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The Insiders: A Look at the Comprehensive and Potentially Unnecessary Regulatory Approaches to Insider Trading in Germany and the United States, Including the SEC's Newly Effective Rules 10b5-1 and 10b5-2

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COMMENTS

THE INSIDERS: A LOOK AT THE COMPREHENSIVE AND POTENTIALLY UNNECESSARY REGULATORY APPROACHES TO INSIDER TRADING IN GERMANY AND THE UNITED STATES, INCLUDING THE SEC'S NEWLY EFFECTIVE RULES 10b5-1 AND 10b5-2

I. INTRODUCTION

Imagine that Albert is the Vice President of Alpha, Inc., a publicly-traded manufacturer of circuit board components, and that Alpha will miss Wall Street's profit expectations for the current fiscal quarter. Prior to public disclosure of the bad news, Albert decides to sell a substantial portion of his Alpha holdings and purchase put options\(^1\) for Alpha stock. Upon Alpha's public disclosure of the bad news, the stock price drops ten percent. After exercising his put options and selling a large portion of his stock prior to the decrease in price, Albert manages to avoid losing several hundred thousand dollars.

Assume further that Alpha is considering whether to acquire Bull's Eye, a small, publicly-traded competitor that would facilitate increased market share and economies of scale for Alpha. In determining whether to make a tender offer\(^2\) for the target company, Alpha hires Beta, Brown & Co., an investment bank, to determine a price range for the tender offer. Prior to Alpha's public disclosure of the tender offer, Sarah, a secretary at Beta, learns of Alpha's plans to acquire Bull's Eye by examining documents that her boss asked her to copy. A savvy trader with a sizeable brokerage account, Sarah decides to purchase call

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1. A put option enables the option holder to sell securities at a fixed price even if the market price falls. BLACK'S LAW DICTIONARY 1121 (7th ed. 1999).

2. A tender offer is "[a] public offer to buy a minimum number of shares directly from a corporation's shareholders at a fixed price, [usually] at a substantial premium over the market price, in an effort to take control of the corporation." Id. at 1480.

Under U.S. and German insider trading regulations, would Albert and Sarah be liable for trading based on inside information? What effects might such trading, if permitted, have on corporations, shareholders, and securities markets as a whole? Are insider trading prohibitions the best way to counteract these problems? What benefits might ensue from allowing insider trading?

This Comment analyzes the preceding questions. Part II sets forth U.S. insider trading regulations and explains why both Albert and Sarah would face insider trading liability. Part III describes the German economic landscape, the history of German insider trading regulations, and current laws that would prohibit Albert and Sarah from trading on inside information. Part IV critically examines some of the arguments in favor of and against deregulating insider trading. Part V briefly examines the performance of German equity markets both prior to and after the implementation of Germany's insider trading laws in 1994, noting that these laws may not have necessarily been responsible for improving German securities markets. Part VI concludes that it might be most efficient to let individual corporations regulate insider trading.

II. THE U.S. APPROACH TO INSIDER TRADING

The United States' insider trading regulations have developed over the past century through statutory enactment, common law interpretation, and regulatory promulgation. The

3. A call option enables the option holder to buy securities "at a fixed price even if the market price rises." Id. at 1121.

4. Insider trading is "[t]he use of material, nonpublic information in trading the shares of a company by a corporate insider or other person who owes a fiduciary duty to the company." Id. at 798. Insider trading also includes trading on information that was deceitfully acquired and properly belongs to persons to whom the trader owes a duty. Id.

regulations, however, are still "in a state of flux and development." The two-pronged prohibition involves a detailed statutory scheme and creates, pursuant to the Securities and Exchange Act of 1934 (Exchange Act), the Securities and Exchange Commission (SEC). The SEC is a "regulatory body empowered to oversee the conduct of securities transactions and to promulgate regulations implementing the federal securities laws."  

Although U.S. securities laws do not define insider trading per se, specific activities are prohibited for insiders and tippees. Under federal insider trading provisions, "buying or selling securities when in the possession of material non-public information pertaining to those securities" is prohibited. The U.S. Supreme Court has defined material information as any fact that would assume "actual significance in the deliberations of the reasonable shareholder," or would be "viewed by the reasonable investor as having significantly altered the total mix of information made available." In addition to trading, "conveying material non-public information to a second party for the purpose of enabling that party to either trade in the relevant securities or to tip yet another party" is also prohibited.  

Violating the insider trading regulations may result in criminal charges, injunctive relief, seizure of related profits, monetary penalties, and/or private civil actions to recover damages. Additionally, corporate officers or directors who violate insider trading laws may also breach fiduciary duties owed to the corporation and its shareholders, opening the door to shareholder derivative litigation.

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6. Id.
7. Id.
8. Id.
9. An insider is defined as "[a] person who has knowledge of facts not available to the general public." BLACK'S LAW DICTIONARY, supra note 1, at 798.
10. A tippee is "[a] person who acquires material, nonpublic information from someone in a fiduciary relationship with the company to which that information pertains." Id. at 1492.
15. JONATHAN R. MACEY, INSIDER TRADING: ECONOMICS, POLITICS, AND POLICY
The precise parameters of the insider trading prohibitions have been set forth by the courts in an effort to interpret the statutes and regulations. The following sections address the liability that Albert and Sarah would face under section 10(b) of the Exchange Act, and Rules 10b-5, 10b5-1, and 10b5-2 promulgated thereunder, which collectively comprise the main body of U.S. insider trading law.

A. Section 10(b) and Rule 10b-5

Section 10(b) of the Exchange Act makes it unlawful to "use or employ, in connection with the purchase or sale of any security, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." Pursuant to its authority under section 10(b), the SEC promulgated Rule 10b-5, prohibiting "the making of misleading statements and fraudulent or deceitful conduct in connection with the purchase or sale of any security."

