

INSIDER TRADING IN COMMODITIES MARKETS

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I. AN INTRODUCTION TO COMMODITIES 453

II. A COMPARATIVE HISTORY OF INSIDER TRADING REGULATION..... 456

 A. *Early Toleration of Insider Trading* 456

 B. *Divergence Between Securities and Commodities Regulation*..... 458

 C. *The Future of Insider Trading* 463

III. TWO MARKETS, ALIKE 466

 A. *Information* 466

 1. *Material Information*..... 467

 a. *Magnitude* 467

 b. *Probability* 469

 2. *Nonpublic Information* 474

 B. *Participants* 480

 1. *The Sophistication of Investors* 480

 2. *The Need to Hedge* 483

 C. *Duties*..... 487

IV. INTERMARKET DIALOG 494

CONCLUSION 499

FROM autumn of 1963 through spring of 1964, executives at Texas Gulf Sulphur (“TGS”) bought their own company’s stock because they knew something the public did not: TGS had found “[t]he biggest ore strike since gold was discovered,”¹ a deposit of copper and zinc

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¹ SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 878 (2d Cir. 1968) (en banc) (internal citation omitted).

greater than three times the annual production of the entire planet.² The executives' foreknowledge made them rich, but it also made them criminals. Insider trading in securities—stocks and bonds—is a federal crime.³

Wiser operators would have bet on minerals. The discovery of new metals will tend to make existing stockpiles cheaper, and commodity futures markets allow speculators to make vast sums of money off of just such predictions. By “shorting” copper and zinc futures, the executives could have reaped similar fortunes, but without the legal problems.⁴ For *while insider trading in securities has long been illegal, the same behavior has been entirely legal in the commodities and futures markets.*⁵

² The mine was thought to contain about 25 million tons of ore. *Id.* at 846. Combined world production of zinc and copper was about 8 million tons at that time. U.S. Geological Survey, Copper Statistics 2 (2014), <http://minerals.usgs.gov/minerals/pubs/historical-statistics/ds140-coppe.pdf> [<https://perma.cc/J2NC-Z5B4>]; U.S. Geological Survey, Zinc Statistics 2 (2014), <http://minerals.usgs.gov/minerals/pubs/historical-statistics/ds140-zinc.pdf> [<https://perma.cc/F8J5-PYPJ>].

³ Section 32(a) makes a crime of willful violations of the Securities Exchange Act of 1934. 15 U.S.C. § 77(x) (2012). The Supreme Court has held that insider trading can constitute a violation of Section 10(b) of the Securities Exchange Act under rules promulgated by the U.S. Securities & Exchange Commission (“SEC”). See *United States v. O’Hagan*, 521 U.S. 642, 650–52 (1997). However, at the time of *Texas Gulf Sulphur*, it was not yet clear that insider trading was punishable as a crime. See *United States v. Chiarella*, 588 F.2d 1358, 1362 (2d Cir. 1978) (affirming first criminal insider trading case conviction), *rev’d* on other grounds, 445 U.S. 222 (1980). So, it is perhaps safer to say that the *Texas Gulf Sulphur* employees became “lawbreakers.” See also 15 U.S.C. § 78p (2012) (restricting trading by directors, officers, and principal stockholders).

⁴ For the massive scale of the gains (160%), see *infra* notes 105–10 and accompanying text.

⁵ U.S. Commodity Futures Trading Comm’n, Open Meeting on Five Final Rule Proposals Under the Dodd-Frank Act 38 (Jul. 7, 2011), http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmissionmult_070711-trans.pdf [<https://perma.cc/6FP5-YBQK>] (“This prohibition in the securities markets rests on the corporate insider’s duty to disclose the information before he is permitted to trade the stock. The futures and derivatives markets, on the other hand, do not impose the same legal duty and the final rule before you expressly states that it does not impose a duty of disclosure.”). See generally *infra* Section II.B. Note that this Article uses a broad definition of “insider trading,” which does not itself presume a particular legal account of the practice. This is in accord with common usage. Peter J. Henning, *Between Chiarella and Congress: A Guide to the Private Cause of Action for Insider Trading Under the Federal Securities Laws*, 39 U. Kan. L. Rev. 1, 1 (1990) (“The term ‘inside information’ is now common parlance . . . to describe situations in which previously undisclosed information is used to gain an unfair transactional or tactical advantage.”). Thus, while misappropriation and fiduciary relationships play an important role for the law and many commentators’ normative analyses, this Article does not imbed those elements in the basic definition of insider trading. Instead, any trading on the basis of material, nonpublic information is insider trading and a candidate for evaluation. Note also that many instances

Why has insider trading been severely restricted in one financial market and entirely unregulated in another? The received answer, common among policymakers and scholars alike, is that dissimilar markets deserve dissimilar laws. Securities laws seek to protect retail investors, but commodities traders are too sophisticated and informed to deserve or desire insider trading protections. Insider trading in securities involves breaches of trust, as executives steal information from their employers and use it to fleece their own shareholders, but there are no “shareholders” in copper or corn. And the information gleaned from corporate files is likely to be both secret and of great importance to the value of that company’s stock, while any news bearing on the worldwide price of a commodity is probably very public in nature; anyone can drive through the Midwest and guess whether the harvests look good. For such reasons, the Chairman of the Commodity Futures Trading Commission (“CFTC”) once told Congress, “[t]here is almost no way to trade insider information in the commodities industry.”⁶

Despite broad acceptance, such assertions of difference are wholly mistaken. It is frequently possible to obtain and trade upon material, nonpublic information, in breach of a duty of trust or confidence, in commodities markets.⁷ The facts of *SEC v. Texas Gulf Sulphur*, described briefly above, make this clear.⁸ The TGS executives misappro-

of insider trading could plausibly be pursued under federal wire fraud statutes. See *United States v. Sleight*, 808 F.2d 1012, 1014 (3d Cir. 1987); *United States v. Dial*, 757 F.2d 163, 169 (7th Cir. 1985). This is true for both commodities and securities markets. The availability of wire fraud actions does not obviate the need for an analysis of doctrines focused on insider trading, since the ease of proof and elements may differ, and since the availability of wire fraud may be bound up in our insider trading doctrine. See generally William K.S. Wang, *Application of the Federal Mail and Wire Fraud Statutes to Criminal Liability for Stock Market Insider Trading and Tipping*, 70 U. Miami L. Rev. 220 (2015) (describing similarities, differences, and interrelations of insider trading prosecutions under wire fraud laws and securities laws).

⁶ SEC/CFTC Jurisdictional Issues and Oversight – Part 2: Hearings on H.R. 5447, H.R. 5515, and H.R. 6156 Before the Subcomm. on Telecomms., Consumer Prot., and Fin., and the Subcomm. on Oversight and Investigations of the H. Comm. on Energy and Commerce, 97th Cong. 405 (1982) [hereinafter *SEC/CFTC Jurisdictional Issues and Oversight Hearing*] (statement of Philip McBride Johnson, Chairman, Commodity Futures Trading Commission); see also Commodity Futures Trading Commission Act of 1974: Hearings on H.R. 11955 Before the H. Comm. on Agric., 93d Cong. 183 (1974) [hereinafter *1974 Hearings*] (statement of Glenn Willett Clark, Professor of Law and Superintendent of Securities for the State of Iowa) (testifying that “[c]ommodities trading, unlike securities trading, takes place in an operational climate in which inside information has been assumed to be nonexistent”).

⁷ *Infra* Sections III.A., C.

⁸ 401 F.2d 833 (2d Cir. 1968) (en banc).

priated geological data from their employer, which they might have used to profitably speculate in minerals. Nor are commodities traders so different from securities investors in terms of their sophistication,⁹ or attitude toward insider trading.¹⁰ Many of the strongest arguments for restricting insider trading in the securities industry purport to strengthen markets and lower trading costs for all traders, a result that should be attractive to farmers and millers, hedgers and speculators alike.

This Article will argue that no good rationale has yet been offered to distinguish commodities markets from securities markets with respect to insider trading. This thesis yields two important corollaries.

First, like markets should be governed alike, and so commodities regulation and securities regulation should be harmonized with respect to insider trading.¹¹ Assuming the current state of insider trading law to be broadly correct for securities markets, this Article will provide strong reasons to adopt similar restrictions in the commodities markets.¹² This rule would make it unlawful to misappropriate material nonpublic information and then trade commodities contracts, but it would not ban trading by those who legitimately acquire information, perhaps through diligent research, or whose information is public or immaterial. Such a rule would ban the *Texas Gulf Sulphur* executives from shorting copper, but it would not seriously inhibit hedging by yeomen farmers.

This policy recommendation is of immense importance at present because the future of insider trading in commodities is far from certain. In the preamble to a recent rulemaking, the CFTC quietly asserted for the first time that it *may* be unlawful to trade using information obtained through fraud or by breach of a preexisting duty, thus signaling a willingness to prosecute insider trading.¹³ Yet the CFTC also went to great lengths to nevertheless assert that insider trading remains legal.¹⁴ The

⁹ *Infra* Subsection III.B.1.

¹⁰ *Infra* Subsection III.B.2.

¹¹ *Infra* Part III.

¹² On the current securities doctrine, see *infra* Part II. It is not feasible to both accord proper focus on this Article's harmonization arguments and also resolve the broader debate as to the appropriate level of insider trading restriction. That debate is rich, and there are forceful arguments for both liberalization and greater restriction. Fortunately, the harmonization thesis is compatible with any level of insider trading restriction. Part IV will develop some of the implications of this argument for the broader debate.

¹³ Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices, 17 C.F.R. § 180.1 (2014).

¹⁴ *Id.* Scholars have likewise seemed to assume that the CFTC will limit any use of this provision to credit default swaps ("CDS"). See, e.g., Douglas B. Levene, Credit Default

CFTC recently brought and settled its first insider trading claim,¹⁵ but it is not clear how such actions would hold up at trial nor how often the CFTC will use this power, which makes an evaluation and defense of the new rule particularly important.

Second, regarding commodities markets as peers to securities markets permits intermarket dialogue. Scholars of commodities have hitherto operated without reference to the securities insider trading literature.¹⁶ Likewise, scholars of securities either never mention commodities,¹⁷ or do so only in order to make clear that their theories would not be so expansive as to impact commodities—without any explanation for why that would be so bad.¹⁸ Yet securities scholars make empirical claims about insider trading, such as that it harms managerial incentives, in-

Swaps and Insider Trading, 7 Va. L. & Bus. Rev. 231, 265–68 (2012); Yesha Yadav, Insider Trading in the Derivatives Market (and What It Means for Everyone Else) 3–4 (Vanderbilt Law & Econ., Working Paper No. 13-24, 2013), <http://ssrn.com/abstract=2317318>.

¹⁵ Arya Motazedi, CFTC No. 16-02 (Dec. 2, 2015), <http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfmotazediorder120215.pdf> [<https://perma.cc/6FP5-YBQK>].

¹⁶ See, e.g., U.S. Sec. & Exch. Comm’n, Transcript of Joint Meeting on Harmonization of Regulation 19–20 (Sept. 3, 2009) (No. 4-588), <https://www.sec.gov/spotlight/harmonization/sec-cftc-harmonization-090309-transcript.pdf> [<https://perma.cc/F4QT-GS44>] [hereinafter Joint Meeting on Harmonization] (commending 1984 CFTC report as explaining why securities law concerns are inapplicable to the commodities markets). Professor Jerry Markham’s recent *History* makes no reference to insider trading in respect of commodities. Jerry W. Markham, Law Enforcement and the History of Financial Market Manipulation (2014). But see Gregory Scopino, The (Questionable) Legality of High-Speed “Pinging” and “Front Running” in the Futures Markets, 47 Conn. L. Rev. 607, 610–12 (2015) (discussing insider trading in futures); Richard Carlucci, Note, Harmonizing U.S. Securities and Futures Regulations, 2 Brook. J. Corp. Fin. & Com. L. 461, 477 (2008) (advocating insider trading restrictions); Nina Swift Goodman, Note, Trading in Commodity Futures Using Nonpublic Information, 73 Geo. L.J. 127, 152 (1984) (arguing that insider trading in commodities should be regulated because it could be used as a work-around to the ban on securities insider trading, it evinced similar unfairness to the securities regime, and it could not be adequately distinguished therefrom).

¹⁷ See, e.g., Research Handbook on Insider Trading (Stephen M. Bainbridge ed., 2013) (no reference to insider trading in commodities); Markham, *supra* note 16, at 244–46 (six-paragraph discussion of insider trading in commodities); Research Handbook on Securities Regulation in the United States 335, 390–91 (Jerry W. Markham & Rigers Gjyshi eds., 2014) (three paragraphs); William K.S. Wang & Marc I. Steinberg, *Insider Trading* (2010) (no reference to commodities).

¹⁸ See, e.g., Victor Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 Harv. L. Rev. 322, 328–29 (1979) (arguing for insider trading restrictions in securities, and clarifying that this rationale “need not extend the common law of fraud to require comparable disclosure in other markets or for other commodities or services”).

creases trading costs, and undermines the market-analyst community. Commodities markets constitute a seven-generation-long,¹⁹ \$400 trillion²⁰ natural experiment in permitting unlimited insider trading, which may help inform existing debates. Significantly, commodities markets seem to operate passingly well without the benefit of insider trading restrictions, suggesting that some arguments against insider trading may have been overstated.²¹ Thus, commodities markets have something to learn from securities markets about the value of insider trading restrictions, but also something to teach.

This Article is the first one to examine potential changes in insider trading rules, as well as the only Article to seriously grapple with the commonalities and differences between the legal treatments of insider trading in the world's two largest financial markets.²² This Article is part of a broader project of intersecting futures and securities markets,²³ a recent resurgence of scholarly interest in insider trading,²⁴ and a broader

¹⁹ See Timeline of CME Achievements, CME Group, <http://www.cmegroup.com/company/history/timeline-of-achievements.html> (last visited Jan. 14, 2015) (beginning in 1848).

