than the existing one. (It is likewise more reasonable than one that dumps the baby out with the bath water, such as reforms in favor of scrapping private suits altogether or moving to a pure arbitration setting for private actions.) Assuming reliance when a market participant purchases early access to a disclosure, and then transacts

[156] We focus on use of the information market by courts, as they implemented the FOTM presumption in the first place. But there is of course much room for Congress or the SEC to act in this area.

just after it, captures the information traders who were detrimentally induced into transacting by the fraudulent statement. That these investors relied on the information and were induced to act based on it is evidenced by their participation in the information market and subsequent trading.

Assuming a sufficiently robust information market,[157] those who purchased early access to the information and then traded during the inflationary period would have enough commonality to form a class and avail themselves of the economies of scale associated with it—economies thought to be necessary for private litigation to work.[158] At the same time, use of the market in this way would restrict compensation of nonvictims. Perhaps most importantly, indexing portfolio traders—who are not really victims of this type of fraud[159]—would in all likelihood be nicely sorted out from the class. Those traders have little to no reason to pay for corporate information and would therefore generally not participate in an early-access market before trading. For that reason, they would generally be unable to avail themselves of our new reliance presumption.

Crucially, this reform would still likely leave in place damages sufficient to deter corporate misstatements in significant ways, thereby achieving enough in terms of this second aim of these suits and doing so at a far lower cost. When new disclosures are made today, a flurry of activity ensues in the marketplace. The same would likely be true with respect to the post–early-release trading environment.[160] It follows that there would likely be enough shares purchased by traders who participated in the information market for the potential damages to provide serious levels of deterrence. There is more to say about firms' inability to avail themselves of this benefit to the extent the relevant statement appears only in simultaneously disseminated disclosure.[161] But for now, it is clear enough that our PIM presumption provides an intriguing device for improvement on the status quo.

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157 We discuss this caveat in more detail in Parts IV.B.1–2 in the context of addressing objections and laying out a framework for further debate.

158 See Part II.B.

159 See Part II.B.

160 See Hu, Pan, and Wang, 126 J Fin Econ at 407–08 (cited in note 14) (showing tenfold increase in the volume of the E-mini S&P 500 futures contract in the milliseconds after the seconds-early release of a key economic indicator before the NYSAG put an end to the practice). See also notes 136–39 and accompanying text.

161 See Part IV.B.1.

Moreover, eliminating the need for the judicially invented FOTM reliance rule would deliver significant administrability benefits and cost savings. The FOTM presumption puts district courts in a tough spot: they have to make determinations about whether the market for a particular stock is efficient or not—a task nonspecialist courts and their judges are generally ill-equipped to complete. And they must do all that at the motion to dismiss phase, before a record has been fully established. This is because the nature of securities fraud cases (namely, the massive potential for damages noted above and the attendant litigation costs) has necessitated courts collapsing the entire inquiry into that stage. And the Supreme Court has recently increased what district courts must do at this stage because it has refined the FOTM theory to include a potential defense of market inefficiency, which district courts are also required to consider at the class certification stage.[162] The result is a kind of dystopian judicial proceeding in which the plaintiffs' lawyers and defense lawyers argue their entire case at a point in the litigation when little is known, focusing on things like market efficiency, and real issues about the appropriate scope of the litigation to serve its compensation and deterrence ends are largely ignored.

The significance of this upside of our market-based approach should not be underestimated. The seriousness and scope of the issue with respect to the selection of an appropriate class for securities fraud suits have led to *Basic Inc v Levinson*'s[163] FOTM presumption of reliance being one of the single most controversial aspects of the US legal system over recent decades. Several Supreme Court cases,[164] hundreds of lower court opinions, a major federal statute (the PSLRA[165]), and about eighteen hundred law review articles have wrestled with the implications of the FOTM theory. Few, other than the lawyers and professional service providers who receive the primary benefits of class settlements today, see the current system as anywhere close to optimal. Moving

[162] See *Halliburton Co v Erica P. John Fund, Inc*, 134 S Ct 2398, 2414 (2014) ("Halliburton II") (allowing defendants to rebut the reliance presumption at the class certification stage by proving the misrepresentation(s) at issue did not affect the stock price).

[163] 485 US 224 (1988).

[164] The most recent review of the FOTM presumption came in 2014. See *Halliburton II*, 134 S Ct at 2411–13.

[165] The change in law relating to the reliance presumption would be consistent with the spirit of the PSLRA—especially its move toward having the shareholders with the most at stake in the litigation steer it. See note 88.

the needle toward a better system for investors and other corporate stakeholders (but not the outside lawyers, auditors, and event-study economists) by any material amount would be a major win for society.

3. Effect on insider trading law.

Lastly, the proposed information market can also help address the underenforcement of illegal trading and tipping by corporate executives. Today, executives, the firm itself, and the firm's large shareholders have incentives to turn a blind eye toward illegal trading by the former.[166] The information market we propose would alter the mix of incentives for each of these corporate stakeholders to make them more likely to favor more robust policing of insider trading within the firm.

More specifically, our information market would allow firms to use their material, nonpublic information to earn profits in return for early-release products. The market price of the disclosure product would reflect the extent to which insider trading based on the material, nonpublic information is tolerated by the enterprise. Firms that do a good job of policing illegal trading by insiders would be able to charge more for their information in the market. The opposite would be true for firms that do a poor job on the insider trading beat. Consequently, firms would have greater incentives to ensure that their agents are not degrading the value of their information by trading in advance of company disclosure, as there would be a market price associated with firms permitting insider trading by executives. This type of system that encourages private enforcement would, on the margin, reduce insider trading as well as the negative externalities to which it is thought to give rise.

The effect of this alteration may be especially important given the large number of public companies, larger number of public-company executives, and existing realities of government enforcement. Firms—or at least their large shareholders and the directors who look out for them—are well situated to spot violations of insider trading law. It is these actors that carefully follow all material developments at the company and how the market reacts to them. With this view from the front lines, they very well may be better situated to detect illegal activity than the DOJ and the SEC. Of course, the government may have some economy of

166 See Part II.C.

scale on this front. But there is no reason why firms could not hire businesses that specialize in detecting this activity to do the work for them. Companies already hire law firms to run internal investigations of various alleged illegality. Moreover, it is well-known that the government does just this with respect to outsourced technology aimed at insider trading detection.[167]

In fact, mobilizing corporations to police their own executives' use of corporate information in this way is arguably a more efficient mechanism than relying on outsiders—be they the government or private attorneys general. Even if no such relative claim can be made, it could provide efficient enforcement in and of itself. In other words, the change is desirable even if there were other changes to government enforcement that were more desirable.

Two final points—each relating to the intersection of insider trading enforcement and corporate disclosure—are noteworthy here.

First, to the extent the proposed market would lead to faster and more frequent disclosure of internal company information,[168] it would reduce insider trading in a second way: by making it harder for executives to earn trading profits on internal company information before market prices reflected the information. Insiders who trade illegally on private information have strong reasons to complete their trading through a series of smaller trades over a substantial period of time rather than in a handful of large trades quickly after learning of new information. In short, running out of a positive board meeting and buying $500,000 of company shares raises red flags. But with the firm's material, nonpublic information exposed sooner, insiders would find themselves with less time to earn illegal trading profits. They would thus once again find themselves deterred on the margin from buying and selling shares illegally—or at least deterred from trading illegally in large quantities.

Second, better-enforced law in this area could be a bulwark against the underproduction of corporate information. In many ways, this is merely the flip side of the first point. Executives generally decide the extent to which firms will provide information to

167 See Emily Flitter and Sarah N. Lynch, *U.S. SEC's Newest Enforcement Weapon: Powerful Software* (Reuters, Feb 26, 2014), archived at http://perma.cc/E4WP-E48S (discussing the SEC's partnership with Palantir Technologies as an effort to "beef[ ] up its capacity to detect insider trading and other illegal activity").

168 See Part III.B.1.a (noting the market's potential to trigger improved disclosure along three dimensions, including frequency).

the public. Without the ability to earn private gains from the firm's material, nonpublic information, they would be more likely to share that information with the public—and do so more quickly.[169] But the ability to avoid sanction provides more than just perverse trading incentives for these executives; it also creates perverse disclosure incentives for them. Why should they disclose more company information (and do so sooner rather than later) if it eliminates their ability to profit on it in a quiet manner over a sustained period of time? Corporate executives are able to answer this question for themselves. That this generally bright and aggressive group has done so is supported by evidence cited earlier suggesting just how common trading on company information before it is made available to all is today.[170] Accordingly, our proposal would have an additional disclosure benefit not focused on earlier, as the corporate executives who decide the amount and pace of information sharing with the outside world would be less likely to hold onto the information for personal gain should the firm be in the business of selling early access to it rather than erring on the side of, at a minimum, delayed disclosure.

* * *

This Part has demonstrated just what could happen to the main areas of securities law—and thus securities law as a whole—if regulators permitted market forces that are now suppressed to operate. With Reg FD and related regulatory stances liberalized to allow firms to sell early-access products, an information market would arise. With information consumer demand unleashed in a competitive market for information, firms would have a revenue-based motivation to give investors and other actual users of corporate information what they want, give it to them in a form that is most valuable to them, and do it more often than under current law. All the while, the characteristics of the market itself would also shed much light on the extent to which the law requires the supply of disclosure items despite a lack of market interest in them. Federal judges could also look to this same market to replace the overinclusive fraud-on-the-market presumption with a participated-in-the-information-market one that could improve the quality of the most significant type of private securities litigation today. Lastly, among other things, the

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[169] See note 28 and accompanying text.