Neither section 10(b) nor Rule 10b-5, however, "specifically prohibits trading by insiders while possessing material non-public information."\(^{24}\) As a result, many commentators question whether Congress intended to regulate insider trading under section 10(b) at all.\(^{25}\) It has been asserted that instead of being directed at insider trading, section 10(b) was crafted as a catch-all provision that allowed the SEC, "under the watchful eye of the federal courts, to prohibit 'manipulative or deceptive' conduct."\(^{26}\) Moreover, the history of the drafting and adoption of Rule 10b-5 "indicates that the provision was directed at various acts of market manipulation by corporate insiders, not at insider trading per se."\(^{27}\) The questionable breadth of Rule 10b-5, as it exists today, was perhaps best articulated by Chief Justice Rehnquist, who described Rule 10b-5 as "a judicial oak which has grown from little more than a legislative acorn."\(^{28}\)

Despite suspicion surrounding the key regulatory tools used to combat insider trading, "case law clearly establishes that both insider trading and tipping are prohibited under [section] 10(b) and Rule 10b-5."\(^{29}\) In their efforts to construe these prohibitions, courts have relied on a view that insider trading involves some sort of deception directed either "at the other party to the transaction who does not know the material information," or "at the corporation whose confidential information is improperly utilized."\(^{30}\)

1. Theories of Liability

Courts have adopted two theories under which section 10(b) and Rule 10b-5 insider trading liability arises: the "classical

\(^{24}\) Id. at 292.
\(^{26}\) Id. at 161 (citing Chiarella v. United States, 445 U.S. 222, 226 (1980)).
\(^{27}\) Id. at 160 n.29 (citing Milton V. Freeman, Remarks at the Conference on Codification of Federal Securities Laws, 22 BUS. LAW. 793, 921-23 (1967)).
\(^{28}\) Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975). In reference to the private cause of action available under Rule 10b-5, Justice Rehnquist also stated that "it would be disingenuous to suggest that either Congress in 1934 or the [SEC] in 1942 foreordained the present state of the law with respect to Rule 10b-5." Id.
\(^{29}\) McLaughlin & Macfarlane, supra note 5, at 292.
\(^{30}\) Id.
theory” and the “misappropriation theory.” Under these theories, both Albert and Sarah would be liable for insider trading violations.

a. The Classical Theory

The classical theory of insider trading asserts that a corporate insider violates section 10(b) and Rule 10b-5 when he or she “trades in the securities of his own corporation with the aid of material, nonpublic information gained through his position in the corporation.” The classical theory is most often used to convict officers, directors, or other insiders who trade stock in the corporation for which they work. Courts have also used the classical theory to prosecute people who are not company employees, but nonetheless work on the firm’s behalf. Such persons, deemed “temporary insiders,” often include accountants, lawyers, and business consultants.

Under the classical theory, Albert, a corporate insider, would be required to either disclose the bad news about Alpha’s quarterly profits to the market or forgo trading in Alpha stock. The duty to disclose or abstain rests on two principal elements: first, the existence of Albert’s relationship with Alpha, which provided “access to non-public information intended to be used only for corporate purposes” and second, the “inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.”

Albert’s trading is regarded as the “use of a deceptive device,” as described in section 10(b), because it is deemed to breach the relationship of trust and confidence existing between the shareholders of a corporation and corporate insiders who obtain inside information due to their positions within the

31. Id.
33. Id.
34. Id.
35. Id.
36. See McLaughlin & Macfarlane, supra note 5, at 292.
37. Id. (citing SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968)).
Note, however, that under the classical theory, Sarah would not be liable. Because she is not an Alpha insider, Sarah has not traded in the stock of the company for which she works, and would thus stand outside the scope of the classical theory.

i. The Use v. Possession Argument

What if Albert, in selling Alpha stock and buying put options, merely possessed inside information but did not use it as an actual basis for the trades? For years, the lower federal courts were split on this issue. While the Ninth Circuit required actual use of the information at the time of the trade, the Second Circuit held that mere possession of material nonpublic information was sufficient to uphold an insider trading conviction. Possession of material nonpublic information, the Second Circuit reasoned, "[u]nlike a loaded weapon which may stand ready but unused...can not lay idle in the human brain." An insider's mere possession of material nonpublic information thus "taints a subsequent trade and renders it illegal, regardless of the insider's subjective motivation at the time the trade was executed." The Eleventh Circuit took an entirely different approach, holding that trading while in possession of inside information created a rebuttable presumption of liability.

ii. Rule 10b5-1 as a Solution to the "Use v. Possession" Debate

Due to the uncertainty of whether actual use or mere possession was required for liability under the classical theory, the SEC enacted Rule 10b5-1 to ensure that the lower of the two standards is met. The rule allows an insider to rebut liability by showing that he or she did not use the information in conducting the trade.

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38. Snyder, supra note 32, at 421 (citing Chiarella v. United States, 445 U.S. 222, 228 (1980)).
40. United States v. Smith, 155 F.3d 1051, 1069 (9th Cir. 1998).
42. Id. at 120.
43. O'Brien, supra note 14, at 1091 (citing Teicher, 987 F.2d at 120).
44. SEC v. Adler, 137 F.3d 1325, 1337 (11th Cir. 1998). Under this approach, the insider could rebut liability by showing that he or she did not use the information in conducting the trade. Id.
thresholds would be used.\(^4\) Rule 10b5-1, effective October 23, 2000,\(^4\) adopts a general rule that any purchase or sale of stock while in possession of material inside information is illegal, without regard to whether the information was a motivating factor in making the trade.\(^4\) The rule therefore abolishes the distinction between use and possession, increasing the risks for executives like Albert who sell stock at a time when they arguably know material undisclosed information, regardless of whether they buy or sell for completely unrelated reasons.\(^4\)

\subsection*{b. The Misappropriation Theory}

As an alternative to the classical theory, the misappropriation theory asserts that corporate outsiders who are not subject to liability under the classical theory may, nonetheless, violate the broad anti-fraud provisions of section 10(b) and Rule 10b-5 if they: (1) obtain nonpublic information through breach of a fiduciary duty or similar duty arising from a relationship of trust and confidence owed to the rightful possessor of the information; and (2) trade on the basis of that information.\(^4\)

The misappropriation theory was designed to impose liability in circumstances similar to Sarah’s—where an individual is entrusted with confidential information and then uses that information to trade in the corporation’s stock.\(^5\)

\begin{itemize}
  \item \(^4\) Brobeck, supra note 47, at 3.
  \item \(^4\) Benjamin D. Briggs, Comment, United States v. O’Hagan: The Supreme Court Validates the Misappropriation Theory of Insider Trading and Rule 14e-3(a), but Does the Court’s Decision Help or Hinder the Quest for Guiding Principles?, 15 GA. ST. U. L. REV. 459, 470 (1998).
  \item \(^5\) See McLaughlin & Macfarlane, supra note 5, at 293–94. Under the circumstances of the hypothetical presented, Sarah would also face insider trading liability under Rule
\end{itemize}
Unlike the classical theory, the misappropriation theory does not depend upon a duty to "the shareholders of the company in whose shares the misappropriator trades." Under the misappropriation theory, "fraud occurs only when an individual deceives the person who entrusted the individual with material, nonpublic information." The person's mere "possession of nonpublic information alone is not enough."