²⁰ The CFTC regulates commodities markets with a notional value exceeding \$400 trillion. U.S. Commodity Futures Trading Comm'n, President's Budget and Performance Plan, Fiscal Year 2015 1 (Mar. 2014), <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cftcbudget2015.pdf> [<https://perma.cc/RLC6-DV9L>]. This is much larger than the securities markets. The market capitalization of all companies in the world is about \$60 trillion. Mark J. Perry, Global Stock Rally: World Market Cap Reached Record High in March, and Is \$2.4T Above Pre-Recession, Pre-Crisis Level, AEIdeas (Apr. 14, 2014, 5:07 PM), <http://www.aei.org/publication/global-stock-rally-world-market-cap-reached-record-high-in-march-and-is-2-4t-above-pre-recession-pre-crisis-level>. The value of all the world's bonds hovers around \$100 trillion. Susanne Walker & Liz Capo McCormick, Unstoppable \$100 Trillion Bond Market Renders Models Useless, Bloomberg Bus. (June 2, 2014, 3:37 PM), <http://www.bloomberg.com/news/2014-06-01/the-unstoppable-100-trillion-bond-market-renders-models-useless.html>.

²¹ *Infra* Part IV.

²² Professors Douglas B. Levene and Yesha Yadav have both discussed insider trading in CDS, but not in commodities generally. Levene, *supra* note 14; Yadav, *supra* note 14. Carlucci's treatment of insider trading is brief (two pages) and fails to notice important features of the commodities markets, such as the existence of breachable duties. Carlucci, *supra* note 16, at 475–78. Similar limitations apply to the 1984 student note by Nina Goodman. Goodman, *supra* note 16.

²³ Rosa M. Abrantes-Metz, Gabriel Rauterberg & Andrew Verstein, Revolution in Manipulation Law: The New CFTC Rules and the Urgent Need for Economic and Empirical Analyses, 15 U. Pa. J. Bus. L. 357 (2013); Andrew Verstein, Benchmark Manipulation, 56 B.C. L. Rev. 215 (2015) [hereinafter Verstein, Benchmark Manipulation].

²⁴ Research Handbook on Insider Trading, *supra* note 17; Jesse M. Fried, Insider Trading via the Corporation, 162 U. Pa. L. Rev. 801 (2014); Sung Hui Kim, Insider Trading as Private Corruption, 61 UCLA L. Rev. 928 (2014); Donald C. Langevoort, "Fine Distinctions" in the Contemporary Law of Insider Trading, 2013 Colum. Bus. L. Rev. 429 (2013); Levene,

movement of looking past rigid doctrinal boundaries to detect market-endangering risks.²⁵ Since access to information is an important motivation for bank growth,²⁶ this Article also intersects with the literature on “too-big-to-fail”²⁷ and the separation of commerce and banking.²⁸

This Article will proceed in the following manner. Part I will provide a brief primer on the role and operation of commodities derivatives markets. Those familiar with commodities markets may wish to simply note the increasing importance of financial derivatives, such as interest rate swaps; the commodities world is no longer just cattle and corn. Part II will review the law on insider trading over time, juxtaposing the treatment of securities and commodities. Again, a reader anxious to proceed should take note of this simple summary: Commodities faced no insider trading restrictions for most of their history, but, beginning in 2011, the CFTC has signaled interest in implementing restrictions akin to those in securities markets. Part III will illustrate why the securities and commodities markets are not so radically different in the ways that matter to insider trading law and policy, and so warrant harmonized restrictions on insider trading. Part IV will apply securities theories of insider trading to commodities markets to gather evidence as it bears on the validity of the theories.

I. AN INTRODUCTION TO COMMODITIES

Commodities markets are the world’s largest markets,²⁹ as well as the oldest.³⁰ Beginning in the mid-nineteenth century, merchants in Chicago

supra note 14; Jeanne L. Schroeder, *Taking Stock: Insider and Outsider Trading by Congress*, 5 *Wm. & Mary Bus. L. Rev.* 159 (2014); Yadav, supra note 14.

²⁵ E.g., Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys., *Implementing a Macroprudential Approach to Supervision and Regulation at the 47th Annual Conference on Bank Structure and Competition* (May 5, 2011); Kara M. Stein, Comm’r, U.S. Sec. & Exch. Comm’n, *Remarks Before the Peterson Institute of International Economics* (June 12, 2014).

²⁶ *Infra* Section III.A.

²⁷ Steven L. Schwarcz, *Too Big to Fail?: Recasting the Financial Safety Net*, in *The Panic of 2008: Causes, Consequences and Implications for Reform* 94, 94 (Lawrence E. Mitchell & Arthur E. Wilmarth, Jr., eds., 2010).

²⁸ Saule T. Omarova, *The Merchants of Wall Street: Banking, Commerce, and Commodities*, 98 *Minn. L. Rev.* 265, 268 (2013); K. Sabeel Rahman, *Democracy and Productivity: The Glass-Steagall Act and the Shifting Discourse of Financial Regulation*, 24 *J. Pol’y Hist.* 612, 613 (2012).

²⁹ See supra text accompanying note 20.

³⁰ One early corner in the olive oil market was executed by the philosopher Thales more than 2,500 years ago. 1 *The Politics of Aristotle* 21–22 (B. Jowett trans., Oxford, Clarendon Press 1885).

met to trade not just grain and livestock, but also *promises* to deliver those commodities in the future.³¹ A rancher and a slaughterhouse could use standardized contracts to memorialize the quantity and price for a transaction many months away. While these contracts could be used to satisfy actual needs for beef, their chief appeal has long been their viability for speculation and hedging.

Consider first the speculator. Suppose that a merchant predicted in 1892 that the 1893 Columbian Exhibition in Chicago would have the effect of increasing the price of beef, as nearly half of all Americans visited the city and had their first taste of the best the stockyards had to offer.³² One way to profit from this insight would be to buy and hold vast herds of cattle, ultimately selling in 1894 at the new, higher price. Yet not all trendpickers are able to drop everything and become ranchers. Futures contracts make speculation easier. The speculator can contract with someone else to raise and then deliver livestock next year; the speculator could offer to pay some predetermined price, such as the 1893 price (plus, perhaps, an allowance for the cost of feeding the cattle), regardless of how the volatile price for beef may move.

If the speculator is correct about rising demand, then the speculator's *contract* to receive cattle at the 1893 price will itself be an attractive asset in 1894. Rather than receiving the cattle and then reselling them, the speculator can sell her cattle entitlement to someone better situated to handle them. Slaughterhouses will be delighted to receive cattle at last year's prices and would gladly pay the speculator to take the cattle and contract off of her hands. Then she locks in her appreciated investment without ever having to herd the livestock.

The speculator may even sell the contract to a rancher who had previously obliged himself to deliver cattle to Chicago. The rancher would then both owe and be owed cattle at the old price, cancelling out his obligation and releasing himself of the hassle of actually driving the herd all the way to Chicago. The rancher's intention all along may have been to sell the cattle locally, but he may have entered into the contract as insurance ("a hedge") against potentially lower cattle prices. If beef had somehow gone down in price, this bad news would be paired with good

³¹ See CME Group, *supra* note 19.

³² U.S. Census Bureau, POP Culture: 1890, https://www.census.gov/history/www/through_the_decades/fast_facts/1890_fast_facts.html [<https://perma.cc/D684-K8GW>] (last revised Jan. 4, 2016) (finding that more than 25 million of the 63 million people living in the United States at that time attended).

news from the futures market, where he is entitled to sell his cattle to the speculator at the older, higher price. The price of hedging bad news is paid in the good years: If the World's Fair really does boost the 1894 price, he will hold a valuable herd, but he will owe much of its value to the speculator.

To the rancher, the futures exchange provides insurance or a hedge. To the speculator, the exchange means a chance to profit from her insights. And society as a whole gets to watch, learning from the futures exchanges' clearing prices what the laws of supply and demand show of cattle at the moment. Price discovery and price signals are essential to a market society.³³ If prices are accurate, and exchanges make those prices public, then it is easy for others to learn from them. Other farmers can see the rising livestock prices and shift their efforts from poultry to cattle, for example.

While it is natural to think of commodities markets in terms of natural resources and agricultural products, the legal definition of "commodity" is actually far more expansive. The category includes "all services, rights, and interests . . . in which contracts for future delivery are presently or in the future dealt in."³⁴

This expansive definition also allows the CFTC to govern the largest financial markets in the world.³⁵ Bets on interest rates make up at least 70% of the entire futures and swaps market.³⁶ The \$5 trillion foreign currency exchange market,³⁷ in which Yen are swapped for Euros, is

³³ F.A. Hayek, *The Use of Knowledge in Society*, 35 *Am. Econ. Rev.* 519, 525–28 (1945).

³⁴ 7 U.S.C. § 1a(9) (2012).

³⁵ Dennis Kuo, David Skeie, & James Vickery, *A Comparison of Libor to Other Measures of Bank Borrowing Costs 1* (June 2012) (preliminary draft), https://www.newyorkfed.org/medialibrary/media/research/economists/vickery/LiborKSV_staff_webpage.pdf [<https://perma.cc/G8R9-KCS4>] (\$360 trillion interest rate swap market).

³⁶ *Oversight of the Commodity Futures Trading Commission: Hearing Before the S. Comm. on Agric., Nutrition & Forestry*, 113th Cong. 53 (2013) (statement of Gary Gensler, Chairman, Commodity Futures Trading Commission), <https://www.gpo.gov/fdsys/pkg/CHRG-113shrg87564/pdf/CHRG-113shrg87564.pdf> [<https://perma.cc/7SZ2-MAK4>].

³⁷ Compare Dagfinn Rime & Andreas Schrimpf, *The Anatomy of the Global FX Market Through the Lens of the 2013 Triennial Survey*, *BIS Q. Rev.* 27 (2013), http://www.bis.org/publ/qtrpdf/r_qt1312e.pdf [<https://perma.cc/R3U5-BJD4>] (indicating the FX market is \$5 trillion per day), with *U.S. Bond Market Trading Volume – Monthly Data*, *Sec. Indus. and Fin. Mkts. Ass'n*, <http://www.sifma.org/research/statistics.aspx> (last visited Mar. 11, 2016) (indicating the bond market is about one-tenth of the FX market's size as of mid-2014).

likewise under the CFTC bailiwick.³⁸ Although *individual* stocks are governed by the securities regime, futures concerning *groupings* of ten or more stocks are subject to commodities regulation.³⁹

With Dodd-Frank,⁴⁰ the CFTC was charged with oversight over other commodities derivatives, including the vast swap market.⁴¹ Swaps, futures, and options are each instruments by which an informed trader could make a profitable bet on commodities prices. Though few would recognize these abstract financial transactions as related to livestock, modern commodities transactions still serve the essential functions of speculation, hedging, and price discovery.

II. A COMPARATIVE HISTORY OF INSIDER TRADING REGULATION

A. *Early Toleration of Insider Trading*

In the early days of the republic, caveat emptor reigned and informed traders were generally able to use their privileged information without disclosing it to their hapless counterparty. The touchstone case for this proposition is *Laidlaw v. Organ*.⁴² Fittingly, *Laidlaw* was a commodities case.⁴³

During the War of 1812, a British fleet blockaded exports and drove down commodity prices. While negotiating with the British, a delegation from the city of New Orleans learned that a truce had been signed between Washington and London.⁴⁴ Owing to the blockade of the port, the difficulty of overland communications, and the strictness of the city's

³⁸ See generally, Verstein, Benchmark Manipulation, *supra* note 23 (discussing the scope of the CFTC's authority over benchmark manipulation).

³⁹ 7 U.S.C. § 1a(25)(A) (2012); U.S. Commodity Futures Trading Comm'n, Security Futures Products Overview (Jan. 13, 2015), <http://www.cftc.gov/IndustryOversight/ContractsProducts/SecurityFuturesProduct/sfpoverview> [<https://perma.cc/78R8-GK7B>]; see also *infra* note 115.

⁴⁰ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

⁴¹ Legal Info. Inst. at Cornell Univ. Law Sch., Dodd-Frank: Title VII – Wall Street Transparency and Accountability, http://www.law.cornell.edu/wex/dodd-frank_title_VII [<https://perma.cc/96UW-369L>].

⁴² 15 U.S. (2 Wheat.) 178 (1817).

⁴³ Morton J. Horwitz, *The Transformation of American Law, 1780–1860*, at 182 (1977) (calling *Laidlaw* “one of the first cases to come before the Court involving a contract for future delivery of a commodity”).

⁴⁴ Joshua Kaye, Disclosure, Information, the Law of Contracts, and the Mistaken Use of *Laidlaw v. Organ*, 79 Miss. L.J. 577, 580 (2010).

martial law, the delegates knew that they were the first ones to hear the good news.⁴⁵

Upon returning from the mission, one of the delegates worked with business associates to buy vast sums of tobacco at blockade prices without disclosing the truce—even to a counterparty who affirmatively “asked if there was any news which was calculated to enhance the price or value of the article about to be purchased.”⁴⁶ The price of tobacco soon shot up, and the seller balked. In the subsequent judicial decision upholding the validity of their agreement, Chief Justice Marshall explained that no fraud had been perpetrated, “unless rising earlier in the morning, and obtaining by superior diligence and alertness that intelligence by which the price of commodities was regulated, be such.”⁴⁷ As such, the buyers were free to use their institutionally-derived, superior information for profit.

Though a commodities case, *Laidlaw* set the tone for nineteenth- and twentieth-century attitudes towards securities trading.⁴⁸ Few firms privately restricted trading by their executives,⁴⁹ and insider trading seems to have been common.⁵⁰ Most states held that officers and directors were free to trade using inside information so long as they did not affirmatively lie, even when trading with their own shareholders.⁵¹ Officers and directors owed duties *to the corporation* and not *to the shareholder* and,

⁴⁵ Id. at 589. Indeed, General Jackson would not see the official document until more than a week later. Id.

⁴⁶ *Laidlaw*, 15 U.S. (2 Wheat.) at 183.

⁴⁷ Id. at 193.

⁴⁸ See, e.g., Kaye, *supra* note 44, at 604 (discussing Naomi R. Lamoreaux, *Insider Lending: Banks, Personal Connections, and Economic Development in Industrial New England* 12 (1994)). On recent creation of a salaried government bureaucracy, see generally Nicholas R. Parrillo, *Against the Profit Motive: The Salary Revolution in American Government, 1780–1940* (2013) (documenting ubiquity of government officials using the power and information of their offices for profit-seeking).