[170] See notes 112–15 and accompanying text.

revenues firms would garner in the market could provide powerful incentives to better police illegal trading and tipping activity within the firm, as that activity would deflate the value for which the firm would be able to sell its information in the information market.

## IV. Objections and Further Framework for Debate

Even if one agrees with us that a market for corporate information can lead to the benefits we describe above, the question of the overall desirability of pursuing this approach still remains. To address that question, in this final Part we consider a variety of objections to the market that thoughtful critics might raise. We consider general objections and then ones that are more specific to each of our three areas of focus (disclosure, fraud, and insider trading law). In so doing, we aim to complete the larger goal of this Article: to set forth a new market-based approach to improve securities law as a whole and provide a framework for considering whether society would be better off by pursuing it.

### A. General Objections

As a general matter, thoughtful critics might object to our approach on the grounds that, despite our earlier representations, it actually does require changes to insider trading law and that, in reality, it is unfair to ordinary investors. We take each of these general critiques in turn in this Section.

#### 1. It requires changes to insider trading law.

At the threshold, it is important to note that this critique is not one that goes to the merits of our approach. Instead, it is specific only to the amount of legal reform necessary to pursue it. That said, at least a small part of the appeal of our approach is that it requires so little by way of regulatory change.[171] And the approach targets the same information around which insider trading law revolves. For these reasons, we address here the extent to which insider trading law presents an additional bar on the operation of our market.

There are two relevant prohibitions on insider trading: the classical theory and the misappropriation theory.[172] A company's

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171 See Part III.A.
172 See Part I.C.

open provision of its own information cannot be said to violate the misappropriation theory. Such a transparent practice, by definition, would not involve any sort of deceptive procurement and use of information.[173] And a misappropriation violation of § 10(b) and Rule 10b-5 requires such deception.[174] Indeed, there would be no misappropriation of information at all because the information would be used in ways allowed by its source, something that in and of itself takes this contemplated market activity outside the scope of the misappropriation theory.

Thinking about the consistency of our proposal with the classical theory is more complicated, but the conclusion is equally clear. The classical theory requires a violation of the *Chiarella v United States*[175] duty to disclose information to counterparties in the market or to abstain from trading on the information (or tipping others with an eye toward them doing the same).[176] The duty is imposed on corporate executives.[177] But its application to firms themselves is far from clear. Many courts have ruled that firms—

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[173] See Part I.C.

[174] See *United States v O'Hagan*, 521 US 642, 653–54 (1997) ("We agree with the Government that misappropriation . . . satisfies § 10(b)'s requirement that chargeable conduct involve a 'deceptive device or contrivance' used 'in connection with' the purchase or sale of securities. We observe, first, that misappropriators, as the Government describes them, deal in deception."); *Santa Fe Industries, Inc v Green*, 430 US 462, 473–74 (1977) (alteration in original) (citation omitted):

> The language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception. Nor have we been cited to any evidence in the legislative history that would support a departure from the language of the statute. "When a statute speaks so specifically in terms of manipulation and deception, . . . and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of the statute. . . ." Thus the claim of fraud and fiduciary breach in this complaint states a cause of action under any part of Rule 10b-5 only if the conduct alleged can be fairly viewed as "manipulative or deceptive" within the meaning of the statute.

[175] 445 US 222 (1980).

[176] See id at 235 ("When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak.").

[177] See id at 227 ("That the relationship between a corporate insider and the stockholders of his corporation gives rise to a disclosure obligation is not a novel twist of the law.").

like their executives—cannot trade on the basis of material, nonpublic information.[178] Some have even done so with great confidence in themselves.[179] But others have come to very different conclusions—finding no fit between trading by firms and the classical theory.[180] These courts are supported by the fact that insider trading law is developed from the fiduciary duty law that applies only to directors and officers. Further support is provided by the fact that there are considerable disclosure requirements imposed on firms when selling securities to the public—requirements which are largely absent when the firm is buying back securities from the same.[181]

Whatever the precise duty of the corporation with respect to trading on the basis of material, nonpublic information in the secondary market (namely, through share buybacks), it is hard to imagine a court finding that the transparent, well-advertised sale of information by a firm involves the requisite deception.[182] That is especially true when the firm is selling securities in compliance with the many disclosure rules applicable to new issues of securities. Moreover, the firm here would not itself be trading but would instead provide the information to others who would be trading. Such "tipping" is actionable only when the tipper provided the tip in return for a personal benefit, as opposed to with an eye toward helping the firm.[183] In our market, the information would of course be marketed by the firm for the firm even if insiders were the ones directing that conduct.

2. It will be unfair to ordinary investors.

Some may object to our approach on ordinary-investor fairness grounds. To them, unequal access to market-moving

178 See, for example, *McCormick v Fund American Companies, Inc*, 26 F3d 869, 876 (9th Cir 1994) ("Numerous authorities have held or otherwise stated that the corporate issuer in possession of material nonpublic information, must, like other insiders in the same situation, disclose that information to its shareholders or refrain from trading with them.").

179 See, for example, *Green v Hamilton International Corp*, 437 F Supp 723, 728 (SDNY 1977) ("[T]here can be no doubt that the prohibition against 'insider' trading extends to a corporation.").

180 See Mark J. Loewenstein and William K.S. Wang, *The Corporation as Insider Trader*, 30 Del J Corp L 45, 59–70 (2005) (discussing arguments against treating corporate issuers as insiders).

181 See id.

182 See text accompanying notes 54–56.

183 See *Dirks v Securities and Exchange Commission*, 463 US 646, 663 (1983).

information is just unfair. To be sure, the market will undoubtedly result in informational unevenness: sophisticated professionals will have access to valuable information at times when ordinary Joes will not. It follows that the proposal will likely touch at least a policymaker's nerve relating to concerns for basic ordinary-investor fairness—whether that concern is based on unequal access itself, the possible results of that unequal access on investor well-being, or related concerns for confidence in the market.[184]

Fairness is important, not least because it goes to issues of wealth distribution and investor confidence in the market. But we do not think it cuts against our approach. This is because our market will improve well-being for ordinary investors, thereby making our approach arguably fairer.

In our 2016 article, we showed why the best that can be said about the Commission's informational fairness agenda—manifested most obviously in the simultaneous disclosure obligation found in Reg FD—is that it has an ambiguous impact on the well-being of average investors.[185] That held for both those ordinary investors who invest directly through retail-level brokerage accounts as well as for those who do so only indirectly through index funds and the like. Moreover, we explained why it likely harms the most vulnerable set of ordinary investors (the direct-trading individuals) in the market.[186] Further, we explained why simple changes in the law, such as requiring set information-release windows each day or the disclosure of upcoming disclosure, would better accomplish the regulation's primary stated end.[187]

Pointing to this description, without repeating the points we made in our earlier paper, should suffice here. But it is still worthwhile emphasizing some of the larger points we made in our earlier paper to further reveal the impact of our current proposal on ordinary investors. Our proposal is for a clearly delineated,

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184 See Part III.A.

185 See Haeberle and Henderson, 101 Cornell L Rev at 1419–30 (cited in note 13). More specifically, we showed that Reg FD simply swapped a market in which there was slightly heightened information asymmetry over prolonged pre-public-release periods and acutely lower information asymmetry after public releases for one in which there is slightly lessened information asymmetry over prolonged pre-public-release periods and markedly higher information asymmetry in post-public-release ones. How that swap changed the well-being for ordinary investors is something that is far from clear—and something the SEC has never examined, let alone identified.

186 See id.

187 See id at 1430–37.

transparent, early-access market.[188] Today, the law—including Reg FD—does not require any notice whatsoever of the upcoming release of market-moving information. Instead, it merely bars insiders from trading on that information before it is released and then requires firms to make that information available to all investors at the same exact time.[189] For this reason, many ordinary individuals will in fact find themselves buying or selling in the moments just after any one of the thirty-five hundred or so public companies first releases new information. When information is released to all investors at the same time during the trading day, ordinary investors therefore find themselves paying the costs associated with a market in which some will inevitably be better informed than them. In short, despite the rubric of fairness and ordinary-investor concern that governs the release of information today,[190] considerable numbers of ordinary investors are ravaged at the watering hole in the moments just after information is released in compliance with the law.[191]

This is because the professional investors are significantly more powerful than average investors. Professional traders colocate their facilities at stock exchanges enabling them to trade in microseconds, meaning even simultaneously disclosed information cannot possibly be simultaneously acted on, which is what really matters.[192] If one has information but cannot possibly act on it before it is stale (that is, already baked into prices), then the "fairness" of getting it at the same time as others is empty. Professional traders also write sophisticated algorithms that make virtually instantaneous trading decisions once they receive new information. As noted in our work from 2016, a study from the same year demonstrated that market-moving information can be incorporated into market prices in less than the time it takes an eye to blink.[193] An average investor hearing news about Facebook on CNBC has no chance of beating the professionals to this punch. And mandating that information be made available to everyone at the same time does not create any postrelease, ordinary-investor fairness with respect to the race to incorporate new information into stock prices, as the professionals are simply too

[188] See notes 11–13 and accompanying text.

[189] See Part III.A.

[190] See notes 127–28 and accompanying text.

[191] See Haeberle and Henderson, 101 Cornell L Rev at 1427–30 (cited in note 13).

[192] See note 139 (discussing colocation practices).