Despite arguments that Rule 10b-5 does not support the misappropriation theory because it was enacted to protect investors rather than a company's rights to its information, the U.S. Supreme Court nonetheless adopted the misappropriation theory in 1997. In doing so, however, the Court failed to define the precise scope of fiduciary duty needed to give rise to liability. For instance, while it was clear that the duty encompassed the relationship between a lawyer or accountant and a client, uncertainty existed as to whether such a duty arose in relationships of lower fiduciary caliber, such as a close friend or computer-repair person entrusted with corporate secrets.

i. Rule 10b5-2 and the Misappropriation Theory

The SEC adopted Rule 10b5-2 to clarify the ambiguities surrounding the misappropriation theory. Effective October 23, 2000, Rule 10b5-2 enumerates three non-exclusive elements for determining when a person receiving material nonpublic information is subject to a "duty of trust or confidence" for purposes of the misappropriation theory: (1) whenever the recipient agrees to maintain the information in confidence; (2)

52. Id. at 471.
53. Id.
54. Milton V. Freeman, Colloquium Foreword, 61 FORDHAM L. REV. S1, S4–S5 (1993). Milton Freeman, who participated in the drafting of Rule 10b-5 and is often called the "father of Rule 10b-5," went so far as to argue before a Senate Committee that construction of Rule 10b-5 to support the misappropriation theory was inappropriate because it extended beyond the Rule's original intent. Id. at S3–S5.
56. Painter et al., supra note 25, at 175–76.
57. Id. at 177.
59. Id.
whenever the person communicating the material nonpublic information and the recipient have a history, pattern, or practice of sharing confidences that results in a reasonable expectation of confidentiality; or (3) whenever the person who provided the information was a spouse, parent, child, or sibling of the person receiving the information, unless it can be shown that no reasonable expectation of confidentiality existed between the parties.\(^6\) Rule 10b5-2 thus expands the Supreme Court's fiduciary duty requirement for insider trading liability under the misappropriation theory and would impose liability on Sarah even if she learned of the confidential information merely because she was, for example, Albert's psychologist.

2. Section 10(b) and the Requirement of Scienter

Courts have ruled that because the language of section 10(b) sets forth an element of deception or dishonesty, proof of scienter, or willful violation, is \(^6\) required.\(^1\) Accordingly, the courts have held that Rule 10b-5 does not prohibit negligent conduct.\(^2\) Some courts, however, have considered the scienter requirement to encompass reckless conduct as well as intentional conduct.\(^3\)

3. Tipper and Tippee Liability

Section 10(b) prohibits tipping by insiders to the same extent as direct trading.\(^4\) If Albert had tipped the bad news of quarterly profits to a friend of his who had no fiduciary duty to Albert or Alpha, Inc., section 10(b) and Rule 10b-5 would prohibit the friend from trading in Alpha stock if: (1) he received the information by virtue of Albert's breach of fiduciary duty; (2) the friend knew or should have known of Albert's breach of fiduciary duty; and (3) Albert received a direct or indirect personal benefit by providing the information to the friend.\(^5\) The friend's liability

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\(^6\) Id.
\(^1\) McLaughlin & Macfarlane, supra note 5, at 295.
\(^2\) Id. (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976)).
\(^3\) McLaughlin & Macfarlane, supra note 5, at 295.
\(^4\) Id.
\(^5\) Id. (citing Dirks v. SEC, 463 U.S. 646, 660–64 (1983); Shapiro v. Merill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 237–38 (2d Cir. 1974)).
under such circumstances arises "from his role as a participant after the fact in the insider’s breach of a fiduciary duty." 66

B. Summary

An overview of U.S. insider trading laws reveals that they are indeed comprehensive. The number of convictions attained each year by the SEC alone illustrates the regulations' effectiveness at curtailing insider trading. 67 Due to ambiguities surrounding the legislative history of section 10(b) and Rule 10b-5, however, it is unclear whether Congress and the SEC initially intended for the judiciary and the SEC 68 to expand U.S. insider trading laws to their current breadth.

III. THE GERMAN APPROACH

In contrast to the United States, which has historically regulated insider trading via a general anti-fraud provision, the German insider trading laws take root in a stronger statutory base. 69 The German regulations, as a result, depend less on judicial interpretation. 70 The ability of the German legislature to avoid the pitfalls of the judiciary may have been enhanced by Germany's delay in regulating insider trading. 71 This, in turn, may have allowed Germany to learn from the performance of the U.S regulations. 72 Before delving into the current state of German insider trading laws, a brief background of insider trading and its regulation in Germany is helpful.

67. See Anita Raghavan et al., Insider Trading: This Crime Begets Little Punishment, WALL ST. J. EUR., Aug. 17, 2000, at A1. Between the years of 1995 and 1999 alone, "the SEC won 162 civil cases against 270 defendants accused of insider trading, and ordered the disgorgement of [over $40 million] in illicit trading profits." Id.
68 See discussion supra note 54 and accompanying text. The SEC's recent enactment of Rules 10b5-1 and 10b5-2 clearly underscores the SEC's support of broadening U.S. insider trading regulations. This effort, however, directly conflicts with the opinions of Milton Freeman (the "father of Rule 10b-5"), who believes that Rule 10b-5 has been expanded beyond its intended scope. See discussion supra note 54 and accompanying text.
70. See id. at 184, 206.
72. Freis, supra note 71, at 83.
A. The History of Insider Trading in Germany

Throughout history, Germans have viewed insider trading with far less disdain than Americans.\(^\text{73}\) Whereas U.S. insider trading regulations have been effective since 1934, Germans were able to use insider trading as an unpunishable means of securing large profits through most of this century.\(^\text{74}\)

Prior to Germany’s enactment of the Second Financial Markets Promotion Act (Promotion Act)\(^\text{75}\) in 1994, German business culture consisted of intertwined relationships between companies, banks, analysts, and journalists.\(^\text{76}\) Inside information was frequently relayed between these groups at so-called “fireside chats,” where companies shared information about their businesses with a select few.\(^\text{77}\) Trading based on inside information in Germany was so common that one German banker quipped that it was a real “joke” to watch stock prices move before news was released to the public.\(^\text{78}\)

Germany’s laissez-faire approach to insider trading was largely due to the structure of business organizations within the country.\(^\text{79}\) Because of a pervasive German sentiment that government involvement in business should be avoided, the majority of German companies opted to remain privately-held.\(^\text{80}\) Moreover, German companies relied heavily on debt financing from banks, and as a result did not need to use stock markets as a source of capital.\(^\text{81}\)

Another factor contributing to Germany’s laissez-faire approach to insider trading was the country’s legal restrictions.\(^\text{82}\) Prior to 1994, insider trading was made illegal only when a
company voluntarily adhered to Germany’s Insider Trading Guidelines (Guidelines), which operated more like a gentleman’s agreement than a law. Despite adoption of the Guidelines by a majority of German corporations by 1992, few insider trading investigations were conducted and conclusive findings of insider trading were extremely scarce.