⁴⁹ See Adolf A. Berle, Jr. & Gardiner C. Means, *The Modern Corporation and Private Property* 327 (1933) (“It is known that certain companies, usually under the dominance of some strong individual, decline to permit anyone . . . whether as director or as employee to conduct speculative operations in the corporate stock. On the other hand, it is certain that this is not the general practice . . .”); see also Henry G. Manne, *Insider Trading: Hayek, Virtual Markets, and the Dog that Did Not Bark*, 31 J. Corp. L. 167, 176–77 (2005) (arguing that business community was silent as to insider trading).

⁵⁰ See, e.g., Edwin Lefèvre, *Reminiscences of a Stock Operator* (1923).

⁵¹ See, e.g., *Goodwin v. Agassiz*, 186 N.E. 659, 661–62 (Mass. 1933); *Bd. of Comm’rs of Tippecanoe Cnty. v. Reynolds*, 44 Ind. 509, 516, 524 (Ind. 1873).

absent some “special facts,” there was no harm in mere silence as to relevant secrets.⁵²

B. Divergence Between Securities and Commodities Regulation

The Great Depression motivated Congress to constrain insider trading in securities markets,⁵³ though it was only by the 1960s that a divergence emerged between securities regulation, which rapidly and intensely limited insider trading, and commodities regulation, which did not.

The watershed moment for the federal regulation of insider trading was *Texas Gulf Sulphur*. Not only was it the first federal court decision to address insider trading of securities under Section 10(b) of the Securi-

⁵² The Supreme Court blessed in *Strong v. Repide*, 213 U.S. 419, 431, 434 (1909), the “special facts” rule. In that case, a director and majority shareholder personally negotiated valuable sales of property to the Philippine government, while buying up shares in face-to-face dealings, and implying that such land sales were unlikely to occur. *Id.* at 424–26. Jurisdictions permitting insider trading began to acknowledge that face-to-face circumstances, with egregious abuses of asymmetric information, might be fraudulent. But the limits on this theory were many. It did not purport to limit anonymous trading or trading in the absence of a fiduciary relationship. See, e.g., *Goodwin*, 186 N.E. at 660–62. Other states adopted more restrictive rules, such as duties of candor when directors trade with shareholders. *Stewart v. Harris*, 77 P. 277, 279, 281 (Kan. 1904); *Oliver v. Oliver*, 45 S.E. 232, 233–34 (Ga. 1903). And several states allowed shareholders to pursue duty of loyalty cases against insiders who had misappropriated corporate assets in the form of tradable information. *Katz Corp. v. T.H. Canty & Co.*, 362 A.2d 975, 980 (Conn. 1975) (“It has been recognized that inside trading by a corporate fiduciary may be a violation of the common-law duty which he owes to his corporation.”); *Brophy v. Cities Serv. Co.*, 70 A.2d 5, 7–8 (Del. Ch. 1949); *Diamond v. Oreamuno*, 248 N.E.2d 910, 913 (N.Y. 1969); cf. *United States v. O’Hagan*, 521 U.S. 642, 655 (1997) (“[T]he fiduciary-turned-trader may remain liable under state law for breach of duty of loyalty.”). Such state law insider trading regimes have had limited influence. See Timothy R. Dudderar & Samuel L. Clocic, *The Slow but Sure Evolution of Brophy: Delaware’s Common Law Action for Insider Trading*, Am. Bar Ass’n: Bus. L. Today, Apr. 2014, http://www.americanbar.org/publications/blt/2014/04/delaware_insider.html (“In the years following the Court of Chancery’s recognition of a *Brophy* claim, the cause of action was infrequently asserted.”); Joel Seligman, *The New Corporate Law*, 59 Brook. L. Rev. 1, 1–2 (1993); accord Henry G. Manne, *Insider Trading and the Stock Market* 22 (1966) (asserting that no common law decision has ever found an insider liable for a transaction that took place over an anonymous exchange); *Research Handbook on Insider Trading*, supra note 17, at 108. But see *Kahn v. Kolberg Kravis Roberts & Co.*, 23 A.3d 831, 836 (Del. 2011) (holding that *Brophy* is still good law, and able to give rise to substantial disgorgement remedies).

⁵³ S. Rep. No. 73–792, at 9 (1934). The degree to which Congress intended a broad insider trading prohibition is contested. See Michael P. Dooley, *Enforcement of Insider Trading Restrictions*, 66 Va. L. Rev. 1, 55–69 (1980); see also Frank H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 Sup. Ct. Rev. 309, 317–20 (arguing that Congress did not intend that the 1934 Act be expansive in the area of insider trading).

ties Exchange Act of 1934⁵⁴ and Rule 10b-5,⁵⁵ it also embraced an expansive theory of liability. Rejecting any requirement of face-to-face exchange, or traditional fiduciary role, the U.S. Court of Appeals for the Second Circuit instead asserted an “equal access theory.” This theory entailed that anyone who has “access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone’ may not take ‘advantage of such information knowing it is unavailable to those with whom he is dealing,’ i.e., the investing public.”⁵⁶ This holding was “based in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information.”⁵⁷ For a time, nearly any kind of securities insider trading was arguably illegal.⁵⁸

While restriction on securities trading reached its zenith under *Texas Gulf Sulphur*, commodities insider trading remained unchanged. No court identified a “special facts” doctrine or “minority rule” in favor of commodities traders,⁵⁹ nor were state misappropriation doctrines brought to bear on executives who used company secrets, suggesting that states were unanimous in their toleration of insider trading in commodities and

⁵⁴ Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881.

⁵⁵ See A.C. Pritchard, *Launching the Insider Trading Revolution: SEC v. Capital Gains Research Bureau*, in *Research Handbook on Insider Trading*, supra note 17, at 33, 47 (discussing *SEC v. Capital Gains Research Bureau*, 375 U.S. 180 (1963), which was the first federal insider trading case, but was brought under Investment Advisors Act of 1940).

⁵⁶ *Tex. Gulf Sulphur*, 401 F.2d at 848 (citing *Cady, Roberts & Co.*, 40 S.E.C. 907, 912 (1961)).

⁵⁷ See *Research Handbook on Insider Trading*, supra note 17, at 137 n.35.

⁵⁸ Commentary during this period sought limiting principles for the holding in *Texas Gulf Sulphur*. Many discussions focused on the difference between true inside information, or “corporate” information relating to the operations of the issuer company, and “market” information, which concerns features about the market’s likely reaction to certain facts and information. See, e.g., Brudney, supra note 18, at 329–30 & 329 n.31; Arthur Fleischer, Jr., Robert H. Mundheim, & John C. Murphy, Jr., *An Initial Inquiry Into the Responsibility to Disclose Market Information*, 121 U. Pa. L. Rev. 798, 798–99 (1973) (distinguishing between corporate information and market information). Others attempted to limit *Texas Gulf Sulphur* to its particular facts. See, e.g., Thomas Lee Hazen, *Corporate Insider Trading: Re-awakening the Common Law*, 39 Wash. & Lee L. Rev. 845, 850 (1982) (describing an effort to limit *Texas Gulf Sulphur*). The present tendency to emphasize the expansiveness of *Texas Gulf Sulphur* may therefore be overstated. Still, the rule from *Texas Gulf Sulphur* is certainly stronger than the contemporaneous requirements in commodities markets.

⁵⁹ A Westlaw search finds no cases citing *Brophy v. Cities Service Co.*, 70 A.2d 5 (Del. Ch. 1949) or *Strong v. Repide*, 213 U.S. 419 (1909), or their equivalents that also address commodities or futures.

futures. No equivalent suit to *Texas Gulf Sulphur* was brought under the Commodity Exchange Act (“CEA”), the governing statute for commodities markets.⁶⁰

The unrestricted trading of commodities can also be seen in *Texas Gulf Sulphur* itself, which was, after all, a commodities case. In that matter, there were no enforcement actions related to mineral trading. When landowners argued that TGS should have disclosed its mineral findings before buying up their land, the Ontario High Court of Justice found no such principle applicable to the real economy: “Under the circumstances, I believe Texas Gulf did what any prudent mining company would have done to acquire property in which it knew a very promising anomaly lay.”⁶¹ Likewise, numerous scholars have explicitly⁶² or implicitly⁶³ asserted that nonsecurities trading based on the facts of *Texas Gulf Sulphur* would have triggered no special legal obligations akin to those imposed on securities traders. The message was clear: No one can use material, nonpublic information to trade mineral companies—but anyone can use any material, nonpublic information to trade minerals.

In the 1980s, the U.S. Supreme Court cabined the scope of securities insider trading, retreating from the “equal access” theory of *Texas Gulf Sulphur*, by requiring the breach of one of two duties in connection with the informed trade. The “classical” theory asks whether the trader has some special duty to *their counterparty*. The Court in *Chiarella v. United States* identified traditional insiders—executives and directors at a company—as having a duty to avoid trading with their current and future shareholders on the basis of undisclosed material information.⁶⁴ In *Dirks v. SEC*, the Court held that noninsiders may also possess such a duty to shareholder-counterparties if either (a) an insider improperly

⁶⁰ See generally Commodity Exchange Act, 7 U.S.C. §§ 1–26 (2012) (establishing a regulatory regime for commodities markets).

⁶¹ *Leitch Gold Mines, Ltd. v. Tex. Gulf Sulphur Co.*, 3 D.L.R. 3d 161, 184–85 (Can. Ont. Sup. Ct. J. 1969); see also Morton Shulman, *The Billion Dollar Windfall* (1969) (describing U.S. litigation concerning land purchases settled out of court).

⁶² See, e.g., Anthony T. Kronman, *Mistake, Disclosure, and the Law of Contracts*, 7 *J. Legal Stud.* 1 (1978).

⁶³ See, e.g., Ian Ayres & Stephen Choi, *Internalizing Outsider Trading*, 101 *Mich. L. Rev.* 313 (2002).

⁶⁴ 445 U.S. 222, 230 (1980); accord *Dirks v. SEC*, 463 U.S. 646, 653–55 (1983).

gave the noninsider the information;⁶⁵ or (b) a noninsider acquired the information solely for a corporate purpose.⁶⁶

Where the trader has no duty—direct or derivative—to shareholders, a second theory finds liability for breaching a duty *to the source of the information*. In *United States v. O’Hagan*, Justice O’Connor explained that “a fiduciary’s undisclosed, self-serving use of a principal’s information to purchase and sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information.”⁶⁷ This “misappropriation” theory disallows informed trading whenever the trader has assumed a duty of confidentiality—to her employer, spouse, or the insider who tipped her.⁶⁸ Requiring the presence and breach of some duty served to exempt most informed trading from the scope of insider trading law.

At the same time that the scope of securities insider trading regulation withdrew, regulation of insider trading in commodities markets barely changed. Restrictions were imposed on informed commodities trading by some government⁶⁹ and exchange officials.⁷⁰ Federal courts upheld

⁶⁵ 463 U.S. at 660. The derivatively-informed trader must know that the information was given in violation of a fiduciary duty and that the tipper received a benefit for the information. *United States v. Newman*, 773 F.3d 438, 442 (2d Cir. 2014). But see *United States v. Salman*, 792 F.3d 1087 (9th Cir. 2015) (ruling that the personal benefit requirement can be satisfied merely if the tipper intended a friend or relative to be able to profit from the information), cert granted in part, 84 U.S.L.W. 3401 (U.S. Jan. 19, 2016) (No. 15-628).

⁶⁶ 463 U.S. at 655 n.14.

⁶⁷ 521 U.S. 642, 652 (1997).

⁶⁸ See, e.g., *SEC v. Yun*, 327 F.3d 1263, 1272–73 (11th Cir. 2003) (explaining that “a spouse who trades in breach of a reasonable and legitimate expectation of confidentiality held by the other spouse sufficiently subjects the former to insider trading liability [such as] if the husband and wife had a history or practice of sharing business confidences, and those confidences generally were maintained by the spouse receiving the information”).

⁶⁹ 7 U.S.C. § 13(c) (2012) (barring insider trading by members of the CFTC and their staff).

⁷⁰ 17 C.F.R. § 1.59 (2013); H.R. Rep. No. 102–978 (1992). Recent changes have increased the scope of this prohibition to include employees at clearinghouses, swap data repositories, and futures associations. 7 U.S.C. § 13(e) (2012). The exchanges have likewise adopted rules. CME Group, SEF Rulebook § 300.F, <http://www.cmegroup.com/rulebook/SEF/cme-sef-rulebook.pdf> (last visited Feb. 9, 2016) (noting that insider trading prohibition applies only to members of CME committees with respect to what they learn on the committee). The New York Mercantile Exchange (“NYMEX”) has a rule prohibiting any person from disclosing another person’s order or “tak[ing] action or direct[ing] another to take action based on non-public order information, however acquired.” CME Group, NYMEX Rulebook § 532 (2009), <http://www.cmegroup.com/rulebook/NYMEX/1/5.pdf>. This arguably prohibits insider trading on the basis of customer orders even when it would not amount to front-running. But see generally Gary Rubin, Note, CFTC Regulation 1.59 Fails to Adequately Regulate

criminal convictions for front-running by brokers of commodities,⁷¹ but further restrictions were not adopted.

Congress frequently considered imposing broad insider trading restrictions in commodities markets, but the CFTC repeatedly deflected such efforts. After considering a 1982 bill to stop informed speculation,⁷² Congress instead kicked the can to the CFTC to prepare a report on the viability of an insider trading regime for commodities and futures markets. That 1984 report argued against insider trading restrictions, citing the rationales discussed in Part III,⁷³ and Congress largely abandoned any efforts at greater regulation.

Similar laws were considered in 1991,⁷⁴ and the CFTC opposed this bill too.⁷⁵ Not only did Congress again follow the CFTC's urging by voting down new restrictions, it would later go so far as to codify the CFTC's position (the opposite of the one considered in the 1991 bill) by clarifying in 2008 that the CEA

shall not obligate any person, in or in connection with a transaction in a contract of sale of a commodity for future delivery, [or a swap], with another person, to disclose to the other person nonpublic information that may be material to the market price, rate, or level of the commodity or transaction, except as necessary to make any statement

Insider Trading, 53 N.Y.L. Sch. L. Rev. 599, 601 (2008) (arguing that 17 C.F.R. § 1.59 is insufficient to regulate insider trading on commodities markets).