[193] See Haeberle and Henderson, 101 Cornell L Rev at 1398 (cited in note 13), citing Hu, Pan, and Wang, 126 J Fin Econ 399, 419 (cited in note 14).

fast for there to be any legitimate competition from at least individual amateurs.

Admittedly, during the early-release periods we propose, information asymmetries between market participants will be higher than those associated with *normal trading environments*. However, whatever ordinary-investor harm results from the enhanced information asymmetry that occurs during the proposed early-release periods must be viewed alongside the effect Reg FD has on them in *postrelease ones*. And it is in those periods, as explained above, that ordinary investors suffer.

Still, we need not speculate whether our approach would help or hurt ordinary investors on the whole. Adding a simple regulatory overlay on our proposal—providing all investors with notice of upcoming tiered releases of information—would result in ordinary investors (other than ones engaged in noise trading[194]) suffering less harm from information releases than they do today. With this notice, these investors could move their trading away from the dangerous windows in which new information is released to the market.

The requirement we suggest would ensure clear announcements to the public that warn of upcoming tiered releases of information and the costly asymmetries they are likely to generate. (Along with this notice that companies would have to make, we would also require some maximum window in which the information would have to be revealed to all investors.[195]) The announcement would have to state that an early release of information is planned for certain explicitly named dates and times. It would also have to provide that market participants who do not have access to the information or the means necessary to analyze its import on par with sophisticated professionals might want to steer clear of financial instrument markets around those times. This type of warning would thus provide notice for at least individual investors and index fund managers who did not purchase the information to steer clear of trouble.[196]

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[194] See note 214 and accompanying text (explaining how the information market would likely affect noise traders). Noise traders base their trades on a perceived informational advantage. However, the information on which they rely is actually already reflected in the price of the stock. Haeberle and Henderson, 101 Cornell L Rev at 1403–04 (cited in note 13); Merritt B. Fox, Lawrence R. Glosten, and Gabriel V. Rauterberg, *Stock Market Manipulation and Its Regulation*, 35 Yale J Reg 67, 88 (2018).

[195] See note 11 and accompanying text.

[196] The contemplated announcement should be made available to all potential investors. But that should not be hard. Firms could make the announcement via the method

Duly warned, rational, ordinary investors would temporarily exit the market. These investors should place no value on early access to disclosures and, as a consequence, will not rationally pay for it or participate in the market when others who have are trading opposite each other and noise traders.[197] The same should apply to index fund managers.[198] Soon after (often in a matter of seconds), they could safely reenter the market with much, if not all, of the earlier-released information already incorporated into prices.

If the costs associated with monitoring releases from a few thousand public companies are too high on any of the affected parties, set early-release windows could be considered or mandated. For example, early-release periods could be limited to 12:00 pm to 1:00 pm on each trading day. We think these windows would be especially attractive, as they would limit any heightened information asymmetry associated with the disclosure of upcoming disclosure. If these windows existed each day for all firms from 12:00 pm to 1:00 pm, the chances of any individual firm releasing new information in that period would be slim. For that reason, little to no prerelease trading in anticipation of a tiered release should occur.

Still, these set windows introduce other costs, namely those associated with ordinary-investor pullback from the market to protect against possible information release and its associated costs. Liquidity will be reduced in these periods, and this is not free. But whatever such illiquidity appeared as a result of a shorter normal trading day that is split in two could be dealt with by extending the standard trading day beyond the current 9:30 am to 4:00 pm Eastern time one. We could just add an additional hour of trading in this scenario. All of these changes

they use when making their disclosures today. Consistent with that law, they would use media "reasonably designed to effect broad, non-exclusionary distribution of the information to the public." 65 Fed Reg at 51716 (cited in note 126). Specifically, the dissemination of the warning could be administered through the existing regulatory framework in the area. The market-related activities of firms, trading platforms, and stockbrokers are already regulated under a developed framework set up by the SEC. Exchange Act § 11A, codified at 15 USC § 78(k)(1) (delegating to the SEC the authority to regulate the trading of public-company stocks). This legal framework requires trading platforms to be accessible only to registered brokers—meaning that all investors must generally go through brokers to access them. For this reason, the law could ensure fair notice of early-release periods by requiring brokers to have systems in place to warn their clients when they are about to trade in such a period.

197 See note 14 and accompanying text.

198 See note 14 and accompanying text.

introduce other costs and benefits, and detailed consideration of them is far beyond the scope of this work. But it is worth noting that the operational costs of bifurcating the trading day around a set early-release period and extending trading at exchanges and alternative trading systems (so-called "dark" pools and the like) would be relatively small. Each of those platforms is almost completely electronic.[199]

Whether there is disclosure of disclosure or some daily set information-release window, ordinary investors would have the notice necessary to delay their trading in a low-cost way. Thanks to the notice associated with either as well as the proposed outside limit on early-release times, the periods in which ordinary investors would want to stay clear of the market would be relatively small—especially when viewed from the perspective of a portfolio trader. Ex ante, whether their orders that help them assemble, balance, and liquidate pieces of their portfolios are executed in a fraction of a millisecond, a second, a minute, an hour, a week, or even longer is largely irrelevant to them.[200]

Certainly, some ordinary investors engaged in portfolio trading would nevertheless transact during the periods of high information asymmetry. Although we doubt it is the case for most of these investors, the transaction costs of exiting the market during early-release periods might be higher than the expected losses associated with trading in them. Or some ordinary investors may simply not see obvious warning signs no matter how clearly the law posts them. Other ordinary investors will fail to detect and avoid harder-to-spot early-release periods. These failures are the natural consequence of a market in which up to approximately

[199] For an overview of this "new" electronic stock market, see Merritt B. Fox, Lawrence R. Glosten, and Gabriel V. Rauterberg, *The New Stock Market: Sense and Nonsense*, 65 Duke L J 191, 199 (2015). See also Kevin S. Haeberle, *Discrimination Platforms*, 42 J Corp L 809, 812–18 (2017) (providing a nuanced overview of the trade transparency and trader-access practices at exchanges and alternative trading systems today).

[200] Portfolio trading, unlike information trading, involves little time sensitivity. See generally Larry Harris, *Trading & Exchanges: Market Microstructure for Practitioners* 488–91 (2003) (discussing index investing and its "buy and hold" approach). By definition, indexing investors and the like are not transacting based on information about firms' prospects relative to current market prices that is fast depreciating in value. See id. Rather, they are simply trying to assemble and maintain a portfolio that tracks some large part of the market or to liquidate it in light of consumption needs. See id; note 14. Before their transactions take place, as far as they know, stock prices during that next interval of time have a more or less 50-50 chance of increasing or decreasing. The idea is simply that stock prices follow a random walk after all new public information has been incorporated into them. See generally Eugene F. Fama, *The Behavior of Stock-Market Prices*, 38 J Bus 34 (1965).

thirty-five hundred public firms would be selling early-access rights and in which the material information released by one firm would often be relevant, not just for it but for a wide range of firms. In these cases, even rational ordinary investors might suffer harm should the law allow an early-access market.[201]

Some ordinary investors might not be rational. For example, many noise traders will knowingly opt to trade in the periods just after new information is first released. But concern for these investors who have voluntarily subjected themselves to the cost of information asymmetry is only nominally disconcerting from any reasonable view of fairness. In fact, their proclivity to subject themselves to losses associated with a market in which participants are unevenly informed is likely a selling point for our proposal for many. The information market will make noise trading more obvious, make the dangers of it more acutely known by traders, and should, by raising the costs of it, reduce it. This final point should be clear by the time we complete our discussion of the concern for extrafirm information production later in this Part.[202]

Three final points bear mention. First, in addition to the new protection our approach lends to ordinary investors, it also allows them to participate in early-access markets if they so choose. Average investors can pool together in investment funds of various kinds, such as pension funds or actively managed mutual funds, and these large institutional investors can serve as a means of accessing the information market in a cost-effective and even profitable manner. This possibility is a crucial linchpin of new securities markets, such as those for venture capital and private equity, and the logic applies here as well. For the especially savvy ordinary investor, perhaps even direct access to information would be profitable.

Second, by making periods of heightened informational asymmetries (that is, periods around corporate disclosures) more transparent, the result for all ordinary investors should be lower fees for index funds. Passive funds try to avoid periods of heightened informational asymmetries because they can suffer when better-informed traders are more present in the market. Accordingly, passive funds now invest clients' and shareholders' money

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201 The law could address the latter concern by requiring all firms to limit their early-release periods to a single standard window—for example, each Wednesday between 10:30 am and 2:30 pm.

202 See Part IV.B.3.

in an attempt to predict these periods and withdraw from the market when they are present. But by making such periods obvious, these monies can be saved and returned to ordinary investors.

Third, it is possible that putting a price on corporate information for firms would actually result in firms shifting information releases from after-market-hours periods to intramarket ones. If that is the case, then the disclosure, fraud, and insider trading benefits we anticipated might be quite powerful. To the extent those benefits came along with such a shift in disclosure timing, the intraday trading environment would be subject to more information asymmetry. With our required disclosure of disclosure or set information-release periods, we don't see this as a problem for ordinary investors. But such a dynamic could have broader implications for securities trading and all that it impacts.