B. Reasons and Incentives for Changing the Insider Trading Laws in Germany

Amidst growing international competition, German legislators adopted new insider trading legislation to preserve Frankfurt’s status as a leading financial market center of continental Europe. In the year before enactment of the new legislation, this competition grew quite fierce. In 1993, Germany received less than $3 billion of the $68 billion that U.S. investors placed in foreign equities.

While many banking and business professionals believed that the presence of and harms associated with insider trading were minimal, some viewed the enactment of insider trading legislation as a key strategy for strengthening investor confidence and fostering the competitiveness of German capital markets. Giving rise to the latter belief were numerous highly-publicized insider trading scandals that some felt eroded domestic and foreign confidence in German securities markets.


84. Pfeil, supra note 73, at 141. The Guidelines were “comparable to a so-called gentleman’s agreement or a moral code in that they were binding only on those persons who voluntarily submitted to them by private contract.” Id.


86. Pfeil, supra note 73, at 145.


88. See id.


90. Pfeil, supra note 73, at 146.

91. Id. at 145; see also id. at 139 n.12 (describing one of Germany’s largest insider
Enactment of Germany's new legislation was also a response to intense pressure from the European Community that urged harmonization of the European capital markets through increased transparency, strengthening of investors' rights, and heightened regulation of securities transactions. On November 13, 1989, the Council of European Communities issued a European Community Directive requiring European member states to promulgate insider trading regulations by June 1, 1992. After Germany's initial failure to comply with the deadline, and the European Commission's subsequent institution of infringement proceedings, Germany finally adopted the Promotion Act on July 8, 1994. In so doing, Germany became the last European Community member state to prohibit insider trading.

C. Current German Insider Trading Regulations

The scope of the insider trading prohibition under the Promotion Act is set forth in the Act's definitions of three key concepts: (1) the insider, (2) insider information, and (3) insider transactions. In order to be convicted of insider trading, all three criteria must be satisfied.

1. Insiders

The Promotion Act classifies two types of insiders: primary and secondary. Primary insiders are specifically defined as persons having access to and knowledge of nonpublic information by virtue of status as a manager, director, or employee of the corporation or a controlling company; as a controlling shareholder; or by means of a professional relationship with the corporation.
Albert would fall under the definition of a primary insider because he received information about Alpha through his position as a manager within the company. Sarah, on the other hand, would be classified as a secondary insider, which the Promotion Act defines as any third party having knowledge of insider information.\footnote{100} In this respect, the definition of secondary insider serves as a catchall provision and encompasses any non-primary insider that holds insider information.\footnote{101}

2. Inside Information

In order for information to constitute “inside information,” the Promotion Act requires that the information be (a) nonpublic; (b) pertain either to one or several issuers of securities publicly traded on a German or other European Union member state stock exchange, or pertain to such securities or derivatives\footnote{102} for such securities themselves; and (c) be likely to have a significant effect on the price of the security to which it pertains if the information were publicly known.\footnote{103} The Promotion Act does not require that nonpublic information be material or contain any indicia of trustworthiness.\footnote{104} An unsubstantiated and immaterial rumor, therefore, while not qualifying as inside information in the United States, would be deemed as such in Germany.

While the definition of “likely to have a significant effect on the price”\footnote{105} of a security seems equally as ambiguous as the term “materiality”\footnote{106} to the stock price, the German standard seems to create a higher threshold than that of the United States.\footnote{107} Not all material information would necessarily be capable of significantly affecting a stock’s price.\footnote{108} For instance, while Alpha’s bad news about quarterly profits would be deemed “material” in the United

\footnotesize{\textit{Id.} § 14, at 46.}  
\footnotesize{\textit{See id.}}  
\footnotesize{\textit{See supra} note 21 and accompanying text.}  
\footnotesize{Promotion Act §§ 12, 13, \textit{translated in GERMAN CAPITAL MARKET LAW}, supra note 97, at 45. The Financial Markets Act also prohibits insider trading with respect to derivatives. \textit{Id.}}  
\footnotesize{Pfeil, supra note 73, at 159.}  
\footnotesize{Promotion Act § 13, \textit{translated in GERMAN CAPITAL MARKET LAW}, supra note 97, at 45.}  
\footnotesize{\textit{See discussion infra} Part II.}  
\footnotesize{See Freis, supra note 71, at 92.}  
\footnotesize{\textit{See id.}}
States, it is uncertain whether, if disclosed, it would change Alpha's stock price "significantly." This question centers around what standard is employed when defining a "significant" change. Would a two percent fluctuation in price suffice? Twenty percent? In this regard, the law is somewhat vague. In addition, it is important to note that the German standard for inside information seems to rely heavily upon the market's reaction to information. Whereas with respect to one company the disclosure of information may not cause a dramatic change in price, such information pertaining to another company may cause the public to overreact, at which point the price would change significantly. The German standard thus seems to require companies to predict how investors will react to certain information, making it difficult for companies to determine precisely what information must be disclosed to the market.

3. Insider Transactions

With respect to the Promotion Act's definition of "insider transactions," separate prohibitions are created for primary and secondary insiders. In making this distinction, the law achieves a result similar to the distinctions between the United States' classical and misappropriation theories of liability. Like the classical theory, German law "prohibits primary insiders [(such as Albert)] from taking advantage of their knowledge of insider information to acquire or dispose of insider securities for themselves or others." In addition, primary insiders are prohibited from tipping or "making available any insider information to another without authorization."