⁷¹ *United States v. Dial*, 757 F.2d 163, 164, 169–71 (7th Cir. 1985). Front-running is the practice of quickly buying one's own stockpile of an asset before helping a client to buy that same asset, so as to ensure a quick profit on any appreciation soon caused by the client order. Because the broker trades on her special knowledge of a secret fact—that her customer will soon demand a large quantity—Judge Posner likened front-running to insider trading. *Id.* at 169 (discussing front-running in terms of the insider trading debate). See Jerry W. Markham, "Front-Running"—Insider Trading Under the Commodity Exchange Act, 38 *Cath. U. L. Rev.* 69 (1988) (discussing front-running by commodities intermediaries and others). The CFTC has subsequently used that precedent to pursue front-running by nonbrokers. Mark J. Sitzman, CFTC No. 96-5, 1997 WL 82610, at *3 (Feb. 26, 1997).

⁷² 128 Cong. Rec. H7522 (daily ed. Sept. 23, 1982) (statements of Rep. de la Garza and Rep. Smith); see also 124 Cong. Rec. 32,704 (1978) (House voted to lightly restrict insider trading, but measure died in conference committee).

⁷³ See *infra* Part III.

⁷⁴ Commodity Futures Improvements Act of 1991, H.R. Rep. No. 102-6, 58-61. Congress did, however, restrict insider trading by employees and officials at commodities exchanges. Futures Trading Practices Act of 1992, Pub. L. No. 102-546, 106 Stat. 3590.

⁷⁵ H.R. Rep. No. 102-6, at 59.

made to the other person in or in connection with the transaction not misleading in any material respect.⁷⁶

While the 1980s and 1990s were a period of great interest in insider trading, there was little change in the regulation of commodities insider trading.

As late as 2009, the CFTC could assert, “the CFTC has no jurisdiction over insider trading in any way, unless a commissioner or a Board of Trade member engages in it”⁷⁷ Officially, there is still no general restriction on insider trading in commodities markets. This has been confirmed by statutory language,⁷⁸ rulemaking,⁷⁹ and testimony by CFTC staff.⁸⁰

C. The Future of Insider Trading

Notwithstanding the rhetoric, a sea change has occurred in the last five years. Concerned that the CFTC had a poor litigation track record, Congress authorized the CFTC to adopt new antifraud rules that would cut through many barriers to enforcement actions. These antifraud powers were intentionally crafted with the Securities and Exchange Commission’s (“SEC’s”) 10b-5 jurisprudence in mind. This was not the first time that Congress and the CFTC had contemplated 10b-5 as a model for new powers, and previous discussions had foundered explicitly because 10b-5 was the situs of the SEC’s insider trading jurisprudence. Fear of accidentally incorporating securities insider trading rules into

⁷⁶ CFTC Reauthorization Act of 2008, Pub. L. No. 110-246, § 4b(b), 122 Stat. 2189, 2195.

⁷⁷ See Joint Meeting on Harmonization, *supra* note 16, at 38.

⁷⁸ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 753, 124 Stat. 1376, 1750 (2010).

⁷⁹ Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41,398, 41,403 (July 14, 2011) (to be codified at 17 C.F.R. pt. 180), <http://www.cftc.gov/LawRegulation/FederalRegister/FinalRules/2011-17549> [<https://perma.cc/QE99-MZ7V>] (“This final Rule does not prohibit trading on the basis of material nonpublic information except as provided in the following paragraph or otherwise prohibited by law.”).

⁸⁰ U.S. Commodity Futures Trading Comm’n, *supra* note 5, at 38 (“This prohibition in the securities markets rests on the corporate insider’s duty to disclose the information before he is permitted to trade the stock. The futures and derivatives markets, on the other hand, do not impose the same legal duty and the final rule before you expressly states that it does not impose a duty of disclosure.”).

commodities markets led the CFTC to reject antifraud authority in the past.⁸¹

But much had occurred since prior debates, including a financial crisis that encouraged the passage of many new financial regulations. “Misappropriation” in commodities returned to the table in connection with the “Eddie Murphy” rule, which banned commodities traders from misappropriating secrets from federal agencies and employees—hitherto quite legal—as was central to the plot in the Eddie Murphy film *Trading Places*.⁸² Proponents of the Eddie Murphy rule discussed *only* the importance of stopping misappropriation of government secrets,⁸³ and the text of Dodd-Frank reflected this limited project.⁸⁴

However, misappropriation doctrines have in the past managed to migrate from governmental actors to corporate actors,⁸⁵ and the CFTC soon included a general misappropriation standard in the preamble to its new antifraud rules.⁸⁶ The Commission’s comments in connection with the issuance of the final rule notes that:

[T]rading on the basis of material nonpublic information in breach of a pre-existing duty (established by another law or rule, or agreement,

⁸¹ 13 Jerry W. Markham, *Commodities Regulation: Fraud, Manipulation, and Other Claims* § 2:3 (2015); cf. 13A Markham, *supra*, § 18:8 (discussing the lack of a broad insider trading proscription under the CEA).

⁸² *Trading Places* (Paramount Pictures 1983).

⁸³ See Hearing to Review Implementation of Changes to the Commodity Exchange Act Contained in the 2008 Farm Bill: Hearing Before the Subcomm. on Gen. Farm Commodities and Risk Mgmt. of the H. Comm. on Agric., 111th Cong. 4–8 (2010) (statement of Gary Gensler, Chairman, Commodity Futures Trading Commission) (discussing only government misappropriation, not private).

⁸⁴ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 746, 124 Stat. 1376, 1737–39 (2010).

⁸⁵ See, e.g., *Skilling v. United States*, 561 U.S. 358, 399–411 (2010) (analyzing a wire fraud statute that was used for decades in prosecuting government corruption and considering whether the same applies to corporate officials). On government insider trading, see Stephen M. Bainbridge, *Insider Trading Inside the Beltway*, 36 J. Corp. L. 281 (2011); see also Stop Trading on Congressional Knowledge Act of 2012, Pub. L. No. 112-105, §§ 4, 9, 126 Stat. 291, 292, 297–98 (prohibiting some kinds of trading by government officials); Manne, *supra* note 52, at 171, 181–83 (condemning insider trading by government officials); Donna M. Nagy, *Insider Trading, Congressional Officials, and Duties of Entrustment*, 91 B.U. L. Rev. 1105, 1113–16 (2011); Donna M. Nagy & Richard W. Painter, *Selective Disclosure by Federal Officials and the Case for an FGD (Fairer Government Disclosure) Regime*, 2012 Wis. L. Rev. 1285, 1287–88 (2012).

⁸⁶ Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41,398, 41,400–01 (July 14, 2011) (to be codified at 17 C.F.R. pt. 180).

understanding, or some other source), or by trading on the basis of material nonpublic information that was obtained through fraud or deception, may be in violation of final Rule 180.1.⁸⁷

This language is in accord with testimony by the CFTC's Head of Enforcement. While asserting that there remains no general ban on insider trading, he stated that "a person who engages in fraudulent or deceptive conduct by trading on the basis of material nonpublic information that he has misappropriated in breach of a preexisting duty will now be subject to a Commission enforcement action."⁸⁸ Thus, after decades of dissimilar regulation, commodities futures markets may potentially be subjected to the main insider trading restriction governing the securities markets.

Analogous changes have occurred in Europe. While some jurisdictions banned insider trading in commodities more than a decade ago,⁸⁹ most are about to experience massive changes to their legal regimes. In 2014, the European Commission promulgated a revision to the Market Abuse regulation requiring member states to ban insider trading in commodities and derivatives markets.⁹⁰ These changes have not gone entirely unnoticed. Professor Craig Pirrong, never afraid to share his candid reactions, told Reuters that Europe's recent new regulation "is mad," and added that "any attempt to apply insider trading concepts to commodities will sow confusion and wreak havoc."⁹¹ However, given

⁸⁷ *Id.* at 41,403. Changes may have occurred only in the preamble out of concern for 7 U.S.C. § 9(1) (2012), which prohibits the CFTC from adopting general disclosure requirements.

⁸⁸ See U.S. Commodity Futures Trading Comm'n, *supra* note 5, and accompanying text. Likewise, CFTC Commissioner Chilton announced, "With the adoption of this new rule Pocketing profits from the misuse of privileged information will now be prosecuted. We'll be able to get at, for example, bad actors akin to insider traders." Bart Chilton, Comm'r, U.S. Commodity Futures Trading Comm'n, *The Waiting: Statement Regarding Anti-Fraud and Anti-Manipulation Final Rules* (July 7, 2011), <http://www.cftc.gov/PressRoom/SpeechesTestimony/chiltonstatement070711> [<https://perma.cc/AE9R-PMFY>].

⁸⁹ See, e.g., 2001. Act CXX. Act on the Capital Markets § 199(2)(f) (Hung.), <http://www.ebrd.com/downloads/legal/securities/hungary2.pdf>.

⁹⁰ Council Regulation 596/2014, ch. 2, art. 7(1)(b), 2014 O.J. (L 173) 24 (EU) (defining insider trading information as that which would have a significant price impact and where disclosure is otherwise expected or required).

⁹¹ Maytaal Angel & Emma Farge, *EU Close to Agreeing Rules for Insider Trading in Commodities*, Reuters (June 14, 2013, 12:29 PM), <http://uk.reuters.com/article/2013/06/14/uk-commodity-regulations-idUKBRE95D0CE20130614>. Professor Pirrong goes on to clarify that he is not opposed to a ban on trading with misappropriated information, which is the sort of rule contemplated both by this Article and the CFTC. *Id.*

the scale of change on both sides of the Atlantic, reactions have been surprisingly muted.

III. TWO MARKETS, ALIKE

Securities-style insider trading restrictions were fought off for many decades by citing three reasons that commodities markets are fundamentally different.⁹² First, it was often argued that “there is almost no way to trade insider information in the commodities industry,”⁹³ usually because there is no material, nonpublic information. Second, it has been argued that commodities markets participants would rationally prefer a regime of unlimited trading, given their sophistication and need to hedge.⁹⁴ A third argument denied the existence of any duty, the breach of which taints the insider trader.⁹⁵ This Part of the Article illustrates why each of the purported differences is overstated.

A. Information

While executives often learn secrets that will significantly impact the price of their firm’s securities, it is thought that information concerning commodities is either immaterial (*Farmer Jones thinks his crop yields will suffer this year because he has not hired enough help*) or inherently public (*Midwestern towns are abuzz with talk of what everyone can see from highways in America’s heartland: Frost seems to have ruined everyone’s crop!*). This reasoning is part of why the Chairman of the CFTC once told Congress, “There is almost no way to trade insider information in the commodities industry.”⁹⁶ This Section goes to show that infor-

⁹² H.R. Rep. No. 102-6, at 59 (1991) (CFTC Commissioner stating that “[i]t is well recognized, however, that there are significant differences between the securities markets and the futures markets”).

⁹³ SEC/CFTC Jurisdictional Issues and Oversight Hearing, *supra* note 6, at 405 (statement of Phillip McBride Johnson, Chairman, Commodity Futures Trading Commission).

⁹⁴ U.S. Commodity Futures Trading Comm’n, A Study of the Nature, Extent and Effects of Futures Trading by Persons Possessing Material, Nonpublic Information 54 n.10 (1984) [hereinafter CFTC Report].

⁹⁵ U.S. Commodity Futures Trading Comm’n, *supra* note 5, at 38.

⁹⁶ SEC/CFTC Jurisdictional Issues and Oversight Hearing, *supra* note 6, at 405 (statement of Phillip McBride Johnson, Chairman, Commodity Futures Trading Commission); see also 1974 Hearings, *supra* note 6, at 183 (statement of Glenn Willett Clark, Professor of Law and Superintendent of Securities for the State of Iowa) (testifying that “[c]ommodities trading, unlike securities trading, takes place in an operational climate in which inside information has been assumed to be nonexistent”).

mation in commodities and securities markets is capable of both similar materiality and nonpublicity.

1. Material Information

The securities laws regulate trading only on “material” information, which is information important enough to be “viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”⁹⁷ Materiality “will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.”⁹⁸ Skeptics have doubted the materiality of commodities information both in terms of its magnitude and probability.⁹⁹ They have underestimated the importance of widespread commodities trading institutions, such as leveraged trading and financial benchmarking, which amplify the magnitude and probability that a given morsel of information will be significant.

a. Magnitude

It may seem unlikely that any single discovery could be of a magnitude to matter to commodities investors, given the immensity of worldwide commodities markets. News of TGS’s gigantic ore discovery in Canada, among the largest in history, only moved the price of copper by 5%.¹⁰⁰ Over the same period, TGS stock soared by 20%.¹⁰¹ This appears

⁹⁷ *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 445–49 (1976).

⁹⁸ *Basic Inc. v. Levinson*, 485 U.S. 224, 238 (1988) (quoting *Tex. Gulf Sulphur*, 401 F.2d at 849).

⁹⁹ SEC/CFTC Jurisdictional Issues and Oversight Hearing, *supra* note 6, at 77.

¹⁰⁰ Compiled prices, Wall St. J. (on file with author) [hereinafter WSJ Data]. Commodities futures prices have long been listed in the financial press. Digital archives of these sources make it easy to build a database of contemporary prices. The following arithmetic is based on such a compilation, drawn from the Wall Street Journal. The 5% price change assumes trading May 1965 copper contracts, shorting on April 10 at \$36.05, and closing out on either April 15 at \$34.30 or April 20 at \$34.25. Also note that only on March 30, 1964, the Wall Street Journal reported: “Copper futures contracts in New York rose to highs for the life of the contracts” *Copper Futures, Dealer Prices Continue to Rise: Quotes on London Exchange Also Climb Beyond 1-Cent Increase Set by Producers*, Wall St. J., Mar. 30, 1964, at 22. Major producers were experiencing labor troubles, and major export nations were agitating for higher commodity prices. *Id.* Thus these gains were against a baseline of inauspicious macroeconomic trends.

¹⁰¹ Buying on April 10 at \$30 1/8 and selling on April 16 at \$36 3/8. WSJ Data, *supra* note 100.

consistent with the oft-banded notion that insider trading in commodities markets lacks the grand rewards offered in securities markets, reducing both the temptation and importance of such trading.¹⁰²

Yet, side by side comparisons do not adequately convey the materiality of commodities market insights.¹⁰³ A dollar invested in TGS stock would appreciate more than a dollar occupied in shorting copper, but appreciation can be multiplied by investing on margin.¹⁰⁴ Investing on margin means taking on a large investment with only some small amount of money down, and the rest bought on credit. Buying on margin magnifies gains and losses.