Overall, there are many possible twists and turns along the path we envision for improved securities law. As these twists emerge, informed regulations would likely be desirable. But for present purposes, it is clear that making the information asymmetries that are part and parcel of financial instrument markets explicit and demarcating a time-constrained period of postrelease asymmetry would provide ordinary investors with a greater ability to detect and avoid dangerous postrelease periods than they have today. For that reason, any ordinary-investor "fairness" concern[203] like that behind Reg FD should be assuaged, as whatever results simultaneity now achieves for ordinary investors (and then some) can be obtained under the well-regulated system that allows an early-access market like the one we offer.[204]

## B. Objections Specific to Securities Disclosure Law

The disclosure benefits we anticipate the information market to generate showcased earlier[205] must be considered in light of a number of reasonable objections that could be made. This Section identifies those objections and considers their merit. Specifically,

203 To the extent the concern is for perceptions of fairness alone, we think the law should encourage education and acknowledgment of reality rather than indulging fiction.

204 Notice provisions along the lines discussed in this Section would also help ordinary investors today, when simultaneous information revelation is required. But we do not support their imposition should the law continue to require simultaneity, as that notice would likely erode information production and sharing. See Haeberle and Henderson, 101 Cornell L Rev at 1432–33 (cited in note 13). We discuss our proposal's distinct impact on this information function below in Part IV.B.

205 See Part III.B.1.

it considers whether (1) those benefits would be muted by insufficient corporate supply of early-access products; (2) the same would result from a lack of market activity on the demand side; (3) the market approach would actually present a net harm to information production by reducing the quality of securities analysis by those outside the firm; (4) the market approach would actually lead to delayed disclosure; and (5) the disclosure overproduction signal is incomplete in a problematic way.

1. There won't be enough supply.

One might object to our information-market approach for securities law on the grounds that the full extent of the market-based improvements that we foresee would not come to fruition because, even if permitted to sell early access to their disclosures, firms wouldn't do so and would instead generally continue to disseminate them simultaneously on their own accord. If that is the case, little—if any—improvement would result for the quality of corporate disclosure.

There are several reasons to think that firms might not supply early-access rights to information consumers.

First, the marginal benefit of producing enhanced disclosure products may simply be small—and thus not exceed the marginal costs of the same. If that were the case, then firms would choose not to supply any type of early-access product—let alone enhanced ones.

A second reason why firms might not supply these products is traceable to a distinct issue. Despite our conclusions about how the market would leave ordinary investors financially better off than they are today,[206] it is entirely possible that those investors would not fully internalize that conclusion. Consequently, they might mistakenly think that the sale of early-access rights harms them and therefore oppose early-access initiatives by the firms they own.

Still, everyday investors may have little ability to change something they vehemently oppose, as they generally play little to no direct role in shaping management decisions. However, many do have significant indirect influence over management because they invest through large mutual funds. Those funds have considerable formal voting power as well as much informal sway

[206] See text accompanying notes 185–96.

over corporate boards.[207] Knowing of any concern among their clients about the sale of early-access products, those funds might use their power in the boardroom to stop firms from participating in the market—and trumpet their guardianship after doing so.

Return-maximizing funds run by the Fidelities and TIAA-CREFs of the world might very well not fight any such push by ordinary investors even when companies have concluded that selling early-access products would increase profitability. For one thing, fund executives may think the fairness perceptions are more important for their bottom line than realities. These funds may prefer to indulge in myth rather than to acknowledge the realities of securities markets. For another, these funds do not only engage in index-based investing. They also sell actively managed investments. Should firms continue with the status quo, those managed funds would continue to share first access to disclosures without paying for it. But if companies sell early-release products, then these funds would have to pay up in order to stay in the game. So these influential players might resist changes that effectively shift the burden of funding corporate disclosure from firms to them. Given this latter point, the funds may not just respond to concerned clients but instead may actually instigate the push against the supply of early-access products in the first place.

Lastly, for the same "pay for what you now get for free" reason, other investment funds that hold large blocks of public-company shares (for example, activist hedge funds) may likewise stop companies from selling early-access products. To the extent that they hold board seats, or even less formal sway over management, the end result might very well be abstention on the part of firms when it comes to participation in the early-access market.

We cannot do more than speculate as to the numbers that would be plugged into either side of the cost-benefit calculation executives would undertake when considering enhanced, early-access disclosures. But we can say that the market itself would generate at least the marginal benefit numbers and produce information on the extent to which they exceed the marginal cost of

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[207] A handful of mutual fund businesses are the record holders of large portions of America's publicly traded companies and therefore vote a large number of shares in corporate referendums. See Jan Fichtner, Eelke M. Heemskerk, and Javier Garcia-Bernardo, *Hidden Power of the Big Three? Passive Index Funds, Re-concentration of Corporate Ownership, and New Financial Risk*, 19 Bus & Polit 298, 311–15 (2017) (documenting the breadth of the holdings of the three largest mutual funds in American public companies).

the same. We can also say that there is little harm in permitting firms to sell their disclosures if all that results is the status quo. If the market-clearing price for early-access products is zero, firms will simply continue to provide their existing disclosures. No harm, no foul.

Our view is that these concerns about the extent to which management will partake in the market for disclosures (including the ones associated with ordinary-investor misunderstandings and angry ownership) should not be overly problematic. We do not mean to belittle these considerations. But it is important to recognize that they would have to be weighed against the benefits the company would realize thanks to this new line of business and its expected revenues. To be sure, management may not use an enterprise-level cost-benefit calculation in coming to its decision on whether or not to sell. Instead, it may factor in the personal costs associated with defying powerful funds (for example, "I'm going to make my life more difficult by ticking off board members"). No matter the benefit to the company's bottom line, supplying early-access products may be unappealing to management if engaging in that line of business costs them personally. But corporate law can seek to address that agency problem if it comes to fruition. For example, it could subject decisions not to sell to more penetrating judicial scrutiny than that associated with the business judgment rule, perhaps requiring management to justify those decisions with company-level cost-benefit analysis.

Still, there is a crucial part of the supply equation that must be kept in mind. The main company benefit of supplying early-access products under our proposal may not be revenue. Rather, it might be saved costs, as a key part of our market-based approach is relief from overbroad class actions.[208] These litigation savings alone might compel robust supply of early-access products even if the price tag on those products is small.

Lastly, it is important to remember that there already are prominent examples of robust information-producer supply of early-access products. Each year, a long list of entities other than public firms generates new information that moves markets and makes it broadly available to the public. Some of these entities that produce this valuable information—such as securities analysis firms—specifically gear their information production toward investors who are looking to buy underpriced securities

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[208] See Part III.B.2.

and sell overpriced ones. Others—such as the government, universities, and trade associations—have primarily directed their generation of information toward furthering their own non-securities-based ends.[209] There has traditionally been no bar on the selective release of either of these types of information. As such, before the most prominent state-level regulator of Wall Street put a halt to it, there was an emerging practice in which the latter set of information was routinely being released early to high-speed traders in a market for information.[210]

Ultimately, we cannot say whether our information market would have a similar amount of supply to that found in these ones. It might have far more or far less. And we cannot say whether that supply would generate more than simply seconds-early products aimed at high-speed traders—although the market for days-early analysis by outside securities analysts suggests that it would. Corporate production of early-access rights may be far larger (especially if it allows firms to avail themselves of class action relief) or far smaller than that associated with either of these markets. But the products in both cases are similar enough to make them nevertheless instructive.

2. There won't be enough demand.

One might also object to the proposal on a related basis: even if the law allowed market forces to operate with minimal legal friction in this area, there may be little demand for early-access products. With insufficient demand, it is hard to imagine robust improvements to corporate disclosure.

For market forces to unleash the full benefits that we anticipate, information traders would have to value early access to information enough to be willing to pay an amount large enough to

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[209] See, for example, Haeberle and Henderson, 101 Cornell L Rev at 1389–92 & n 35 (cited in note 13) (discussing the University of Michigan's Index of Consumer Sentiment, the Chicago Business Barometer, and the Institute for Supply Management's manufacturing index).

[210] See id at 1387–92; Brody Mullins, et al, *Traders Pay for an Early Peek at Key Data*, Wall St J A1 (June 13, 2013) ("[S]elling early access [to non-governmental, market-moving information] is routine."); Michael Rothfeld and Brody Mullins, *Peeks Are Still Available for Some Key Economic Data* (Wall St J, July 8, 2013), online at http://www.wsj.com/articles/peeks-are-still-available-for-some-key-economic-data-1390488428 (visited Apr 9, 2018) (Perma archive unavailable) ("Many high-speed traders and hedge funds pay non-governmental organizations for early access to economic reports and other data that often affect financial markets.").

incentivize firms to enhance disclosure. Traders will pay a significant amount for early-access rights only if they are able to use them to earn substantial trading profits.

For an information trader to earn profits in the zero-sum game of stock trading, some other market participant has to suffer trading losses. When it comes to trading based on corporate announcements, the losers are often portfolio traders or noise traders who happen to be swimming by during the feeding time that occurs just after new material information is released.[211] In this way, "uninformed" traders compensate "informed" ones for the work they do in improving stock price accuracy at any time.[212]

By encouraging ordinary investors of both types to leave the market (to improve their outcomes), our proposal limits the size of the meal. To ensure ordinary-investor fairness, we insist on clear notice of early-release periods.[213] With those periods transparent to the public in this way, at least savvy portfolio traders who heeded these mandatory warnings would take a simple step to protect themselves: take a time-out from their non-time-sensitive trading.[214] Thus, during the early-release periods for which we advocate, the "easy money," in Wall Street parlance, would flee the market, and information traders might find their early peeks to be of limited value. Consequently, the notice-based safeguards would leave those traders without what may be their primary source of profit, at least during early-release periods and those periods that immediately follow them, thereby curtailing their demand for early access to disclosures.[215] The disclosure-quality benefit provided by the market-based regime for which we advocate would then be, at best, largely muted.