109. See Promotion Act § 13, translated in GERMAN CAPITAL MARKET LAW, supra note 97, at 45.
110. See id.; see also Tony Hickinbotham & Christoph Vaupel, Germany, in INTERNATIONAL INSIDER DEALING 144 (Mark Stamp & Carson Welsh eds., 1996).
111. Hickinbotham & Vaupel, supra note 110, at 144.
112. Id.
113. See id.
114. See Promotion Act § 14(2), translated in GERMAN CAPITAL MARKET LAW, supra note 97, at 46.
115. Pfeil, supra note 73, at 162–63 (citing Promotion Act § 14).
116. Promotion Act § 14(1)2, translated in GERMAN CAPITAL MARKET LAW, supra note 97, at 46.
Secondary insiders are prohibited only from using inside information to buy or sell securities for themselves or others. As such, secondary insiders may tip information to others. With respect to secondary insiders, the German prohibition is quite similar to the United States' misappropriation theory in that it prevents people "outside" the corporation from trading on inside information. The German definition of a secondary insider, however, spans even further than the breadth of Rule 10b5-2. Whereas Rule 10b5-2, at its outer perimeter, encompasses relationships exhibiting a reasonable expectation of confidentiality, the German definition of a secondary insider prohibits any third party having knowledge of inside information from trading, regardless of whether an expectation of confidence was reasonable at the time the third party received the information. The scope of the German regulations thus prohibits insider trading not only by individuals such as Sarah, who received the information in confidence, but also by third parties such as a friendly office visitor, who accidentally stumbled upon the inside information on her way to the coffee machine.

D. Punishment

Failure to comply with the Promotion Act's insider trading regulations is punishable by up to five years in prison or the imposition of fines. Unlike the U.S. approach, however, the Promotion Act does not provide for civil sanctions. Civil suits are often an effective remedy for individuals claiming to be harmed by insider trading because such suits generally require a lower standard of proof. Moreover, the Promotion Act does

117. Id. §14(2), at 46.
118. See id.; see also Standen, supra note 69, at 205.
119. See Promotion Act § 14(2), translated in GERMAN CAPITAL MARKET LAW, supra note 97, at 46.
120. See id.
121. Standen, supra note 69, at 204.
122. Id.
123. Id. Whereas criminal cases typically require a showing of guilt beyond a reasonable doubt, civil cases use a preponderance of the evidence standard. Thomas C. Newkirk & Melissa A. Robertson, Speech by SEC Staff: Insider Trading—A U.S. Perspective, at http://www.sec.gov/news/speech/speecharchive/1998/spch221.htm (last visited Feb. 28, 2001) [hereinafter SEC Staff Speech]. Because most insider trading cases involve only circumstantial evidence (unless the defendant confesses to knowledge of
not provide for claims by shareholders or contemporaneous traders. The Promotion Act’s enforcement mechanisms and ability to deter insider trading may thus be weaker than analogous measures in the United States.

E. Summary

German insider trading prohibitions are quite expansive with respect to their coverage of insiders, inside information, and insider transactions. While the scope of the German approach to corporate “outsiders” seems to reach beyond that of the United States, the ability of German regulations to serve as an effective deterrent may be somewhat limited due to their exclusion of civil and shareholder derivative suits as remedies for violations.

IV. SHOULD INSIDER TRADING BE PERMITTED?

Given the expansive breadth of U.S. and German insider trading laws, this Comment explores whether insider trading regulations are truly necessary. Insider trading prohibitions are not cheap. Regulatory bodies and law enforcement agencies expend vast resources to detect and prosecute inside traders. Similarly, courts must devote considerable judicial resources to convict perpetrators. Once convicted, a trader’s life can be devastated due to prison time, actions for damages, and public stigma.

The deregulation of insider trading has been debated for decades. While both sides of the argument have strong points, each position likewise has its weaknesses. This section analyzes

insider trading in some admissible form), meeting the standard in a criminal context is often onerous. Id.

124. Standen, supra note 69, at 204–05.
125. See id.
126. Pfeil, supra note 73, at 163.
127. See Standen, supra note 69, at 204–05.
128. BAINBRIDGE, supra note 21, at 125.
129. Id.
130. Id.
131. Id.
132. Id. at 125–26 (noting that the debate arose in the 1960s with the publishing of Professor Henry Manne’s book, INSIDER TRADING AND THE STOCK MARKET (1966), which asserted that insider trading should be permitted because it promotes market efficiency and creates efficient incentives for corporate managers).
some of the harms associated with insider trading and several of the potential benefits that might ensue if insider trading was permitted.

A. Harms Associated with Insider Trading

1. Impeding Efficient Management, Moral Hazards, and Short Selling

Insider trading may be harmful because it creates a moral hazard by allowing corporate managers to profit on bad news as well as good.\textsuperscript{133} Insider trading enables managers to profit on good news by buying the company's stock prior to disclosure of the news.\textsuperscript{134} Upon disclosure, the stock's price typically rises to reflect the good news, at which point the manager could sell the shares for more than what was paid.\textsuperscript{135} Similarly, insider trading can be used by managers prior to disclosure of bad news to either avoid losses by selling existing positions, or earn money by selling short.\textsuperscript{136} Permitting insiders to profit on bad information in this fashion may, at the extreme, make "managers indifferent between working to make the firm prosperous and working to make it bankrupt."\textsuperscript{137}

This problem is especially pronounced if short selling is permitted.\textsuperscript{138} Banning short selling would therefore largely alleviate the moral hazard problem.\textsuperscript{139} Even where short selling is permitted, however, several factors exist to counteract incentives for managers to run the firm into the ground.\textsuperscript{140}

First, managers intentionally causing the firm's stock price to fall so that they can reap insider trading profits would be in clear

\textsuperscript{133} MACEY, supra note 15, at 34.
\textsuperscript{134} Id. at 35.
\textsuperscript{135} See id. at 10.
\textsuperscript{136} A short sale is the sale of a security that the seller does not own in expectation that the price will fall, whereupon the seller buys the security for less than he sold it for and returns the shares to the person from whom he borrowed them. See BLACK'S LAW DICTIONARY, supra note 1, at 1339.
\textsuperscript{138} Id.
\textsuperscript{139} Id.
\textsuperscript{140} MACEY, supra note 15, at 34–36.
breach of their fiduciary duty of loyalty to their firm.\textsuperscript{141} The threat of a potential shareholder derivative suit may thus dissuade managers from taking such actions.\textsuperscript{142} Also, because managers work in teams, the efforts of one manager to make the firm bankrupt will most likely be thwarted by other managers on the team.\textsuperscript{143} These other managers will be too concerned with losing their compensation packages and tarnishing their reputations to let one manager ruin it for them by creating bad news.\textsuperscript{144}

The final problem with the moral hazard argument is that it fails to acknowledge the economic disincentives that managers face if they try to bankrupt the firm.\textsuperscript{145} In order for a manager to willfully make poor management decisions that lead to a decline in stock price, the profits from a particular short sale must exceed the present value of the manager's entire compensation package.\textsuperscript{146} If such profits are not attainable with reasonable certainty, the insider will forgo the transaction for fear that he or she will be fired and lose the entire package.\textsuperscript{147} Therefore, with respect to short selling, a manager would have to put a great deal on the line for the payoff from making the firm bankrupt to be worth his or her while.