Buying on margin is the norm in commodities markets. For about \$2,500 down as margin,¹⁰⁵ an investor can gain exposure to a contract representing 25,000 pounds of copper.¹⁰⁶ At prices of \$3.15740 per pound,¹⁰⁷ such a contract is exposure to \$78,935 worth of copper. In *Texas Gulf Sulphur*, the price of copper dropped by 5% when newspapers reported the bonanza.¹⁰⁸ A 5% move (from \$3.15740 to \$2.99953 per pound) changes the value underlying the contract by \$3,946.75. An investor with \$2,500 in her pocket could wager against the price of copper, watch a 5% change in copper prices, and realize a magnificent gain

¹⁰² CFTC Report, *supra* note 94, at 30, 58, app. IV-A at 8 (“Futures prices, by contrast, only rarely fluctuate with any one public firm’s performance.”).

¹⁰³ Yet large price swings do occur. See U.S. Geological Survey, Copper Statistics 3 (2014), <http://minerals.usgs.gov/minerals/pubs/historical-statistics/ds140-coppe.pdf> [<https://perma.cc/F8J5-PYPJ>] (reporting copper prices quadrupled between 2003 and 2007); U.S. Geological Survey, Zinc Statistics 3 (2014), <http://minerals.usgs.gov/minerals/pubs/historical-statistics/ds140-zinc.pdf> [<https://perma.cc/J2NC-Z5B4>] (reporting zinc prices nearly tripled between 2005 and 2006).

¹⁰⁴ It is far easier to invest on margin in commodities than securities. For securities, an investor can borrow *at most* 50% of the price of the security. 12 U.S.C. § 220.12(a) (2012). By contrast, margin limits for commodities trading are set by individual exchanges, and allow traders to readily borrow 95% or more of the future’s value. See, e.g., *infra* note 105.

¹⁰⁵ Margins vary from \$2,550 to \$2,850 depending on the contract. Copper Margins, CME Group, http://www.cmegroup.com/trading/metals/base/copper_performance_bonds.html#sortField=sector&sortAsc=false&exchange=CMX (last visited Mar. 11, 2016).

¹⁰⁶ Copper Futures Contract Specs, CME Group, http://www.cmegroup.com/trading/metals/base/copper_contract_specifications.html (last visited Mar. 11, 2016).

¹⁰⁷ Copper Pricing, Trade Serv. (on file with the Virginia Law Review Association), http://www.tradeservice.com/copper_pricing (providing pricing data for September 8, 2014).

¹⁰⁸ The 5% price change assumes trading May 1965 copper contracts, shorting on April 10 at \$36.05 and closing out on either April 15 at \$34.30 or April 20 at \$34.25. See WSJ Data, *supra* note 100. Shorting a financial asset amounts to betting against the asset’s price, since it obliges the trader to deliver the asset or its value *in the future* in exchange for its price at the present.

of almost 160%.¹⁰⁹ This is considerably better than the 20% return on TGS stock over that same period.¹¹⁰ Margin trading and the relative speed of commodities markets allow information to be used very profitably.¹¹¹

b. Probability

Magnitude aside, information may be material if it is essentially certain to impact the market price. Certainty might seem elusive in commodities markets, since so many factors impact the price of a commodity, threatening to dampen the influence of any one fact, but certain classes of information yield great confidence about future prices. For example, those with privileged access to information about price benchmarks can trade for almost certain gain.

Benchmarks are price-aggregating institutions. They gather relevant facts from market participants (“how much oil did you buy today? At what price?”) and then publish a synthesized result (“Platts Bakken assessment”). These summary statistics are of enormous importance in all markets,¹¹² but they are particularly meaningful in commodities markets.¹¹³ These summary statistics are by definition material, since they are written directly into financial contracts, and so foreknowledge of the benchmark price is foreknowledge of *the* price in many instances.¹¹⁴

Producers of benchmarks know before the market what the benchmark will report, and they can trade on this information or sell it to those who will. For example, the University of Michigan publishes a research

¹⁰⁹ This number is derived by dividing the amount realized (\$3,946.75) by the initial margin (\$2,500). Of course, a small decline in the value of the price of copper would have cost her dearly, potentially wiping out her position. A move of less than 4% would entirely overtake the investor’s margin.

¹¹⁰ Buying TGS Stock on April 10 at \$30 1/8 and selling on April 16 at \$36 3/8. See WSJ Data, *supra* note 100.

¹¹¹ It may seem that more information will have a larger impact on securities prices than commodities prices. This will depend on the relative size of the traded company and how much a given commodity insight relates only to that one company’s business—TGS stock would have moved rather little if the large copper deposit had been under land owned by several mining companies, but copper prices would still have responded. Even if so, it is not essential for this Article’s argument that information be material *as often* for commodities trading so long as information is *rather often* material.

¹¹² Gabriel Rauterberg & Andrew Verstein, Index Theory: The Law, Promise and Failure of Financial Indices, 30 *Yale J. on Reg.* 101, 106–114 (2013) [hereinafter Verstein, Index Theory].

¹¹³ Verstein, Benchmark Manipulation, *supra* note 23, at 225–30.

¹¹⁴ *Id.* at 228–29.

report on consumer confidence, which is thought to impact stock market prices.¹¹⁵ From 2007 until 2014, Michigan financed the benchmark by selling early access to its findings—to traders eager to buy and sell before others learned the news.¹¹⁶

Even without a tip from the benchmark provider, major contributors of data to the benchmark automatically gain substantial insight into the benchmark number. Consider the recent abuse of the London Interbank Offered Rate (“LIBOR”). This interest rate benchmark stands for the cost of money in most contracts seeking to represent a floating interest rate value. Subprime mortgages in the United States came to rest almost exclusively according to LIBOR, as did the most widely traded financial instrument in the world, Eurodollar Futures, which is a bet on interest rates.¹¹⁷ LIBOR has been called “the world’s most important number.”¹¹⁸

¹¹⁵ Bets on the report are usually placed on futures on broad-based stock indices, which are regulated as commodities futures. While *stocks* are securities, stock *baskets* are commodities. U.S. Commodity Futures Trading Comm’n, supra note 39. Contra CFTC Report, supra note 94, at 58–59 (opining that stock indices would be useless as vehicles to leverage inside information).

¹¹⁶ Grant Vingoe, Kathleen Scott & Lauren Bittman, New York Attorney General Applauds the Decision of the University of Michigan to Prevent Favored Release of its Consumer Sentiment Survey, Norton Rose Fulbright: Fin. Serv.: Reg. Tomorrow (Oct. 9, 2014), <http://nrf-fsrt-updates.ignite.lexblog.com/us/new-york-attorney-general-applauds-the-decision-of-the-university-of-michigan-to-prevent-favored-release-of-its-consumer-sentiment-survey>. See generally Grace Xing Hu, Jun Pan, & Jiang Wang, Early Peek Advantage? (Oct. 6, 2015) (unpublished manuscript, <http://ssrn.com/abstract=2361311>) (quantifying gains to fastest traders). Thompson Reuters, intermediary in these information sales, promised to desist after New York’s Attorney General announced his intent to investigate the conduct. Press Release, N.Y. Attorney Gen., A.G. Schneiderman Secures Agreement By Thomson Reuters To Stop Offering Early Access to Market-Moving Information (July 8, 2013), <http://www.ag.ny.gov/press-release/ag-schneiderman-secures-agreement-thomson-reuters-stop-offering-early-access-market> [<https://perma.cc/QU3V-A8J4>] (announcing new policy); Christie Smythe, Schneiderman Calls Traders With Early Data Growing Threat, Bloomberg Bus. (Sept. 24, 2013), <http://www.bloomberg.com/news/articles/2013-09-24/schneiderman-calls-traders-with-early-data-growing-threat>. However, it took thirteen months for Michigan to partner with a new intermediary—Bloomberg—that would distribute the data freely. Press Release, N.Y. Attorney Gen., A.G. Schneiderman Applauds Deal Between University of Michigan and Bloomberg Ending Early Release of Market-Moving to High-Frequency Traders (Oct. 7, 2014), <http://www.ag.ny.gov/press-release/ag-schneiderman-applauds-deal-between-university-michigan-and-bloomberg-ending-early> [<https://perma.cc/C8SQ-RYXZ>].

¹¹⁷ Oversight of the Commodity Futures Trading Commission: Hearing Before the S. Comm. on Agric., Nutrition & Forestry, 113th Cong. 53 (2013) (statement of Gary Gensler, Chairman, Commodity Futures Trading Commission), <https://www.gpo.gov/fdsys/pkg/CHRG-113shrg87564/pdf/CHRG-113shrg87564.pdf> [<https://perma.cc/7SZ2-MAK4>] (“Today, LIBOR is the reference rate for 70 percent of the U.S. futures market, most of the swaps market and nearly half of U.S. adjustable rate mortgages. It’s embedded in the wiring of our financial system.”).

¹¹⁸ LIBOR: The World’s Most Important Number, MoneyWeek (Oct. 10, 2008), <http://www.moneyweek.com/personal-finance/libor-the-worlds-most-important-number-13816>.

It was also the site of epic manipulation, the subject of which has already led to criminal indictments and billions of dollars in fines. LIBOR could be manipulated because it is set by a daily *poll* of a dozen or so major banks as to what rate they *think* they could borrow at. Much has been written about manipulation and fraud in this process.¹¹⁹ But no one has yet noted that *the polling system allowed even nonfraudulent bankers to make big trading gains*. A trader could bet profitably on interest rates if she always received a tip from poll participants about what answers they would submit today.

There is every indication that banks' traders expected and received such tips, as demonstrated by one abbreviated exchange at the Dutch lender, Rabobank:

Trader: Why did you put all the Yen libors higher for today without telling me? . . . I can't believe you did this without telling me. If you had to put them higher for some reason but at least you could have told me . . . before hand. . . .

Submitter: I am really sorry. . . . And I would never change libors without consulting you.¹²⁰

How much money could be made from the tipoffs that the trader had come to expect?¹²¹ Imagine that the exchange took place on December 10, 2010 regarding changes made from the previous day. The LIBOR submissions on those two days are listed in Table A:

¹¹⁹ See generally Verstein, *Index Theory*, supra note 112 (discussing manipulation and fraud in the LIBOR poll process).

¹²⁰ U.S. Commodity Futures Trading Comm'n, Office of Pub. Affairs, *Examples of Misconduct from Written Communications*, <http://www.cftc.gov/ucm/groups/public/@newroom/documents/file/abobank.pdf> [<https://perma.cc/5QDT-S9NP>] (quoting October 18, 2010 instant message exchange between JPY traders).

¹²¹ As a matter of fact, the trader in the above exchange does not appear to have lost any opportunity—LIBOR's mechanism was designed to erase the importance of some informational advantages, and it did on that October day. *Id.*

Table A: 6 Month JPY BBA LIBOR¹²²

Bank	9 December 2010	10 December 2010
Bank of Tokyo	0.32000	0.32000
CA-CIB	0.35000	0.35000
Barclays	0.35000	0.35000
Deutsche	0.34000	0.34000
Lloyds	0.34000	0.34000
Mizuho	0.36000	0.36000
HSBC	0.35000	0.35000
Citibank	0.36000	0.36000
MGT	0.34000	0.34000
Norinchukin	0.34000	0.34000
Rabobank	0.35000	0.34000
RBS	0.35000	0.35000
Société Générale	0.35000	0.35000
Sumitomo Mitsui	0.35000	0.35000
UBS	0.33000	0.33000
WestLB	0.39500	0.39500
Overall LIBOR	0.34750	0.34625
Difference in Overall LIBOR	0.00125 or 0.125%	

Table A demonstrates a day on which Rabobank was reporting to the market that it could borrow Yen for six months and pay an interest rate of 0.35%—less than a postage stamp per \$100 borrowed. On the following day, Rabobank lowered its submission by 1 basis point—one penny per hundred dollars. Due to the foibles of LIBOR’s arithmetic, this tiny change resulted in an even tinier—but very real—change in the overall LIBOR.¹²³ Table B gives some representative payoffs. At \$4.3 billion, a

¹²² British Bankers Association (“BBA”), JPY BBA LIBOR (2012) (data on file with author). LIBOR’s former provider, the British Bankers Association, maintained records of all LIBOR data, including banks’ individual submissions. That data is made available to academic researchers on an ad hoc basis. The author’s calculations are drawn from such a data set.

¹²³ Sixteen banks were on the USD panel at many times. Half would be excluded, leaving the remaining banks contributing as much as one-eighth each. See Verstein, Index Theory, supra note 112, at 133 & n.171 (explaining why a single bank can influence LIBOR).

cool \$5.4 million in profits would be made from the tiniest sprig of market data.¹²⁴

Table B: Difference in Value of Notional Contract

Principal Amount	Profit attributable to 0.125% change
\$1 million	\$1250
\$4.3 billion	\$5.4 million
\$50 billion ¹²⁵	\$62.5 million
\$2 trillion ¹²⁶	\$2.5 billion

Rabobank knew that it would nonfraudulently cause a unilateral change in the day's LIBOR, and it knew this with almost certainty.¹²⁷ Similar confidence is available to large traders in gold,¹²⁸ foreign curren-

¹²⁴ A \$4 billion position may sound like a large number, but one can achieve this exposure without even leaving the CME. At current position limits and exchange rates, five thousand contracts at about \$875,000 each (100,000,000 JPY) is about \$4 billion. Position Limits, CME Group (2015), <http://www.cmegroup.com/market-regulation/position-limits.html> (follow "CME Position Limits" hyperlink) (last visited Feb. 9, 2016). That is, a trader without any connections, plan, or complex financial model could quickly acquire a position of that size from any personal computer. A higher bet could be made if the trader were to take the opposite position on some other tenure, partially zeroing out the position.

¹²⁵ Anecdotal, this is the amount that one banker told me could be easily accumulated in the over-the-counter ("OTC") swap market. Telephone Interview with Banker, Head of Interest Rate Derivatives Strategy (Nov. 12, 2014).