The concern here is a powerful one and, therefore, one that should lead to interesting debate as to whether the proposal is

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211 See Haeberle and Henderson, 101 Cornell L Rev at 1419–24 (cited in note 13); Part IV.A.2.

212 For the original work modeling how uninformed portfolio traders and noise traders fund the profits earned by informed traders, see generally Albert S. Kyle, *Continuous Auctions and Insider Trading*, 53 Econometrica 1315 (1985).

213 See Part IV.A.2.

214 See Part IV.A.2.

215 Interestingly, any disclosure of upcoming disclosure might in and of itself lead to information-based trading based on the fact that a new disclosure is coming and speculation as to its content. The precise trading dynamics that would ensue are interesting to think about but well beyond the scope of this work. But it is worth noting that any concern about such trading could be addressed through deploying set information-release windows each day rather than requiring specific disclosures of upcoming disclosure.

worth pursuing. However, that debate should acknowledge significant counterarguments.

At the threshold, it is important to note that information traders may still have a high amount of profit-based demand for early-release products. For example, one might think that announcement traders would demand early access to information only if they could guarantee they were the only ones to receive this information. However, this misunderstands the nature of how these investors use information and vastly overstates the ability of a large group of investors to coordinate their behavior. To be sure, all professional investors (many thousands across the world) might want to coordinate and refrain from paying early-access fees, as the same information would be released shortly thereafter. Every professional would be better off if all professionals would refrain from jumping the gun. But this presents an insurmountable collective action problem that the early-access market exploits to the benefit of corporations and average investors. Any attempt to form a cartel among professional investors that would include them all and be effective at shunning the early-access market is doomed to fail—and would be illegal under antitrust law to boot.

Moreover, our proposal does not bar these and other information traders from feasting on noise traders and portfolio traders. Instead, it merely places a "Swim at Your Own Risk" sign by the water.[216] It is not uncommon to see surfers and triathletes putting on dark wetsuits and jumping into waters known to be frequented by great whites—and doing so at dawn and dusk no less. Analogously, despite the warnings that we would require, many individual investors who trade directly through brokerage accounts will still trade in the moments after firms release disclosures selectively.[217] And even institutional portfolio traders would likely do the same to some degree, perhaps even rationally at times.[218] Thus, it is likely that speculating professionals will still be able to earn profits based on first access to corporate announcements.

But even if all portfolio-trading and noise-trading investors avoided the market in the moments after new disclosures were

[216] See Part IV.A.2.

[217] See Haeberle and Henderson, 101 Cornell L Rev at 1427–29 (cited in note 13) (describing certain ordinary investors who mistakenly think that "there is a level playing field among various trader types when it comes to the ability to procure, analyze, and trade on newly announced information").

[218] See id at 1401–03 (discussing the investing strategies of institutional portfolio traders).

first shared with information traders, the latter might still have a high amount of relevant demand. While these traders surely profit from those easy marks, they also profit from each other. One such instance of this type of direct information-trader-versus-information-trader buying and selling is the type that often takes place immediately after well-advertised releases of information today. In these very brief postrelease moments, savvy portfolio traders are thought to back away from the market, leaving information traders to trade among themselves.

The trading among sophisticated professionals that takes place during these periods is intuitive enough. These traders often have divergent views of what any given piece of new information means for stocks' values. Consequently, they are more than happy to purchase from, and sell to, each other as they battle it out to determine the more accurate price of a given stock. When the dust settles, some information traders profit and others lose. In fact, it is along these exact lines that the trading that took place immediately after the well-documented early release of Michigan's consumer sentiment index proceeded.[219] In that case, high-speed traders were to some degree paying for early-access rights with the aim of earning trading profits against other traders with the same information—even if those profits were likely reduced due to the absence of at least savvy portfolio traders during the early-release periods.[220] Thus, professional investors (not always known for their humility) will likely believe that they can beat other professional investors with the same information, either through speed of execution or better analysis.

There is an additional reason why a professional investor might pay for early access. Even if a professional would not pay for early access to information about a semiconductor manufacturer to help it trade in that manufacturer's stock if it knew that other professional investors would have the same information at the same time, that investor might pay for the information to use it to trade some other security. After all, information from Manufacturer A tells us not only about the value of the stock of Manufacturer A, but also about its competitors Manufacturers B,

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[219] See id at 1413 (noting that certain firms may remove themselves from the market prior to a news release in order to "protect themselves from incurring losses to better-informed traders around the time at which they occur").

[220] About twelve firms subscribed to a 9:54:58 am computer-readable premium feed, each paying about $6,000 per month. See Peter Lattman, *Thomson Reuters to Suspend Early Peeks at Key Index* (NY Times, July 7, 2013), archived at http://perma.cc/8NHS-DTF7.

C, D, and so on. In addition, the information might tell the investor something about computer sales, smartphone sales, or a host of other industries. Even more, the information might feed into an algorithm that predicts a broad stock market index, the price of the dollar in currency markets, or the future price of gold.

The point is simply that information can be valuable even when other people have it (if you have different predictions or can get to market first) or if it can be used to predict outcomes in related areas. In short, there are multiple uses of any piece of corporate information, and this means the scope of potential early-access demand is likely too large and diverse to make abstention from the market the optimal individual choice for professional investors. And as some of these investors choose to participate, the incentive for others to follow grows, lest they be left out of the information-trading game altogether.

Further, this analysis of likely demand is overly narrow. Even if information traders do not have sufficient demand, others mentioned earlier might.[221] For example, news services may pay for a minutes- or hours-early head start over the competition. This may be true even if they were barred from redisseminating the new information until it was made public. The head start may allow them more time to carefully consider it before reporting on it—something that might be welcome in a world of twenty-four-hour cable and online breaking news. Or perhaps the extra time—measured in even smaller increments—would be valuable to them for mere content-formatting and presentation reasons. Current practices with respect to the early release of Department of Labor data to news professionals confirm our intuitions.[222]

Lastly, just as with the concern for insufficient supply that we discuss above,[223] it is important to remember that there is little harm in allowing the market to tell us that there is insufficient demand for early-access products. And like with the incentive for firms to supply early-access products in order to avail themselves of our limitation on current FOTM actions, traders may have more demand for early-access products if they include a right to

221 See text accompanying note 11.

222 See *US Department of Labor Press Lock-ups Policy Statement and News Organization Agreement* *1 (Department of Labor, Oct 1, 2016), archived at http://perma.cc/KQR8-D779. See also Bernard Baumohl, *The Secrets of Economic Indicators: Hidden Clues to Future Economic Trends and Investment Opportunities* 1–4 (Wharton 1st ed 2004).

223 See Part IV.B.1.

participate in private litigation should there be a false or misleading statement in them.

3. It will reduce outside information production and sharing.

Healthy debate may also revolve around whether the proposed information market would dampen information production and sharing on the whole and, thus, stock price accuracy.

Although one of the chief appeals of the market we tout is its potential to boost information production and sharing by providing firms with the incentive to generate and release more information, our market might also place a drag on the same forces by reducing the incentive of outsiders to produce and share information about firms and their prospects.

Firms—and therefore stocks—have fundamental values that are based on the future cash flows that they are likely to produce.[224] Stocks' market prices reflect these fundamental values to varying degrees. When those prices are closer to fundamental values, they are said to have a higher degree of accuracy. Conversely, when they are farther from those values, they are said to have a lower degree of accuracy.

Traders have the incentive to produce information that allows them to identify inaccurate stock market prices because they can use that information to profit by purchasing stocks that are priced inaccurately low or selling ones that are priced inaccurately high.[225] As a byproduct of this profit-motivated trading, they place enough upward or downward pressure, respectively, on prices to cause them to better reflect the information on which they are trading. This price-correcting work has long been lauded, as it incorporates valuable information into prices, thereby sharing it with all in ways that improve economic efficiency.[226]

Crucially, though, these traders will produce information and impound it into prices only if they expect to earn revenues that

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[224] In the finance context, the term "fundamental value" refers to the present value of the future cash flows that stockholders expect to receive. See, for example, Kahan, 41 Duke L J at 979 n 11 (cited in note 7) (defining "fundamental value" as "the best estimate at any time, and given all information available at such time, of the discounted value of all distributions . . . accruing to a stockholder who continues to hold the stock").

[225] See, for example, Goshen and Parchomovsky, 55 Duke L J at 726 (cited in note 5) ("[I]nformation traders detect discrepancies between [a stock's fundamental] value and [market] price based on the information they possess. They then trade to capture the value of their informational advantage.").

[226] See notes 6–7 and accompanying text.

exceed the costs associated with their work. The more profit they expect to earn from informed trades, the stronger their incentive to engage in this valuable work. Conversely, the less profit they expect to garner, the weaker that incentive. The extent to which information about firms is generated and signaled by outsiders is affected by these traders' expected profits.[227]

Our proposal, we soberly admit, reduces these profits. The more precise concern is that shifting from a securities law system in which information traders get corporate information for free (without advanced notice to ordinary investors) to one in which they must pay for first access to that information (with notice to the entire marketplace) would add to the traders' costs while also taking away from their revenues. In different words, opening up a market for corporate disclosures would allow companies to charge these traders for what they now get for free while also decreasing their take from ordinary investors due to the transparency measures we include.[228] This one-two punch dictates that many of these traders would have higher costs and lower revenues than they now have. The result would be a diminished incentive to undertake their socially valuable work, thereby reducing one of the key things our proposal supposedly bolsters.