Aside from these disincentives to abuse short selling, insider trading in the form of short selling may in fact be beneficial where managers use it to hedge\textsuperscript{148} against risky projects.\textsuperscript{149} Ordinarily, managers are risk averse with regard to new projects because they fear being blamed for failure.\textsuperscript{150} Such risk aversion is not

\begin{enumerate}
\item[141.] Id. at 35.
\item[142.] See id.
\item[143.] Carlton & Fischel, supra note 137, at 873–74.
\item[144.] See id. at 874.
\item[145.] MACEY, supra note 15, at 34.
\item[146.] Id. Managerial compensation packages typically include salary, stock options, deferred compensation such as pensions and annuities, and other perquisites. Id. Prestige and standing within managers' communities that occur as a result of positions held within the firm also factor into this analysis. Id.
\item[147.] See id. at 34–35.
\item[148.] A hedge is the making of "advance arrangements to safeguard oneself from loss on an investment, speculation, or bet, as when a buyer of commodities insures against unfavorable price changes by buying in advance at a fixed rate for later delivery." BLACK'S LAW DICTIONARY, supra note 1, at 726.
\item[149.] MACEY, supra note 15, at 33.
\item[150.] Id.
\end{enumerate}
beneficial to shareholders. Unlike bondholders, who have fixed claims on the firm's assets, shareholders are residual claimants who are entitled to all of the firm's gains resulting from successful projects. Moreover, shareholders want managers to take risks because shareholders can insulate themselves from firm-specific risks by holding a diversified portfolio or mutual fund. Because short selling allows managers to profit from projects that initially appear optimal but end up failing, it may effectively alter the risk preferences of management, making them more like those of the shareholders.

2. Insider Trading Interferes with Information Disclosure

Another argument against insider trading is that it may motivate managers to delay disclosure of information so that they have ample time to trade in the company's stock. Alternatively, because an insider's ability to profit depends on information reaching the market, insider trading may, in some instances, result in premature disclosure. Either way, insider trading may motivate managers to release information at times that are profitable for them, rather than the firm.

3. Fairness Arguments and Market Confidence

One of the most common arguments against insider trading is that it is unfair or immoral. This belief is so prevalent that many commentators have argued that insider trading should be prohibited regardless of whether or not it is efficient. Such critics also assert that the unfairness resulting from insider trading creates an uneven playing field amongst traders and erodes market liquidity. This belief is espoused by Arthur Levitt,

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151. Id. at 32–33.
152. Id. at 32.
153. Id. at 33. A mutual fund is an investment operated by a company that invests its shareholders' money in a selection of securities that is usually diversified. BLACK'S LAW DICTIONARY, supra note 1, at 1040.
154. MACEY, supra note 15, at 33; see also Carlton & Fischel, supra note 137, at 872.
156. Carlton & Fischel, supra note 137, at 879.
157. Id. at 880.
158. Id. at 880–81.
159. MACEY, supra note 15, at 41–44.
former Chairman of the SEC, who asserts that "[the U.S.] markets are a success precisely because they enjoy the world's highest level of confidence. Investors put their capital to work—and put their fortunes at risk [in the U.S. securities markets]—because they trust that the marketplace is honest."\(^{160}\)

Evidence from Germany may tend to illustrate that insider trading undermines investor confidence.\(^{161}\) Because insider trading was common in Germany prior to 1994, and because the majority of publicly traded stock was held by institutional investors, many believed that the stock market was "slanted in favor of large, sophisticated traders."\(^{162}\) This perception materialized into a stock ownership rate of only seven percent amongst German adults in 1993, whereas in the United States, thirty-five percent of adults owned stock.\(^{163}\)

Insider trading, however, may not be the sole reason that individual investor participation in German securities markets was low.\(^{164}\) Many attributed this problem to high transaction costs, expensive stock prices, and a lack of transparency in the securities markets due to lenient reporting and disclosure requirements.\(^{165}\) Moreover, the unfairness and market confidence arguments are refuted strongly by countries like Japan,\(^{166}\) where securities markets and liquidity have historically flourished regardless of rampant insider trading.\(^{167}\)

The unfairness argument is rebutted largely by the proposition that if investors know that insider trading occurs, they will not be disadvantaged because they will discount security prices to accurately reflect the risk of insider trading.\(^{168}\) This discount enables investors to "self-insure" against the risk of

\(^{160}\) See SEC Staff Speech, supra note 123.

\(^{161}\) See Standen, supra note 69, at 193.

\(^{162}\) Id. at 192–93; see discussion supra Part III.A.

\(^{163}\) Id. at 193 (citing Glenn Whitney, Europe Moves to Curb Insider Trading, WALL ST. J., Nov. 4, 1993, at A11).

\(^{164}\) See GERMAN CAPITAL MARKET LAW, supra note 97, at 8.

\(^{165}\) Id.

\(^{166}\) MACEY, supra note 15, at 44. Japan's insider trading laws lacked enforcement for many years. Id. See also discussion infra Part IV.B.3. Despite Japan being known as an "insider's paradise," the Japanese capital markets did not suffer any "crisis in confidence." MACEY, supra note 15, at 44.

\(^{167}\) MACEY, supra note 15, at 44.

\(^{168}\) See SOLOMON ET AL., supra note 155, at 912.
insider trading, thereby making the price that the investor pays fair. Additionally, if insider trading is an efficient compensation scheme, then profits of firms that permit insider trading should increase, thereby benefiting insiders and outside investors alike.