¹²⁶ Daily volume of OTC JPY interest rate swaps cleared at CME. A trader who doubled the volume for one day would amass a position of this size. See, e.g., Cleared OTC Interest Rate Swaps, CME Group, <http://www.cmegroup.com/trading/interest-rates/cleared-otc> (last visited Mar. 10, 2016).

¹²⁷ There was little chance Rabobank would be surprised in the absence of any other banks changing their submissions. Changes were infrequent in this period. See Rosa M. Abrantes-Metz et al., LIBOR Manipulation? (Aug. 4, 2008) (unpublished manuscript, <http://ssrn.com/abstract=1201389>).

And it may have been possible to collusively learn whether the others were planning to stand pat, making the bet a relatively safe one. One financial intermediary, ICAP, provided the service of *pre*-polling the reporting bankers and compiling a list of (very) likely LIBOR rates before the official report. ICAP's daily email served as an important starting place for those lucky enough to receive it. Even if other banks were to change, their change might as easily *negate* Rabobank's anticipated change as *amplify* it. Importantly, these uncertainties are small relative to the course of uncertainty faced by any insider trader. *Only* changes in these other banks' submissions could influence the overall LIBOR.

¹²⁸ The Gold Fix is set during twice-daily dealer negotiations. Its rules make clear that anyone is permitted to trade in this window. See London Bullion Mkt. Ass'n, & London Platinum & Palladium Mkt., A Guide to the London Precious Metals Markets 14–15 (2008). Many avail themselves of this privilege. Trading volume goes up by almost 50% during the

cy,¹²⁹ oil,¹³⁰ and any other market where benchmark computations draw on a small and concentrated group of traders.¹³¹

Nonpublic information may be material for a firm's stock price and also to the price of a commodity, especially in light of the market's heavy reliance on leverage and benchmarks.

2. Nonpublic Information

It is sometimes thought that all commodity information is fundamentally public. As Professor Jerry Markham writes, "It is doubtful whether a broad inside information concept could be applied to commodities since most 'inside' information will be 'market' information that may be freely acted upon even under the federal securities law."¹³² Markham and others have in mind the sort of information that can be discovered by diligent research, or perhaps even visible by driving through farm country.

Researcher diligence is now a major industry. Helicopters with infrared cameras snoop around storage facilities in Oklahoma, hoping to estimate oil reserves.¹³³ Satellites photograph crop plantings to anticipate likely supplies.¹³⁴ This research undoubtedly gives informational advantages, but those advantages are available to anyone who puts in similar efforts. To put this argument into the language of securities law

banks' negotiation, compared to only an 8.7% increase in volume when the actual result is disclosed. Andrew Caminschi & Richard Heaney, Fixing a Leaky Fixing: Short-Term Market Reactions to the London PM Gold Price Fixing, 34 J. Futures Mkts. 1003, 1019 (2014); Liam Vaughn et al., London Gold Fix Calls Draw Scrutiny Amid Heavy Trading, Bloomberg (Nov. 26, 2013, 10:56 AM), <http://www.bloomberg.com/news/articles/2013-11-26/gold-fix-drawing-scrutiny-amid-knowledge-tied-to-eruption>. If volume tracks information, the information seems to be leaking long before the result. Moreover, this trading is basically *correct*. Something like 80–90% of the time, trades in this window move the market price in the direction of the ultimate benchmark number, compared to only 50% in the period just prior to the beginning of the negotiation period. *Id.*

¹²⁹ See Verstein, Benchmark Manipulation, *supra* note 23, at 233–35.

¹³⁰ *Id.* at 242.

¹³¹ *Id.* at 215.

¹³² 13A Markham, *supra* note 81, § 18:8; accord Markham, *supra* note 71, at 88 ("The distinction between nonpublic 'market' information and so-called 'inside' information is not easily drawn.").

¹³³ Michael Rothfeld & Scott Patterson, Traders Seek an Edge with High-Tech Snooping, Wall St. J. (Dec. 18, 2013, 11:15 PM), <http://www.wsj.com/articles/SB10001424052702303497804579240182187225264>.

¹³⁴ Eamon Javers, From Russia with Profits: Spy Pictures of Crops, CNBC (Aug. 17, 2010, 1:35 PM), <http://www.cnbc.com/id/38738523/>.

scholarship, informational advantages in commodities markets are very rarely ineradicable. As Chief Justice Marshall declared in *Laidlaw v. Organ*, there is no evil in “rising earlier in the morning, and obtaining by superior diligence and alertness that intelligence by which the price of commodities was regulated”¹³⁵

This reasoning is flawed in two ways.¹³⁶ First, it is inappropriate to conclude that all commodities market information *is* public just because it *could* be discovered through public means. The pathway of learning tends to matter quite a bit. It appears to be possible to predict Wal-Mart’s quarterly earnings based on the flow of truck deliveries, as determined by satellite imagery,¹³⁷ but no one would dare suggest that Wal-Mart’s quarterly earnings are inherently public market information. Rather, an executive who learns these figures at a meeting and then trades on them has traded on nonpublic information.¹³⁸ It seems plausible that the same executive, trading crude oil futures based on Wal-Mart’s fuel price projections, trades on nonpublic information.

Moreover, it is wrong to conclude that informational advantages in commodities markets are only rarely ineradicable. There are at least five kinds of knowledge asymmetries that no helicopter or spy satellite can equalize. First, officials at futures exchanges have foreknowledge of changes to trading rules. Knowing, for example, that the exchange will try to make it harder to corner the soy market would allow the exchange official to profitably bet against soy. Second, knowledge of government research or decision-making would give federal officials an undeniable

¹³⁵ 15 U.S. (2 Wheat.) 178, 193 (1817).

¹³⁶ These positive criticisms are independent of the normative question of whether perhaps such industrial espionage has crossed the line from socially valuable to wasteful.

¹³⁷ Eamon Javers, *New Big Brother: Market-Moving Satellite Images*, CNBC (Aug. 16, 2010, 2:15 PM), <http://www.cnbc.com/id/38722872>.

¹³⁸ In *SEC v. Steffes*, 805 F. Supp. 2d 601 (N.D. Ill. 2011), a district court denied the motion to dismiss of two railroad employees who allegedly learned of a pending acquisition of their employer through on-the-job observations of suit-wearing visitors to the rail yards and using a special railcar used for visitors. Insofar as any train passenger or visitor to neighboring property could have made these same discoveries, there is nothing “intrinsicly” non-public about this information. See Stephen Bainbridge, *SEC Stretches Definition of Inside Information and Materiality Past Breaking Point* (Feb. 8, 2011), <http://www.professorbainbridge.com/professorbainbridge.com/2011/02/sec-stretches-definition-of-inside-information-and-materiality-past-breaking-point.html>. However, the pathway by which these employees came to observe the visitors—obtaining a job that gave them routine access to such information, and signing agreements not to disclose or use such information—makes this a candidate for nonpublic information. The fact that information *could* be discovered by others does not mean that the information is public in all respects.

trading advantage based on nonpublic information. Trading on either of these ineradicable advantages has already been prohibited.¹³⁹

Third, with knowledge that her client will soon execute a large trade, a broker can quickly trade on her own behalf, securing a large inventory of an asset soon to appreciate. This “front-running” by brokers is also prohibited.¹⁴⁰ Yet intermediaries can still secure and use many kinds of informational advantages. Rather than focusing on individual customers, dealers in commodities learn important market trends by watching aggregate customer order flow.¹⁴¹ For example, in currency markets, simply betting in the direction of such order flow allows large dealers of foreign exchange to beat the market return by a staggering 15%.¹⁴²

¹³⁹ *Supra* notes 69–70. Note, however, that restrictions apply less stringently to the exchanges’ governing board members, because the CFTC believed that strong insider trading rules would deter participation. Final Rules Concerning Amendments to Insider Trading Regulation, 65 Fed. Reg. 47,843, 47,844 (Aug. 4, 2000) (to be codified at 17 C.F.R. pt. 1).

¹⁴⁰ See *United States v. Dial*, 757 F.2d 163 (7th Cir. 1985). CFTC Rules §§ 155.3(a)(1) and 155.4(a)(1) require brokers of commodities to ensure that their employees “do not take advantage of their relationship with customers by using their knowledge of customer orders to trade ahead of or against the interests of such customers for their own benefit or that of their preferred customers.” Records of Cash Commodity and Futures Transactions: Trading Standards for Floor Brokers and Futures Commission Merchants, 41 Fed. Reg. 56,134, 56,139 n.18 (Dec. 23, 1976) (codified at 17 C.F.R. pt. 1). Note also that there are often restrictions on acting as both a broker and a dealer in commodities. See 7 U.S.C. § 6j (2012) (instructing the CFTC to determine whether to ban instances of dual trading); Press Release, Commodity Futures Trading Comm’n, CFTC Issues Order Granting CME a Dual Trading Exemption for the S&P 500 Futures Contract Market and a Proposed Order Granting CME Conditional Dual Trading Exemptions for Seven Other High-Volume Contract Markets (Nov. 7, 1997), <http://www.cftc.gov/opa/press97/opa4076-97.htm> [<https://perma.cc/3VYQ-CEZB>].

¹⁴¹ Nabil Khoury, Stylianos Perrakis, & Marko Savor, PIP Transactions, Price Improvement, Informed Trades and Order Execution Quality, 16 *Eur. Fin. Mgmt.* 211, 226 (2010) (finding Boston Options Exchange market makers adopt positions matching those of informed traders); Stanislav Dolgoplov, Insider Trading and the Bid-Ask Spread: A Critical Evaluation of Adverse Selection in Market Making, 33 *Cap. U. L. Rev.* 83, 116 & nn.159–62 (2004). Indeed, the use of all information available is how prices are updated in society. See generally Ronald J. Gilson & Reinier H. Kraakman, The Mechanisms of Market Efficiency, 70 *Va. L. Rev.* 549 (1984) (elaborating on the channel of information transmission from informed trader to market intermediary).

¹⁴² Lukas Menkhoff et al., Information Flows in Dark Markets: Dissecting Customer Currency Trades 30 (Bank for Int’l Settlements, Working Paper No. 405, 2013), <http://www.bis.org/publ/work405.pdf>; see also Bettina Peiers, Informed Traders, Intervention, and Price Leadership: A Deeper View of the Microstructure of the Foreign Exchange Market, 52 *J. Fin.* 1589, 1589 (1997) (finding Deutsche Bank able to anticipate major currency price changes by 60 minutes).

Powerful informational advantages inure to large transactional intermediaries that cannot be feasibly matched.¹⁴³

A fourth example is found in financial benchmarks, which provide an unappreciated example of ineradicable trading advantages. The benchmark provider and its tippees know, and important data contributors can probabilistically guess, the summary statistic long before it is generally published.¹⁴⁴ This advantage exists where the benchmark covers physical commodities, as well as where the benchmark is composed of a basket of traditional securities. A traditional insider with inside information about her employer can largely circumvent securities insider trading laws by instead trading futures on a stock basket in which her employer figures prominently. The Dow Jones Industrial Average (“DJIA”) serves as a basis for numerous financial instruments and, though it is composed of thirty securities, just four firms make up a quarter of the benchmark’s value.¹⁴⁵ Anyone with ineradicable inside information about Goldman Sachs, IBM, 3M, or Boeing could profit from a bet on the DJIA.

Fifth, large multi-industry conglomerates gain informational advantages that are not available to solitary market analysts. A recent Senate subcommittee report addressed just this issue, finding that large banks have spent the last decade accumulating massive physical commodity and commodity-business holdings largely because it gives them an informational edge in commodities trading.¹⁴⁶ For example, when a bank is a large shareholder of a commodity-related enterprise, the bank could gain special information from its board seats.¹⁴⁷

¹⁴³ CFTC Report, *supra* note 94, at 86 (“[T]he transaction information available to brokerage house employees is not aggregate or market-wide. Rather, the information available to those acting as agents for other futures market participants concerns the specific transactions with which they have been entrusted.”).

¹⁴⁴ See *supra* Subsection III.A.1.b. The benchmark provider retains an advantage even if all market data are publicly available, due to the ineradicable subjectivity in index design and function. See Verstein, *Index Theory*, *supra* note 112, at 114–24.

¹⁴⁵ Index Component Weights of Stocks in the Dow Jones Industrial Average, IndexArb (Oct. 16, 2015, 11:30 PM), <http://indexarb.com/indexComponentWtsDJ.html>.

¹⁴⁶ U.S. Senate, Permanent Subcomm. on Investigations, Majority and Minority Staff Report on Wall Street Bank Involvement with Physical Commodities 10 (2014) [hereinafter *Senate Report*]. On the size of these massive holdings, see also *id.* at 31 (estimating commodity derivatives holdings by large banks exceed \$1 trillion); *id.* at 32 (finding JPM held \$10 trillion in physical commodities, Goldman held about \$5 trillion, and Morgan Stanley held about \$3 billion); *id.* at 33 (indicating bank holdings include uranium, electrical power plants, coal and gold mines; banks also supply jet fuel to airlines).

¹⁴⁷ *Id.* at 265. The Senate report lists numerous other examples of how a bank could gain special information. *Id.* at 36, 365.

As a case study, the report discusses Goldman Sachs's purchase of Metro International, one of the world's most important commodity warehousing companies. As Metro's owner, Goldman gained firsthand knowledge of the ebb and flow of the aluminum market. Were warehouses flush or empty? Were the stockpiles held by many small traders or just a few concentrated owners? It is widely recognized, including by the principal metals exchange warranting the Metro warehouses, "that traders privy to such warehouse information before it becomes available to the broader market could use that nonpublic information to benefit their trading strategies, gaining an unfair advantage over the rest of the market and their own counterparties."¹⁴⁸

The London Metal Exchange requires that warehouses set up information barriers limiting traders' access to this precious information, a policy that Goldman adopted. "Despite that Goldman policy, and a corresponding one at Metro, the Subcommittee found that confidential Metro information was made available to dozens of Goldman employees, including personnel active in trading commodities."¹⁴⁹ Several incidents were characterized by Goldman employees as "extremely questionable."¹⁵⁰ In all, almost fifty Goldman employees, including those managing commodity traders, received occasional or repeated access to material nonpublic information about aluminum markets.¹⁵¹

Not only do banks stand to gain information useful for trading, they candidly admit that this is a chief motive for expanding their operations. Banks expanding their commodities divisions have been required to explain to bank regulators why this conduct—normally understood as apart from the permitted "business of banking"—will nevertheless serve important and legitimate needs, and they have been happy to explain their desire to extract information from commodity affiliates. One passage, written by J.P. Morgan Chase in a 2005 request to the Federal Reserve, is representative:

[It would] position JPM Chase in the supply end of the commodities markets, which in turn will provide access to information regarding the full array of actual produce and end-user activity in those markets. The information gathered through this increased market participation

¹⁴⁸ Id. at 214.