We take these concerns seriously. But it is important to identify the scope of the harm that the proposal presents to information production. That scope is limited in two main ways.

First, our market approach to information dissemination would affect only trading based on the information *found in corporate disclosures*. While this information is of paramount importance to many traders, information trading as a whole focuses on a far wider range of information. For example, many information traders focus not on sales data generated and released by firms but instead on their own, earlier-produced projections of that data. Others focus on extracorporate information, for example by analyzing satellite images of orange groves before the government releases its report on the state of those crops.[229] Allowing a market for corporate disclosures would

[227] For an overview of these points on the connection between information trading and stock-price accuracy with a focus on the effects of legal drags on information-trader profits, see generally Kevin S. Haeberle, *Stock-Market Law and Accuracy of Public Companies' Stock Prices*, 2015 Colum Bus L Rev 121.

[228] See Part IV.A.2.

[229] See Bradley Hope, *Tiny Satellites: The Latest Innovation Hedge Funds Are Using to Get a Leg Up* (Wall St J, Aug 14, 2016), online at http://www.wsj.com/articles/satellites

often leave the costs associated with these types of information trading untouched.

Second, and perhaps more importantly, the information in corporate disclosures is disclosed to the entire public, both today and under our proposal. For that reason, it will get into market prices eventually. And there is strong reason to believe that "eventually" today is, well, more like immediately.[230] Under the suggested information-dissemination regime, the process is unlikely to be much different at its core: the information contained in corporate disclosures would get incorporated into market prices immediately after it is released, as information traders could profit on it only if they traded on it immediately.[231]

Ultimately, though, we cannot say with certainty that the early-access market would improve overall levels of information production and sharing. But we can say that the market's negative effect on the incentive of outsiders to produce information about firms' prospects must be weighed against its positive one on the incentive of firms to produce information about themselves. We can also say that securities law has long taken the common sense view that firms are the lowest-cost suppliers of information about themselves.[232] Indeed, that is the crux of the argument for the very foundation of modern federal securities law, the mandatory disclosure regime.[233] Thus the implementation of our proposal would not represent the first time the law intervened in a manner that reduced information-trader profits, yet increased information production and sharing. Thus, there is still much reason to believe that the incentives for efficient information production and sharing that the proposed market creates dominate those it takes away.

Also, recall that our proposal is motivated by more than just the desire to spur information production where there is now too little. It also seeks to, among other things, rein in disclosure

-hedge-funds-eye-in-the-sky-1471207062 (visited Apr 9, 2018) (Perma archive unavailable) (describing a company that "mines satellite imagery for trading tips for hedge funds").

230 See Hu, Pan, and Wang, 126 J Fin Econ at 406–10 (cited in note 14).

231 See id.

232 See Rafael La Porta, Florencio López-de-Silanes, and Andrei Shleifer, *What Works in Securities Laws?*, 61 J Fin 1, 5 (2006); Fox, 109 Colum L Rev at 268 (cited in note 7) (discussing how, in situations "where the information either is already known to the issuer or can easily be discovered by it, . . . the issuer is clearly the least cost provider" of corporate information).

233 See notes 28–29 and accompanying text.

where there is now too much.[234] Some scholars have even gone as far as positing that the defining role of modern securities law is to support a robust market for the work of outside securities analysts.[235] But the status quo may be resulting in the production of the current level of corporate information by a group (outsiders) other than the one that could produce it at the lowest cost (firms). Adding the precise political economy of the information-overproduction concern into the mix should make this assertion and the implications that follow especially thought-provoking.[236]

It follows that any information-trader costs generated by the proposed alterations to securities law may provide only a counterweight to what may be viewed as excessive existing legal support for those very market participants. In different words, there will still be enough profit incentive to generate information and correct inaccurate market prices for those who are best able to determine the import of new corporate information and trade on it. So long as enough of those traders continue to engage in this competition, an optimal level of *external* information production and sharing may take hold, leaving PhD-level astrophysicists and their colleagues to assemble algorithms that analyze time, speed, and space rather than serially coordinated price movements in stock market order flow.[237]

It bears mentioning that, even if the proposal has a net negative effect on price accuracy, it may nevertheless have an overall net positive effect on society due to the larger changes envisioned—namely, those relating to securities fraud actions and insider trading enforcement. Indeed, in addition to the independent

234 See Part II.A.1.

235 See, for example, Goshen and Parchomovsky, 55 Duke L J at 781 (cited in note 5) ("[T]he essential role of securities regulation is to facilitate and maintain a competitive market for [noninsider] information traders.").

236 See Part II.A.1.

237 Interestingly, in addition to its fairness motivation, Reg FD was motivated by a desire to ensure robust competition in the information-trading market. See 65 Fed Reg at 51716–19 (cited in note 128). The regulation no doubt helped on this front by ensuring that all information traders could begin the race to price new information on equal footing. Our proposal leaves this aspect of Reg FD in force, as nothing about our information market would stop information traders from accessing disclosures when they are first released beyond the firm so long as they can afford the market price of admission. We also believe the price of admission will follow the Michigan consumer sentiment model, see note 220 and accompanying text, thereby involving not some monopoly buyer but instead a robust group of information traders. After all, if only one buyer purchased first access to a disclosure in a transparent market, profitable trading based on that information might not be available. Firms would therefore have the incentive to price the early-access rights in a way that attracts a far larger group of traders.

benefits touted earlier, the changes to these areas of law would provide a disclosure-enhancing force. For one thing, firms would likely be more willing to share information if not for the current overbroad approach to securities fraud suits.[238] For another, if firms did in fact further restrict illicit trading on company information, outside analysts would have more room for profit[239]—profit that would incentivize more information generation.[240]

A final point is worth mentioning briefly. If the market has the deterrence impact we expect—to reduce the number of noise traders and other uninformed traders in the market during early-release periods—and that results in professional traders reducing their activity to suboptimal levels, this would be a valuable fact about the world that we learned. It would suggest that securities markets function best when extra-informational investors are fleeced by the professionals. This might be a bargain worth defending, as the profits the professionals earn are perhaps the only way to get much important information produced and reflected into stock prices in a timely manner. But at the very least, this result would lay bare the reality of the market and cast doubt on the SEC's claim that its "fairness" rules are about protecting average investors. If we are going to promote a securities market in which average investors are encouraged in various ways (or at least not actively discouraged) to invest in individual stocks based on changes in corporate information merely as a means of transferring wealth from them to the professionals, we should at least know this is what we are doing and be honest about it. Our proposed market would tell us whether this is what we are in fact doing and whether it is in fact necessary.

4. The disclosure overproduction signal is incomplete.

Another concern specific to the quality-of-disclosure point would be that the disclosure overproduction signal is far from complete. Here, the specific argument would be that early-access demand for corporate information will likely represent only a subset of overall demand for that information. For that reason, while that demand will certainly signal much about which disclosure content is and is not valuable for information consumers to have before others, the signal at times would say much less about what

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[238] See Part II.B.
[239] See note 29 and accompanying text.
[240] See note 29 and accompanying text; Part III.B.3.

information is and is not more generally valuable to them, let alone to society as a whole. For example, shareholders qua shareholders might not be interested in paying for early-access rights to conflict mineral disclosures, as those disclosures might have no impact on the firm's financial value.[241] Yet that information could be something that society as a whole values at a level above and beyond its cost of production. For this reason, a lack of demand for early access to corporate information will not provide a dispositive judgment of its social value. Instead, it will provide only another input to be considered when determining that value.

Of course, to the extent nonshareholders (including the media, corporate watchdogs, and others with extramarket demand for early access to corporate information) participate in early-access markets, the informational signal would be broader. But it is far from clear that their lack of interest in early access to any given piece of information indicates a lack of appreciation of that information—especially given that their use of the information, by definition, is not based on trading on it before its value depreciates.

Whatever the precise power of the informational signal on disclosure overproduction generated by the early-access market, it is clear that the signal based on trading-specific information alone would still help lawmakers identify instances of Congress and the SEC wanting investors to know more than those market participants want to know on the margin. For this reason, the information market provides a step in the right direction even if it will not comprehensively identify each and every aspect of disclosure overproduction.

## C. Objections Specific to Securities Fraud Law

A number of thoughtful objections to our claims on the market's ability to improve private securities litigation must also be considered in determining the overall desirability of our new approach to securities law.

### 1. Applicability of earlier objections.

For starters, it is important to briefly note the applicability of two of the objections considered above with respect to securities disclosure law, as it is clear that insufficient supply or demand would undercut much of our claim as to the market's potential to

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241 See note 75 and accompanying text.

improve private securities litigation. Focusing on the litigation-specific demand concern here should suffice to make the point.

If demand for early access is very small, then PIM class actions would also be very small—perhaps too small to have damages sufficiently deter fraud. Indeed, if you have a small market with relatively few purchasers of information, the market might fail to generate sufficient economies of scale for a securities fraud lawsuit altogether, thereby rendering it insufficient for victim-compensation purposes as well.[242]

Of course, courts could deploy the PIM presumption in only those cases in which the disclosure at issue was released in an active information market and continue to use the FOTM presumption in all other cases. Perhaps judges would presume a robust market unless plaintiffs demonstrated the absence of one at the class certification stage. In the end, our approach could be a large step in the right direction even if courts used the PIM presumption in only some subset of the universe of putative § 10(b)/Rule 10b-5 class actions.