B. The Potential Benefits of Permitting Insider Trading

1. Insider Trading May Be an Efficient Compensation Scheme

Because managers are risk averse, they may not choose the most lucrative investment projects for the firm for fear that they will be blamed for failure. A dilemma thus exists as to how firms should properly motivate managers to take risks. Due to the difficulty in valuing an innovation prior to its creation and execution, employment agreements entered into before a managerial innovation will fail to properly reward managers who do take chances.

Renegotiating a manager’s contract after an innovation, however, presents high transaction costs and can result in managers employing strategic behavior in the negotiations. Insider trading, if used as a substitute for contract renegotiations, can alleviate costs associated with renegotiating by allowing the manager to alter his compensation with each trade. “[B]ecause managers themselves determine the frequency of the ‘renegotiations,’ they can tailor their compensation scheme to their particular attitudes toward risk.” In addition, rewarding managers by allowing them to trade on inside information may be efficient where it provides better “incentive[s] to acquire and develop valuable information.”

169. Id.; MACEY, supra note 15, at 25.
170. Carlton & Fischel, supra note 137, at 881.
171. MACEY, supra note 15, at 33.
172. Carlton & Fischel, supra note 137, at 869.
173. See HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET 133 (1966); see also Carlton & Fischel, supra note 137, at 869–71.
174. BAINBRIDGE, supra note 21, at 137.
175. Carlton & Fischel, supra note 137, at 870.
176. Id. at 871.
177. Id.
Insider trading, however, is not a perfectly efficient means of compensating managers.\textsuperscript{178} Due to the unfettered ability of an insider to buy shares in the market, a unique situation is created. Unlike stock option grants,\textsuperscript{179} which are allotted to employees in quantities relative to their potential contribution to the firm, the allocation of shares to an inside trader depends entirely on how many shares he or she can afford to buy.\textsuperscript{180} Insider trading thus rewards managers disproportionately based on their own wealth rather than on the value of their innovations.\textsuperscript{181} In addition, because information can spread to other managers and employees within a firm, these individuals may benefit by trading on information without having contributed to its production.\textsuperscript{182}

No compensation scheme, however, is flawless.\textsuperscript{183} Even stock option plans have their inefficiencies.\textsuperscript{184} For example, “[m]anagers may profit from a stock option plan . . . because of an upturn in the [stock] market as a whole” rather than a price increase generated by management’s own productivity.\textsuperscript{185} Moreover, the stock might reach the same price with or without the incentive effects created by a stock option plan.\textsuperscript{186} In this respect, insider trading may be no less efficient than other compensation schemes.

2. Insider Trading as a Significant Form of Information Disclosure

Information disclosure by firms is important because it promotes accurate stock prices and reduces investor uncertainty about individual companies.\textsuperscript{187} If a firm does not supply relevant information to the market, investors may “assume the worst and discount the amount they are willing to pay for that firm’s shares

\textsuperscript{178} See BAINBRIDGE, supra note 21, at 138–39.
\textsuperscript{179} A stock option with respect to compensation is an “option that allows a corporate employee to buy shares of corporate stock at a fixed price or within a fixed period.” BLACK’S LAW DICTIONARY, supra note 1, at 1431.
\textsuperscript{180} BAINBRIDGE, supra note 21, at 138.
\textsuperscript{181} Id.
\textsuperscript{182} Id.
\textsuperscript{183} Carlton & Fischel, supra note 137, at 878.
\textsuperscript{184} See id.
\textsuperscript{185} Id.
\textsuperscript{186} Id.
\textsuperscript{187} BAINBRIDGE, supra note 21, at 128–29.
to compensate [them] for the uncertainty.  

Corporations are therefore motivated to distinguish themselves from other firms that fall victim to negative market speculation. Through the production of information that is either positive, or less negative than the public speculates, traders will be willing to pay a higher price for the firm's shares than if no such disclosure was made.

Information disclosure, whether through press releases or via insider trading, also enables firms to better observe when corporate managers are performing successfully. Where the stock market reflects all available information, a high stock price generally tends to indicate that management is doing a good job.

Complete disclosure of all information via press releases or otherwise, however, is not optimal. Disclosure is costly, and at some point the costs of increased disclosure outweigh its benefits. In some cases, disclosure may even destroy the information's value. For instance, an investor would not want his company to disclose confidential information regarding the presence of valuable mineral ore deposits on land the company intended to purchase. This disclosure might result in a competitor bidding up the price of the land or even buying the land itself, thereby harming the investor's firm.

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188. Macey, supra note 15, at 46; see also Eric Moskowitz, Propaganda Dot Com: Companies Are Increasingly Using the Internet to Manipulate Their Own Stocks—and You, Red Herring, Nov. 13, 2000, at 266. The importance of information disclosure was recently illustrated by the Chief Executive Officer of the publicly-traded Track Data, Inc., who stated, “I want to apologize to our faithful stockholders who are looking each morning for our latest corporate developments. Rest assured that we do not take this lack of news lightly.” Id.

189. Carlton & Fischel, supra note 137, at 867.

190. See id.

191. Id.

192. See id. Extrinsic market factors such as interest rates, consumer confidence, mania, etc., can potentially inflate stock prices even when management is not performing successfully and corporate earnings are poor. See Thomas S. Mulligan & Tom Petruno, Fears Over Economy Spur Nasdaq Sell-Off, L.A. Times, Feb. 28, 2001, at C1. The high prices of technology stocks relative to their earnings (or lack thereof) in 1999 illustrate this phenomenon.

193. Carlton & Fischel, supra note 137, at 867.

194. Id.

195. Id.

196. Id. at 867–68.

197. See id.
Insider trading may also be beneficial because it provides corporations with an additional method of communicating and controlling information. If insiders trade, a company's stock price will move closer to the point it would have ultimately reached had the information been disclosed. The more that market participants are able to identify insider trading, the greater the quantity of information such trading will convey.

A related advantage of allowing insider trading as a method to relay information to the financial market is that it may facilitate smoother transitions in stock prices. Because insiders typically comprise a minority of trading volume in any given company, their stock transactions would gradually drive the market price to equilibrium as the supply and demand for the stock adjust to the insiders' trades. In contrast, if a release of material information was not anticipated, public disclosure of this new information would cause an immediate adjustment in the supply and demand for the particular stock, creating a potentially drastic spike or dip in the share price. Insider trading can be used to indirectly convey credible signals to the market, ultimately avoiding sharp changes in stock prices that would occur with unanticipated public disclosure of new information.