¹⁴⁹ Id. at 215.

¹⁵⁰ Id. at 219.

¹⁵¹ Id. at 220.

will help improve projections of forward and financial activity and supply vital price and risk management information that JPM Chase can use to improve its financial commodities derivative offerings.¹⁵²

Regulators, for their part, have likewise acknowledged the “important asymmetrical information on conditions in the physical markets such as production and supply/demand information, etc., which a market participant without physical global infrastructure would not necessarily be privy to.”¹⁵³

These are not just recent trends localized in the financial industry. Traditional commodities players have long profited from substitute and outsider trading. Consider Cargill, a trader of some \$130 billion worth of commodities, futures, and related services.¹⁵⁴ Cargill exploits information from its many business operations to outfox the futures market,¹⁵⁵ going so far as to award its nontrader employees substantial bonuses when they glean any sort of information relevant to trading profits.¹⁵⁶ Amid a global recession, large commodities traders like Cargill have made profits of a quarter of a *trillion* dollars over the last ten years, netting more profits than all of the major Wall Street firms.¹⁵⁷ As the Senate report notes, much of the conglomerates’ cross-division information transfer—within and without the major banks—is both profitable and lawful.¹⁵⁸

It is therefore incorrect to assume that all material information is universally public in commodities markets. Large information asymmetries

¹⁵² *Id.* at 5 & n.7 (citation omitted).

¹⁵³ *Id.* at 36 & n.148 (citation omitted).

¹⁵⁴ At a Glance, Cargill, <http://www.cargill.com/company/glance> (last visited Mar. 10, 2016).

¹⁵⁵ In discussing *Cargill, Inc. v. Hardin*, 452 F.2d 1154 (8th Cir. 1971), Judge Easterbrook explained the court’s decision in finding Cargill liable for manipulation. Frank H. Easterbrook, Monopoly, Manipulation, and the Regulation of Futures Markets, 59 J. Bus. S103, S119 (1986) (“Cargill had used its special knowledge to advantage—it profited not because it knew more about the demand and supply of wheat in the cash market but because it alone knew who owned the deliverable wheat in Chicago.”). Cargill’s knowledge of who owned the deliverable wheat allowed it to better engineer a squeeze in the grain market. *Id.*

¹⁵⁶ Ann Davis, Cargill’s Inside View Helps It Buck Downturn, *Wall St. J.* (Jan. 14, 2009, 12:01 AM), <http://online.wsj.com/articles/SB123189501407679581>.

¹⁵⁷ Javier Blas, Commodity Traders’ \$250bn Harvest, *Fin. Times* (Apr. 14, 2013), <http://www.ft.com/intl/cms/s/0/9f6f541e-a397-11e2-ac00-00144feabdc0.html?siteedition=intl#axzz3GgtsBPH0>. This is not the first time that Cargill has gained notoriety for its acquisition and use of market information. Cargill was adjudged liable in one of the earlier and more important commodity market manipulation cases. *Cargill*, 452 F.2d at 1172–73.

¹⁵⁸ E.g., Senate Report, *supra* note 146, at 34–36.

frequently arise and cannot be eradicated due to market structure. Whether the law should discourage such advantages is another question, but it is clear that there are numerous candidates for both material and nonpublic information advantages that cannot be overcome merely by rising earlier and being diligent.

B. Participants

It is often asserted that the traders in commodities markets are too sophisticated to warrant protection from insider trading. They are knowledgeable commercial traders, such as ranchers and refineries, or else very sophisticated speculators, such as hedge funds. These are not the sorts of folks that the law should coddle. It is likewise asserted that sophisticated traders prefer a regime of unlimited insider trading. The distinctive purpose of commodities markets is risk shifting and hedging, but one will sometimes be unable to shift risk and hedge if the law bars trading while in possession of certain kinds of information.

Neither of these arguments is persuasive. The character of commodities markets has changed rapidly in recent years, creating a constituency of users who are closer to the quintessential retail securities investor, and whose support is politically important for the sustainability of the market. Likewise, the need to hedge is unpersuasive as a rationale for insider trading. It is far from clear that hedging becomes harder with insider trading restrictions.

1. The Sophistication of Investors

It has been argued that paternalistic insider trading rules are not required in commodities markets because the vast majority of market participants are sophisticated or informed.¹⁵⁹ When Congress considered whether to implement insider trading restrictions in commodities in 1982, CFTC Chairman Johnson asserted that there were only some 100,000 commodity traders, compared with 32 million securities owners.¹⁶⁰ These commodities traders had net worths averaging perhaps \$450,000 (in excess of \$1 million in present dollars) and incomes of

¹⁵⁹ CFTC Report, *supra* note 94, at 53 (“Numerous futures market participants may have legitimate access to what some may perceive as superior information.”).

¹⁶⁰ SEC/CFTC Jurisdictional Issues and Oversight Hearing, *supra* note 6, at 59, 403 (statement of Philip McBride Johnson, Chairman, Commodity Futures Trading Commission).

\$64,000 (more than \$150,000 in present dollars). He argued that such restrictions were less appropriate in commodities markets, owing to the wealth and sophistication of participants.¹⁶¹

Although Chairman Johnson's argument would carry the day, he admitted that his data were incomplete and at best suggestive, since the CFTC did not rigorously gather such data at that time.¹⁶² And information from other sources paints a different picture. In the late nineteenth century, numerous smalltime trading houses called "bucket shops" offered commodity betting to thousands of investing newcomers.¹⁶³ In the 1930s, the Department of Agriculture concluded that the plurality of commodities traders were farmers.¹⁶⁴ These individuals probably knew something about grain, but they were not financially sophisticated professional traders. Nor were a great many of the other traders, who included "eighteen undertakers, twelve candy store proprietors, and a large number of laborers, students, manicurists, widows, secretaries, stenographers, housewives, and unemployed individuals."¹⁶⁵ A report in 1949 found that one-third of traders were sophisticated business people, but that farmers were still numerous as were "[a] surprisingly

¹⁶¹ *Id.* at 402–03.

¹⁶² *Id.* at 300, 403.

¹⁶³ Letter to the Editor, *Stock Exchange Reforms*, N.Y. Times, Aug. 14, 1887, at 9 (reporting that bucket shops catered to folks "no broker would care to have"). Many patrons were middle class and female. *New Bucket Shops: Growth Surprises Stock Exchange Members—Some of Their Works and Methods*, N.Y. Times, May 18, 1913, at XX9. This concern was perhaps best stated in 1911 by Columbia University Professor Carl Parker, who recommended the "elimination from the field of speculation of those who are unfitted by nature, financial circumstances, or training to engage in it." David Hochfelder, *How Bucket Shops Lured the Masses into the Market*, Bloomberg View (Jan. 10, 2013, 10:04 AM), <http://www.bloombergvie.com/articles/2013-01-10/how-bucket-shops-lured-the-masses-into-the-market>; see also Sereno S. Pratt, *The Work of Wall Street: An Account of the Functions, Methods and History of the New York Money and Stock Markets* 296 (3d ed. 1921) (examining commodities markets); C.V. Durell, *The Arithmetic Syllabus in Secondary Schools*, 6 *Mathematical Gazette* 28, 41 (1911) (proposing that "young ladies should be taught something about 'bucket-shops,' because those young ladies who have a little money invested, and especially maiden ladies, are generally flooded with horrible papers which invite them to invest their money through these 'bucket-shops'"); Jonathan Ira Levy, *Contemplating Delivery: Futures Trading and the Problem of Commodity Exchange in the United States, 1875–1905*, 111 *Am. Hist. Rev.* 307, 317 (2006) (showing the popularity of bucket-shop trading).

¹⁶⁴ Chi. Bd. Of Trade, *Commodity Trading Manual* 109 (1985); see also Jerry W. Markham, *Fiduciary Duties Under the Commodity Exchange Act*, 68 *Notre Dame L. Rev.* 199, 204–07 (1992) (indicating farmers comprised a plurality of commodities traders in the 1930s and discussing the subsequent evolution of the trading population).

¹⁶⁵ Markham, *supra* note 164, at 205.

large number of retired persons.”¹⁶⁶ That same report found that the typical speculator lost money through their trading, losing some six dollars for each dollar they made.¹⁶⁷ One market regulator (and law professor) who testified at the 1974 CFTC authorization hearings described “the steadily growing[] population” of commodity investors, “[t]he scant existing empirical data would suggest that he is a farmer and small town merchant or professional far more often than may have been thought. The set of speculators is not congruent with Chicago millionaires.”¹⁶⁸

If Chairman Johnson’s statement was ever accurate, it is quickly being refuted by changing market composition. Uninformed investors have found it easy and attractive in recent years to flood into commodities markets.¹⁶⁹ Increasingly, investors are uninformed and unconnected to the production or consumption of commodities, and they buy with an investment motive rather than to hedge. At least \$300 billion was invested in commodities through index-based investment vehicles in 2010, an increase of 500% over the last ten years.¹⁷⁰ At least 12.5% of all commodities market participation is now retail investment—and if one adds indirect investments by way of mutual funds, the number could be double that figure.¹⁷¹ This is a staggering figure given the relative decline of retail investment in the equities markets during the same period.¹⁷² Any

¹⁶⁶ Blair Stewart, *Commodity Exch. Auth., U.S. Dep’t of Agric., Technical Bull. No. 1001, An Analysis of Speculative Trading in Grain Futures* 46 (1949).

¹⁶⁷ *Id.* at 129.

¹⁶⁸ 1974 Hearings, *supra* note 6, at 183.

¹⁶⁹ A number of factors have driven the rush to commodities investing. Many prominent academic papers, beginning in 2004, sought to demonstrate that commodities investments increased the diversification of portfolios at little or no cost to expected return. See Gary Gorton & K. Geert Rouwenhorst, *Facts and Fantasies About Commodity Futures*, 62 *Fin. Analysts J.* 47, 54–60 (2006). Such reports may have found a receptive audience, as the rise of the housing bubble and then its collapse sent investors looking for safety and yield elsewhere. The early and mid-2000s also brought fundamentally new tools for commodities investing. Gold is the most invested commodity, and it was only in 2004 that it became practical for investors to reach gold through exchange-traded funds. GLD SPDR Gold Trust, *ETFdb.com*, <http://etfdb.com/etf/GLD/> (last visited Oct. 19, 2015).

¹⁷⁰ Scott H. Irwin & Dwight R. Sanders, *Index Funds, Financialization, and Commodity Futures Markets*, 33 *Applied Econ. Persps. & Pol’y* 1, 5–6 (2011) (stating that 2004 quantity was \$50 billion).

¹⁷¹ Cf. Hans R. Stoll & Robert E. Whaley, *Commodity Index Investing and Commodity Futures Pricing* (Sept. 10, 2009) (unpublished manuscript at 22, 27, <http://ssrn.com/abstract=1478195>) (referring to “retail investors holding ETFs, ETNs, and similar instruments”).

¹⁷² E.g., Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 *Va. L. Rev.* 1025, 1026 n.4 (2009) (stating that institutions owned

argument for different insider trading rules in commodities markets must not be predicated on the notion that it is a sport of kings.

2. *The Need to Hedge*

It has long been argued that commodities markets participants have legitimate needs to hedge and that insider trading prohibitions could get in the way.¹⁷³ As the CFTC put it:

[F]utures markets have as a basic function facilitating risk shifting, certain information cannot be equally accessible to all. Otherwise, a firm that is hedging its cash market risk would be disadvantaged in making those transactions, or, were its cash market operations or the full extent of its risk publicly disclosed, might have its ability to shift that risk impaired.¹⁷⁴

The farmer who sees a bumper crop may become concerned that prices will fall at harvest time; she wants to hedge precisely because she knows something about the market that few do. Indeed, once others know that wheat prices are likely to drop, it will be too late to find an affordable hedging opportunity. If an insider trading rule required a farmer to tell everyone her fears before hedging, it might pose a burden to socially valuable and legitimate hedging. By contrast, few of us think that

over 70% of public equities, leaving less than 30% of public equities owned by retail investors).

¹⁷³ Thomas A. Russo & Marlisa Vinciguerra, *Financial Innovation and Uncertain Regulation: Selected Issues Regarding New Product Development*, 69 *Tex. L. Rev.* 1431, 1494 (1991) (“To the extent any frontrunning or insider trading provisions derived from Rule 10b-5 are adopted, further, such prohibitions should not apply to bona fide hedging transactions, because of the important role hedging plays in the futures and options markets.”); accord Letter from Harry Ng, Vice President, Gen. Counsel & Corp. Sec’y, Am. Petroleum Inst., & Greg Scott, Exec. Vice President & Gen. Counsel, Nat’l Petrochemical & Refiners Ass’n, to David A. Stawick, Sec’y, Commodity Futures Trading Comm’n, Proposed Rules Regarding Prohibition on Market Manipulation, RIN No. 3038-AD27 (Jan. 3, 2011) (on file with author) (discussing oil refiners’ associations’ view on importance of hedging and the risks an insider trading rule might pose for hedgers); Letter from John M. Damgard, President, Futures Indus. Ass’n, Robert G. Pickel, Exec. Vice Chairman, Int’l Swaps and Derivatives Ass’n, & Kenneth E. Bensten, Jr., Exec. Vice President, Pub. Policy & Advocacy, Sec. Indus. and Fin. Mkts. Ass’n, to David A. Stawick, Sec’y, Commodity Futures Trading Comm’n, Proposed Rulemaking on the Prohibition of Market Manipulation, Notice of Proposed Rulemaking on the Prohibition of Market Manipulation, RIN No. 3038-AD27 (Dec. 28, 2010), [http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26803&SearchText=\[https://perma.cc/J2JX-XUN2\]](http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26803&SearchText=[https://perma.cc/J2JX-XUN2]).