Still, whatever the precise judicial response to any anemic demand for early-access products, weak demand would clearly reduce much of the appeal of our device for cleaning up securities fraud class actions. The same goes with respect to weak supply. However, as noted here, all-or-none thinking obscures the fact that the PIM presumption can, at a minimum, help improve the status quo. And the case we lay out earlier for believing there will be robust demand and supply—and therefore a viable PIM presumption—must be considered as well.[243] Indeed, the ability for firms to replace the FOTM presumption with a PIM one would give firms powerful incentives to provide investors with early-access products they value. Our earlier explanations also show that there is limited downside to permitting the market to tell us that all of our thinking on both demand and supply is off.[244]

2. The PIM presumption is overinclusive.

Another objection to using our information market to address the current gross overbreadth of the FOTM presumption is that our PIM replacement is itself overinclusive.

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[242] See Part II.B.

[243] See Part IV.B; Part III.A; Haeberle and Henderson, 35 Yale J Reg at 401–10 (cited in note 26).

[244] See Part IV.B.1.

Many traders could purchase early-access rights to a firm's disclosures that included a corporate misrepresentation and then trade in the firm's securities—albeit not based on the misrepresentation. This is because corporate disclosures will likely continue to be largely bundled so that they contain a variety of information, and traders will purchase early-access rights based only on some subset of that information. That information may have little or no relation to the misrepresentation. For example, suppose that the information market is characterized by a long line of investment fund customers, each of which pays only a relatively small price for the early-access products sold by Thor Industries (a medium-capitalization public company that manufactures recreational vehicles).[245] If many of these funds buy Thor Industries stock just after its latest disclosure is released to them, yet do so based only on the reliable statements found in the disclosure, then it is likely that many investors will be able to satisfy the PIM presumption in any ensuing litigation arising out of some other misstatement in the same disclosure.

While we think this objection is worth considering, our approach would still represent a step in the right direction—here, a giant one—because the plaintiff class will be reduced from basically everyone who purchased during the inflationary period to just those who purchase in that period after taking an additional step (purchasing access to the disclosure) that evidences their reliance on the misstatement. Moreover, this objection should be considered against not just the ill-advised status quo, but also the common calls to replace it with a system that scraps private enforcement of § 10(b)/Rule 10b-5 in whole or one that moves to mandatory arbitration in a way that eliminates class actions in the area altogether.[246] Some degree of overinclusion may thus be far preferable to the gross overinclusion of the status quo or the gross underinclusion of today's most prominent competing proposals.

3. The PIM presumption is underinclusive.

One could also construct an opposite argument: that there is an element of underinclusion to our PIM presumption. There will be instances in which a nonparticipating fundamental-value trader makes a purchase during an inflationary period based on

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245 *History* (Thor Industries, 2018), archived at http://perma.cc/CET4-VLJ5.

246 See note 19 and accompanying text.

a false or misleading corporate statement, but only based on reading it in the full public release. Our presumption alone would not allow this trader into the plaintiff class despite actual reliance. Today, this underinclusiveness is not present thanks to the FOTM presumption, which casts a net large enough to grab such a trader—for better or worse.

We do not think this particular underinclusion objection has more than surface-level appeal. The stock market we contemplate would be one in which information found in newly released corporate information (including misstated information) begins to be incorporated into prices when it is first released. For that reason, these traders would either have no actual damages (because the misstatement on which they are trading was already fully incorporated into prices) or limited damages (because much of that information was already incorporated into prices). And there is much reason to believe that the former situation would dominate.[247]

Still, there is another underinclusion concern to consider here. Even if firms provide much information to investors on a tiered basis in our information market, at least some firms will provide some information to all at the same time with some frequency. When that is the case and the information is false or misleading, no one can meet the requirements of our PIM presumption, as there was no information market in which to participate. But here too the information market provides only upside.

Evidence of routine participation in these information markets in general along with a purchase in an inflationary time period would tell us much about the likelihood of actual reliance. Judges could use that evidence to allow these frequent information-market participants to join in the class so long as they demonstrated sufficient likelihood of actual reliance. These traders can thus be eligible for a PIM presumption even when they did not participate in a specific information market that included tiered release of the specific information at issue. For these reasons, the class-action vehicle would still be a possibility for these private suits.

Moreover, although we do not favor it, a broader fix to either of these types of underinclusiveness concerns could be considered. In particular, judges could enlarge the PIM presumption by interpreting "participated in the information market" to refer to not

[247] See note 193 and accompanying text.

just participation as a buyer of early releases, but also participation as a subscriber to the ultimate public release. This interpretation would open the door for a larger universe of information traders to essentially opt in to the potential class by signing up for at least the public release of the information that we mandate. These subscribers would thus obtain a direct email or similar means of accessing the disclosure at issue upon the end of the sneak-peek window. In this way, even those who did not pay for early access could benefit from the presumption—so long as they did in fact receive the information and then purchase shares at inflated prices. This could be accomplished without reopening the door to gross overcompensation; judicial tools could be developed to keep it at least partially shut. For example, judges could allow the presumption of reliance to be rebutted more easily by defendants when it comes to those claiming participation in the market in this more basic way. Or they could deploy subclasses for damages purposes, with those receiving only the public release (and trading only after it) receiving only any damages they incurred, which would likely be little, if any.[248]

Stepping back, it is important to see that these caveats and examples we use to respond to the underinclusive objection far from undermine our approach. Instead, they should make our larger litigation-specific point clear: the information market has the potential to help improve the status quo by providing a mechanism for better identifying those who are actually harmed by securities fraud. That potential matters for each of the two aims of these suits. Our larger point here is thus not to provide any precise formulation of the rule that courts should use. Instead, it is to open the door to a discussion about how the information market can serve as the basis for coming up with such a rule that gets a more optimal compensation and deterrence bang for the suits' buck. To be sure, wrinkles associated with the new approach would have to be ironed out by the federal courts, perhaps with guidance or even more direct intervention from the SEC or Congress. But all in all, the flexibility embodied in our suggested approach provides courts with a way to select a far more optimal scope of private securities litigation than that of the approach in existence today.

Lastly, it is worth noting two important points relating to any concern about underinclusion in the PIM plaintiff class. First, our

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[248] See note 193 and accompanying text.

presumption would leave the larger assurances against corporate fraud in place. A number of other existing sticks would continue to whack those who committed securities fraud. The strength of public enforcement actions, which do not require proof of any reliance, would be untouched by our proposal. The SEC and its Division of Enforcement have the power to prosecute securities fraud and routinely do. They can even distribute their recoveries to victims.[249] And the DOJ can bring securities fraud criminal actions so long as the fraud is willful.[250] Along the same lines, state-level enforcement should not be forgotten. And market forces that provide carrots and sticks that combine to curb corporate fraud would likewise continue to operate in full force. For example, CEOs who pump up stock prices with misstatements might survive the quarter. But eventually their lack of integrity will likely be exposed as information comes out to the market. All the while, whatever short-term personal boon they receive from steering a ship with a higher market value over some period is likely outweighed by the expected costs associated with directing it into the rough seas ahead with the exposure of their fraud.

Second, the plaintiffs in this class would likely have smaller damages than the plaintiffs who flood these class actions today. After all, these investors will often have purchased as soon as the new (false) information came out in reliance on the information itself (or at least information with which it is bundled). For that reason, they would have paid something less than the price the information dictated, as it is these traders' buying that drives up the price to reflect that information. They thus buy shares at, for example, $8.01, $8.02, and so on until their buying (as a group) pushes the market price up to reflect that new information (say $10). So using the current measure of damages in these cases[251] would lead to lower damages per average class member than that in existence today when portfolio traders (who generally purchase once the price has already adjusted upward) are included in the class and therefore get the amount they paid minus the amount of the deflation that occurs when the market ultimately learns of the previous misstatement. Thus, our damages measure would

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[249] See 15 USC § 7246(a) (authorizing the SEC to provide victims of securities violations with disgorged funds and civil penalties the agency collects from those who harm them).

[250] Section 32 of the Exchange Act criminalizes any conduct that "willfully violates any provision of [the Exchange Act]." 15 USC § 78ff.

[251] See note 110.

decrease the overall damages in these suits in two ways: first by reducing the number of plaintiffs in the class and second by including only those who generally would have lower damages. From a victim-compensation perspective, that is a good thing. The law should compensate only actual victims, and it should address only the actual harm they have suffered. Still, we admit that the underinclusiveness objections outlined here could give rise to at least an interesting conversation about whether the resulting damages would cause the opposite deterrence problem (underdeterrence) to the one in existence today (overdeterrence). But as should be clear from this Section, our proposal allows for a number of levers to be pulled to better turn out a more optimal private securities fraud mechanism.

## D. Objections and Framework Specific to Insider Trading Law

Finally, thoughtful critics might question the extent to which our information market would actually improve insider trading enforcement.

### 1. Applicability of earlier objections.

As with the objections specific to the market's potential to improve securities fraud law, earlier objections discussed in detail with respect to securities disclosure law apply here as well. Specifically, the objections relating to possible insufficient supply and demand are pertinent here. If firms cannot sell their disclosures at a high enough price to enough buyers, then the incentive to crack down on insider trading provided by the information market will be eliminated. The same can be said if firms do not want to supply these products. In the interest of brevity, we will not repeat our analysis of why there might be inadequate supply and/or demand. But it is worth repeating that there is little to fear from allowing the market itself to tell us the relevant levels of market activity.