3. If Insider Trading Is Inefficient, Let the Market Prevent It

Insider trading arguably constitutes theft, provides inefficient compensation, destroys investors' confidence, and may simply be unfair. On the other hand, "[t]hese characterizations just as aptly describe a hypothetical compensation scheme whereby managers pay themselves huge salaries and consume unlimited perquisites, regardless of their productivity." The government need not prohibit this hypothetical compensation agreement because competitive markets motivate firms to avoid unprofitable

198. Id. at 868.
199. Id.; MACEY, supra note 15, at 26–27.
201. SOLOMON ET AL., supra note 155, at 913.
202. See BAINBRIDGE, supra note 21, at 135–36.
203. See MACEY, supra note 15, at 26–27.
204. Id. at 46.
205. Carlton & Fischel, supra note 137, at 862.
206. Id.
arrangements. The same argument can be applied to insider trading. If insider trading was inefficient, companies that permitted the practice would be at a competitive disadvantage compared with firms that prevented it. As a result, market forces would drive corporations to create internal measures prohibiting insider trading.

Several factors may tend to show that, contrary to popular belief, insider trading may be efficient. First, U.S. firms have, throughout history, made little attempt to prohibit insider trading. While insider trading was common in the 1920s, the SEC and federal courts did not aggressively pursue insider trading convictions until the late 1960s. There is no reason to believe that between the years of 1920 and 1968 the practice of insider trading was forgotten—if insider trading was inefficient, firms would have prevented it.

Second, the treatment of insider trading by state law may illustrate that insider trading is efficient. Because investors seek companies that have efficient practices, firms are motivated to incorporate in states that have efficient corporation laws. Likewise, because states receive revenues from corporations in the form of filing fees and taxes, states are motivated to enact legislation that promotes corporate efficiency. If insider trading is harmful, therefore, states would have an incentive to outlaw the practice. For the most part, however, state common law has historically permitted insider trading.

207. Id.
208. Id.
209. Id. at 862–63.
210. See id.
211. Id. at 858.
213. See id. at 44.
214. See Carlton & Fischel, supra note 137, at 858.
215. See id. at 860.
216. Id.
217. Id.
218. See id.
219. Barry Alexander K. Rider & H. Leigh Ffrench, The Regulation of Insider Trading 99 (1979). The majority common law rule with respect to insider trading was that directors and officers owed no duty of disclosure to the market as a whole, and could thus trade on inside information. Id. In the early twentieth century, this rule
The proposition that insider trading is efficient may be further supported by the fact that throughout the majority of the twentieth century, insider trading was either not regulated or leniently enforced in many foreign countries. Japan, for instance, was for many years criticized as being an “insider’s heaven” due to its lack of effective laws and enforcement mechanisms. Insider trading in Japan went largely unregulated until numerous insider-trading scandals in the 1980s prompted legislative reform in 1988. It was not until 1992, however, that Japan implemented a regulatory body capable of enforcing its laws. Until 1991, when criminal sanctions and civil remedies were provided, Hong Kong punished insider trading only by publication of a report identifying a particular person as an inside trader. France provides an additional example. Insider trading in French securities markets has been a criminal offense since 1970, but convictions under the regulations were scarce. It was not until 1989, when France empowered its regulatory body to enforce its own rules, that insider trading began to be effectively curtailed. If insider trading was in fact inefficient, it would seem

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220. Carlton & Fischel, supra note 137, at 860; see also MACEY, supra note 15, at 44.
222. Id.
223. Id. at 44.
225. Patricia Peterson, France, in INTERNATIONAL INSIDER DEALING 153 (Mark Stamp & Carson Welsh eds., 1996); see also RIDER & FFRENCH, supra note 219, at 238 (stating that in 1975, five years after the implementation of France’s insider trading laws, the “total number of suits and administrative sanctions [was] nearly nil.”).
that these countries would have prohibited the practice much sooner.227

V. GERMAN EQUITY MARKET PERFORMANCE

A look at the performance of German equity markets provides assistance in determining whether insider trading in fact harms securities markets. Due to its lack of strict insider trading laws until 1994,228 Germany presents an interesting analytical model.

In 1993, the year prior to Germany's enactment of insider trading regulations, 664 German corporations were listed on the German stock exchanges and there were nine initial public offerings (IPOs).229 In that same year the total value of stock trades on German exchanges was $564 billion.230 In contrast, during 1999, 933 corporations were listed on the German exchanges, there were 168 IPOs, and trading volume on the German exchanges reached $1.6 trillion.231

These figures, however, may be less informative than they first appear. Equity markets throughout the world virtually mirrored this growth.232 In the United States, trading volume on the New York Stock Exchange increased from $22.8 trillion in 1993 to $89.5 trillion in 1999.233 Volume on NASDAQ increased from $13.5 trillion to $104.7 trillion in the same period.234 The London Stock Exchange also shared growth similar to that in Germany during these years, as share volume increased from £564 billion.

227. See Carlton & Fischel, supra note 137, at 860.
228. See discussion supra Part III.A.
229. Deutsche Börse, Historical Statistics (of German Stock Exchanges): Cash Market, at http://www.exchange.de/INTERNET/EXCHANGE/index_e.htm (last visited Nov. 21, 2000) [hereinafter Deutsche Börse]. The number of IPOs, while not as good an indicator as market volume, is nonetheless an important reflection of investor confidence. See MACEY, supra note 15, at 9. Investors are willing to pay less for securities traded in an inefficient or illiquid market. Id. Companies may therefore abstain from issuing stock if investor confidence in the market is weak, thus bearing the costs associated with investors' concerns about the market. Id.
231. Id.; Deutsche Börse, supra note 229.
232. See FIBV, supra note 230.
233. Id.
234. Id.

The German markets, therefore, even in view of their upturn in trading volume, number of publicly traded companies, and increase in the quantity of IPOs, seem to have merely been a beneficiary of a global economic up-trend. If so, enactment of insider trading laws may not have played a significant role in the development of Germany's equity markets.

VI. CONCLUSION

The insider trading regulations in the United States and Germany are comprehensive responses to insider trading. While it is uncertain whether insider trading actually harms securities markets, recent evidence from Germany and the global securities markets tends to support the proposition that government regulation of insider trading may not be necessary. Insofar as insider trading is efficient, therefore, it might be best to let regulatory bodies like the SEC detect insider trading and then refer cases to individual corporations for private litigation. If, at that point, insider trading proved to be inefficient and such corporations failed to prosecute perpetrators, competitive markets would drive firms to prohibit the practice.

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