### 2. It will actually lead to more insider trading.

One might also contend that our market would lead to more insider trading for two related reasons. First, it is possible that firms would find their information to be of most value to early-access consumers if they held back information for longer periods. If that was the case, our approach would create longer periods in which insiders could use the firm's private information for profit in securities markets. Second, it is likewise possible that our approach would introduce a bidding process that would take place after firms announced their intention to disclose new information in an upcoming tiered-release window to take place in, for example, a day. In that interim between disclosure of upcoming disclosure and the disclosure release itself, there would be room for insiders to use the firm's information in nefarious ways.

We do not believe that either of these concerns are material. First, delaying disclosure in the name of building up its value is a risky proposition. If outside sources figure out the information in part or in whole, the information would lose its value to the same degree. Indeed, material information would likely have the most value to firms when it carries the biggest surprise for markets. So the incentive to accelerate disclosure would likely dominate any incentive to hold back information to build up its value.[252] Also, a firm would have to comply with the four-day requirements of 8-K material and the quarterly requirements for 10-Q materials. These requirements place outside limits on any such delay gamesmanship.

Second, we do not believe the bidding concern will be present. We expect a subscription model to firm information and not one-off auctions each time a firm has new information to disclose.[253] Firms would thus have the incentive to maintain the value of their disclosure products, lest the market lose interest in early-release subscriptions. Moreover, the releases could be keyed to set information-release windows, determined by either firms or regulators well before any specific early-release is contemplated.[254] This would also erase any of the bidding-period concern. But even if firms held one-off auctions, we do not fear excessive insider trading during the period from auction announcement through early release. This is because it is hard to imagine that those periods would be long. The mere disclosure of upcoming disclosure would trigger speculation that would cause volatility and related illiquidity in a firm's stock, each of which is bad for firm value. Management would therefore have much reason to avoid any delay from disclosure announcement to actual release. Further, any trading or tipping activity during such a period would be easier

[252] This response should also assuage any concerns one might have relating to a delayed-disclosure objection against our claims in Part III.B.1 relating to our approach's potential to improve the frequency of disclosure.

[253] See Part III.A.

[254] See note 202 and accompanying text.

for both firms and the government to detect. Knowing that, insiders would be less likely to pursue it.

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This final Part has considered a number of interesting objections to pursuing our information market. Some, we have demonstrated, do not withstand scrutiny, such as those rooted in hoary notions of fairness and a lack of understanding of the mechanics and economics of securities markets. Others, we concede, provide compelling reasons for at least questioning the degree to which our market-based approach would in fact improve securities law. For example, there is no doubt that the full social benefits associated with enhanced corporate disclosure that could arise out of the market rely on sufficient activity on both the supply side and the demand one—and we cannot guarantee robust market activity. But while legitimate concerns exist, there are also a variety of reasons to expect a market that produces some significant degree of each of the benefits we envision. Moreover, interaction among the various aspects of our proposal should not be overlooked. For example, the savings from our PIM presumption would provide considerable incentives for firms to participate in the market on the supply side. Likewise, that same approach to securities fraud class actions would provide traders with a significant incentive to participate in the market on the demand side by tying class action eligibility to information-market participation. And crucially, even if we are wrong on these points, little harm would result from the experiment. In sum, our new market-based approach to securities law calls for a serious conversation, and that conversation should include consideration of the objections we explore in this Part but also acknowledge the realistic boundaries of each.

## CONCLUSION

This Article proposes a new approach to securities law: permit a market for the public-company information that sits at the center of modern securities law. This approach would allow the reshaping of the law around the market to address the areas' fundamental flaws. By repealing Reg FD and reforming regulatory attitudes about tiered information releases, demand for information would be unleashed in a way that motivates firms to provide not just the information they already produce today, but additional amounts, in improved formats, and at more optimal frequencies. The forces of information supply and demand would likewise provide a powerful signal as to which information that must be disclosed today is and is not valued by actual information consumers. All the while, the information market would help identify the real victims of securities fraud, thereby guiding judges, the SEC, or Congress to a new reliance presumption that would help private securities class actions better achieve each of their two chief aims. Lastly, no longer forced to share their information on equal terms with all for free, a number of company stakeholders would have more incentive to police illegal trading by insiders, resulting in a reduction in the negative externalities of insider trading on the margin.

Important questions remain. For many of those questions, only the proposed information market itself can provide the answer. Delving too far down each possible twist and turn relating to those objections and relevant counterpoints can obscure that point. This Article is not a three-hundred-page SEC proposing release. But by providing the close look at key objections and their weight in Part IV while attempting to avoid excessive analysis of issues that may or may not arise, we have provided a thoughtful framework for debate that is sure to follow. Still, it bears emphasizing that our exploration of the aforementioned possible objections shows their limits as much as their power.

Whatever the outcome of that debate, it is important to emphasize three final points here.

First, any negative effects of the market must be weighed against the totality of the benefits it would bring—beyond even those relating to the optimality of public-company disclosure, private securities class actions, and insider trading enforcement. To the astute observer of securities law, our information market should hold much additional promise beyond that in focus above.[255]

[255] Two notable examples bear mention. First, the core informational signal provided by the market could also be deployed to help make the materiality determinations that are so central to the full range of public and private securities actions. The obvious (rebuttable) presumption would be that information purchased in an information market was material under the Supreme Court's definition of that term of art, see note 90 and accompanying text, and that information not purchased was immaterial. This presumption would increase litigation certainty for litigants (including potential ones) and ease the burden of the judges and juries making materiality findings. All the while, it would leave much room for rebuttal due to additional considerations, such as those that dictate the materiality determination today.

Second, the market could also be used to address the nonpurchaser/nonseller problem of private securities suits. Today, a bright-line rule blocks all those who forgo transacting

Second, a key feature of our proposal is that it calls for a well-regulated market, including through requirements of transparency, open access to all consumers, and full public disclosure of any early-released information within a relatively short time period. In other words, our proposal is something very different than a call to simply return to what existed before Reg FD, when regulatory animus toward tiered information revelation restricted the market for legal tiered information release to shady, backroom deals, which—even when legal—couldn't improve securities law in the ways explained in this Article. In fact, the pursuit of our market and these benefits should be bolstered considerably by the well-known "secret" that Reg FD has failed to stop such selective disclosure and that insider trading law leaves a large gap for problematic selective disclosure.[256] While the Second Circuit, Ninth Circuit, and Supreme Court have struggled in recent years to determine the extent to which current insider trading law under § 10(b) and Rule 10b-5 can address this gap more generally,[257] one must wonder whether the more promising return can be found in changes to much less prominent law—like those we have considered with respect to Reg FD alone.

Third, stepping back from even these two more general points reveals what will surely be the most surprising (and sobering) broader insight of this Article for many readers: the most powerful resistance to pursuit of such a market-based approach to securities law to improve overall social welfare is likely provided not by principled concerns like those found in the framework for debate set forth in Part IV, but instead by our approach's wealth-distributive effects and its related political economy.

Our market (namely, the regulatory components we would impose) reduces the profits of information-trading investors to protect portfolio-trading ones.[258] At the same time, our PIM presumption moves wealth away from portfolio investors and to

in the market from pursuing relief under § 10(b)/Rule 10b-5, shutting courthouse doors on them out of fear of additional nonvictims burdening the federal courts. See generally *Blue Chip Stamps v Manor Drug Store*, 421 US 723 (1975). But the proposed information market could jar the door open for relying nonpurchasers/nonsellers by making those in this group who purchase access to a fraudulent disclosure sympathetic plaintiffs while still keeping the masses out—thus using the information market in yet another way to better identify the appropriate class of plaintiffs in § 10(b)/Rule 10b-5 private actions.

256 See note 185 and accompanying text.

257 See generally *Salman*, 137 S Ct 420 (2017); *United States v Salman*, 792 F3d 1087 (9th Cir 2015); *United States v Newman*, 773 F3d 438 (2d Cir 2014).

258 See Part IV.B.3

firms, at least in the first instance.[259] The changes we envision thus involve some wealth transfer among participants in the market even if they have larger social benefits. For that reason, our approach might face SEC headwinds to the extent the agency is focused on "investor" protection rather than social welfare. That the SEC may be formally required to engage in investor-welfare analysis rather than social-welfare analysis provides a further headwind against the change to Reg FD and related regulatory attitudes we envision.[260]

Each of these concerns is exacerbated by the fact that investment funds are a concentrated interest group, whereas average shareholders are dispersed and rationally apathetic.[261] To the extent our approach results in the funds shouldering more of the cost of disclosure and losing out on FOTM recoveries, they would likely oppose our approach. Moreover, these funds would find support from fellow concentrated groups, such as trial lawyers, who plainly stand to lose if courts used our market as the focal point for their reliance presumption. Ultimately, progress that could be gained from infusing modern securities law with a well-regulated information market would ironically be impeded not out of the concerns for ordinary investors and fairness one might have had before reading this Article, but instead out of these unfortunate realities of our current democracy.

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[259] See Part III.B.2.

[260] See generally Yoon-Ho Alex Lee, *The Efficiency Criterion for Securities Regulation: Investor Welfare or Total Surplus?*, 57 Ariz L Rev 85 (2015).

[261] Lucian A. Bebchuk, Alma Cohen, and Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J Econ Perspectives 89, 89–93 (discussing the rise and concentration of equity ownership in institutional investors in contrast to the traditional dispersion of ownership among individual shareholders).