¹⁷⁴ CFTC Report, *supra* note 94, at 54 n.10.

corporate executives have a strong and legitimate need to hedge their company's stock, and so we are not worried that an insider trading rule might sometimes prevent executives from trading. The greater need to hedge in commodities justifies a regime more permissive of insider trading, or so the argument goes.

There are several problems with this argument. Current insider trading doctrine for securities bans only trades in breach of a duty. Harmonizing commodities markets to such a rule would do little to disrupt legitimate hedging, since it would primarily prohibit trading by executives who have misappropriated someone else's secret. It seems unlikely that anyone will be upset that disloyal fiduciaries cannot adequately hedge. Sympathetic farmers do not breach any duty by drawing on their own operational data, and so would not be restricted under the misappropriation standard considered by the CFTC.

While the current securities doctrine weakens any argument based on hedging needs, the flaws with hedge-based arguments preexisted the current doctrine. Such arguments were flawed even under earlier and more expansive insider trading rules that did not explicitly require the breach of a particular duty. The remaining four responses of this Section show weaknesses in hedge-based arguments even under the law of *Texas Gulf Sulphur*, showing that very few socially valuable trades would actually be blocked by an expansive insider trading restriction.

First, many farmers' knowledge is immaterial; knowledge of their own harvest is probably not enough to implicate insider trading rules since it is unlikely to impact market price and a reasonable investor would not care to be so informed.

Second, many putative examples of "hedging" and "risk shifting" prove to be mislabeled and of dubious social value upon consideration, and thus insider trading rules will not frequently block socially valuable trading. Consider a farmer who really does have inside information that corn prices are going to fall this year. She has a good reason to trade corn futures—the virtual certainty that low prices will render her crop worthless—but we need not call it "risk shifting" or "hedging." When one party knows about an impending loss and convinces a less-informed party to accept the loss, we should instead call it "loss shifting." An insider trading ban would limit some loss-shifting transactions, but it is not clear that we should care about that from a social point of view. It may be good to shift risk to better bearers, just like it is good for a troublesome car to be owned by a mechanic and not a chef, but there is little

social gain from letting the chef sell it without disclosing a latent and serious mechanical failure. Indeed, undisclosed loss shifting increases adverse selection, harming the markets for all uninformed hedgers.

Third, a ban on informed hedging is at worst a ban on *late* hedging. A ban on loss shifting could harm legitimate hedgers who fail to hedge prior to learning crucial information. We may think that this is an avoidable harm, since the trader can just vow to hedge earlier in the future. The late hedger is like an individual who strategically avoids buying insurance until she becomes sick. It is true that she will find it easier to insure if the law permits her to omit mentioning her present illness on her insurance application. But everyone would be better off if people generally insured earlier in the process, and a rule that bans loss-shifting trades would tend to improve the efficiency of commodities markets.¹⁷⁵ Among professionals, the effect of the rule is likely to simply encourage timely hedging.

Fourth, arguments discussing the need to hedge are directly applicable only to hedgers, but not all futures and commodities traders are hedgers. At present, there are perhaps twice as many speculators as there are hedgers.¹⁷⁶ At most, this argument directly justifies insider trading by hedgers, and it is possible—as Congress has contemplated doing—to limit insider trading to just those individuals.¹⁷⁷ Such a proposal is feasible, since the CFTC already requires futures traders to declare whether they are acting as a hedger or speculator.¹⁷⁸

To be sure, reduced speculation might indirectly frustrate hedgers, since hedging is much easier if there are numerous potential trading

¹⁷⁵ However, if timely hedging is not feasible, we could solve the problem of inhibited hedging by adopting the equivalent of a 10b5-1 plan. We could allow hedgers to hedge, even while in possession of inside information, if it is according to a prearranged plan of hedging. And, of course, “Chinese walls” are already sufficient to insulate one part of an informed firm from another, permitting hedging even if other groups are informed. There are numerous ways to address the risks to hedging without a wholesale legalization of informed trading.

¹⁷⁶ Senate Report, *supra* note 146, at 6; see Excessive Speculation and Compliance with the Dodd-Frank Act: Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Homeland Sec. and Governmental Affairs, 112th Cong. 32–33 (2011) (testimony of Gary Gensler, Chairman, Commodity Futures Trading Commission) (indicating that in 2011, 80% of the oil futures market participants were speculators, as opposed to producers or consumers).

¹⁷⁷ In 1982, the House passed an amendment to the CEA that would have allowed hedging by insiders, but precluded insider trading by nonhedgers, but it was written out in conference committee. 128 Cong. Rec. 24,955–56 (1982).

¹⁷⁸ See 17 C.F.R. § 1.3(z) (2015).

partners.¹⁷⁹ If many speculators would refuse to trade except when informed, then the right to speculate with inside information as well may be indirectly useful to advancing the distinctive goal of hedging. However, it is an open question whether insider trading—by speculators or hedgers or both—actually helps hedgers.¹⁸⁰ The literature examining this question in securities suggests that insider trading generally harms liquidity.¹⁸¹ Informed speculators are more likely to trade with the farmer, but uninformed speculators are less likely if they face informed counterparties, in the form of speculators or hedgers. It is at best an open and empirical question whether permitting more informed trading will improve liquidity for hedgers. It is possible that hedgers would rather lose the right to trade when informed if it makes hedging otherwise easy, particularly if few hedgers actually possess material nonpublic information, and particularly if it just means hedging slightly earlier in the production cycle before inside information is likely to have emerged.

¹⁷⁹ *Leist v. Simplot*, 638 F.2d 283, 288 (2d Cir. 1980) (“The system would not function, however, if only hedgers sold and purchased commodity futures contracts.”), *aff’d sub nom. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982); accord *David T. Johnston, Understanding the Dynamics of Commodity Trading: A Success Story*, 35 *Bus. Law.* 705, 709 (1980) (asserting that “50 to 75 percent” of the market must be speculators for the market to function).

¹⁸⁰ See *Markham*, *supra* note 71, at 121–22 (acknowledging that trading on the basis of nonpublic information can undermine hedgers’ legitimate hedging efforts).

¹⁸¹ *Lawrence R. Glosten & Paul R. Milgrom, Bid, Ask and Transaction Prices in a Specialist Market with Heterogeneously Informed Traders*, 14 *J. Fin. Econ.* 71, 72–77 (1985); *Albert S. Kyle, Continuous Auctions and Insider Trading*, 53 *Econometrica* 1315, 1332 (1985); see also *George A. Akerlof, The Market for “Lemons”: Quality Uncertainty and the Market Mechanism*, 84 *Q. J. Econ.* 488, 488 (1970) (discussing liquidity of durable goods); *Walter Bagehot* (pseudonym for *Jack Treynor*), *The Only Game in Town*, 27 *Fin. Analysts J.* 12, 13–14 (1971) (discussing the role of market makers in providing liquidity); *Zohar Goshen & Gideon Parchomovsky, On Insider Trading, Markets, and “Negative” Property Rights in Information*, 87 *Va. L. Rev.* 1229, 1251 (2001) (“It is widely agreed that insider trading diminishes liquidity. This view is based on a theoretical model that suggests that market makers will offset the risk of trading against insiders by increasing the bid-ask spread.”); *Kimberly D. Krawiec, Fairness, Efficiency, and Insider Trading: Deconstructing the Coin of the Realm in the Information Age*, 95 *Nw. U. L. Rev.* 443, 467, 469–70 (2001) (discussing the mixed evidence on how insider trading affects liquidity); *John C. Coffee, Jr., Is Selective Disclosure Now Lawful?*, *N.Y. L.J.*, July 31, 1997, at 5–6 (suggesting that impaired disclosure affects market efficiency). These theories have been successfully validated in commodities futures markets. See *Henry L. Bryant & Michael S. Haigh, Bid-Ask Spreads in Commodity Futures Markets*, 14 *Applied Fin. Econ.* 923, 924 n.1 (2004); see, e.g., *Carol L. Osler et al., Price Discovery in Currency Markets 2* (Mar. 2007) (unpublished manuscript, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=890774) (noting the relationship between FX spreads and adverse selection).

C. Duties

Securities law permits most informed trading.¹⁸² One is free to trade on virtuously acquired information, be it through diligent research of public information,¹⁸³ by receiving a tip of information with no strings attached,¹⁸⁴ or by utter fortuity.¹⁸⁵ The law is breached only by trades in violation of some duty of “trust and confidence.”¹⁸⁶

¹⁸² See *Chiarella v. United States*, 445 U.S. 222, 233 (1980) (rejecting “a general duty between all participants in market transactions to forgo actions based on material, nonpublic information”).

¹⁸³ *Id.*; see also 18 Donald C. Langevoort, *Insider Trading Regulation, Enforcement and Prevention* § 11:5 (2015) (“[T]he mosaic theory says that it is not unlawful tipping or trading when a professional investor uses his or her own skill and expertise to piece together bits of information that, standing alone, would not be considered material to a reasonable investor.”).

¹⁸⁴ *Dirks v. SEC*, 463 U.S. 646, 660–64 (1983); *United States v. Newman*, 773 F.3d 438, 442 (2d Cir. 2014).

¹⁸⁵ *SEC v. Switzer*, 590 F. Supp. 756, 758, 762, 766 (W.D. Okla. 1984) (holding that a football coach did not violate law by trading on information overheard in bleachers).

¹⁸⁶ *Chiarella*, 445 U.S. at 230. But see Donna M. Nagy, *Insider Trading and the Gradual Demise of Fiduciary Principles*, 94 Iowa L. Rev. 1315, 1320–21 (2009) (noting the Supreme Court’s declining emphasis on fiduciary breaches in favor of something similar to an equal access theory). Trading on information in connection with a tender offer can be a breach of trust. See 15 U.S.C. § 78n(e) (2012) (“It shall be unlawful for any person . . . to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer . . .”). Likewise, it is not lawful to trade on a special tip from an issuer, even without a breach of trust. *Selective Disclosure and Insider Trading*, 65 Fed. Reg. 51,716, 51,738–39 (Aug. 24, 2000) (to be codified at 17 C.F.R. pt. 230, 240, 243, and 249). Tender offer and analyst disclosure are illegal for inequality reasons, as well as from a fear that firms will use insider trading opportunities as a means to corrupt the takeover market or the analyst market. See *Selective Disclosure and Insider Trading*, 64 Fed. Reg. 72,590, 72,592 (Dec. 28, 1999) (to be codified at 17 C.F.R. pt. 240, 243, and 249) (stating that managers “may delay general public disclosure so that they can selectively disclose the information to curry favor or bolster credibility with particular analysts or institutional investors”); Jeff Lobb, *SEC Rule 14e-3 in the Wake of United States v. O’Hagan: Proper Prophylactic Scope and the Future of Warehousing*, 40 Wm. & Mary L. Rev. 1853, 1878 (1999). Likewise, computer hackers steal data without breaching any ordinary sense of trust and confidence, but courts have been increasingly willing to find liability. *SEC v. Dorozhko*, 574 F.3d 42, 49–51 (2d Cir. 2009). When journalists are convicted of insider trading in securities, courts construe their newspaper to be the “source” to whom they breached a duty, but their counterparties are not shareholders in that newspaper. *Carpenter v. United States*, 484 U.S. 19, 22–23, 28 (1987) (discussing journalist’s tippee trading); *Zweig v. Hearst Corp.*, 594 F.2d 1261, 1262–63 (9th Cir. 1979) (discussing journalist trading). Journalists stand to make similar gains from “scalping” in commodities markets. CFTC Report, *supra* note 94, at 19, 39, 42–43. For some reason, the CFTC’s report then summarily dismisses the importance of this phenomenon. *Id.* at 43. While duty remains important, the law is deemphasizing the special focus on shareholder counterparties that marks the only per se difference between securities and commodities trading.

Many have concluded that there is no corresponding duty in the commodities markets.¹⁸⁷ They have pointed out that there are no “shareholders” of commodities to whom a special duty is owed.¹⁸⁸ This stands in contrast to the typical securities insider trading scenario. An insider trader in equity securities either buys from a shareholder or sells to someone who will become a shareholder. Insider trading law has sometimes conceived of directors and executives as fiduciaries of their shareholders, who must not abuse that trust by trading to the disadvantage of their wards.¹⁸⁹

Yet duty to the shareholder-counterparty is only essential under one theory of insider trading, the classical theory. The misappropriation theory operates by identifying a duty flowing to the information source.¹⁹⁰

¹⁸⁷ Carlucci, *supra* note 16, at 477 (asserting that “breach of a fiduciary duty . . . has no application to the futures markets”); accord Goodman, *supra* note 16, at 144–46. Note that the CFTC does acknowledge such duties for brokers. CFTC Report, *supra* note 94, at 7.

¹⁸⁸ CFTC Report, *supra* note 94, at 7; Letter from Christine M. Cochran, to David Stawick, Sec’y, Commodity Futures Trading Comm’n, Notice of Proposed Rulemaking on Prohibition of Market Manipulation, RIN No. 3038-AD2 (Jan. 3, 2011), <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26904&SearchText> [<https://perma.cc/L2YD-ZVL7>] (Commodity Markets Council arguing that there is no fiduciary analog in futures). While it is possible that the *Texas Gulf Sulphur* executives would have sold copper futures to a shareholder of their employer, this would have been by barest coincidence.

¹⁸⁹ *Tex. Gulf Sulphur*, 401 F.2d at 848; *Cady, Roberts & Co.*, 40 S.E.C. 907, 911 (1961). Of course, this notion is widely contested, and was in no event persuasively argued in *Texas Gulf Sulphur* and *Cady, Roberts*. Cf. *Chiarella*, 445 U.S. at 228–29 (“This relationship gives rise to a duty to disclose [or to abstain from trading] because of the ‘necessity of preventing a corporate insider from . . . tak[ing] unfair advantage of . . . uninformed . . . stockholders.’” (quoting *Speed v. Transamerica Corp.*, 99 F. Supp. 808, 829 (D. Del. 1951))). Fiduciary concepts undergird the classical theory of insider trading, which forbids officers and directors from trading company shares on the basis of corporate information, as well as its ancestors in the “special facts” and minority rule tests. See generally Stephen M. Bainbridge, *Securities Law: Insider Trading* 41–46 (2d ed. 2007) (discussing insider trading and disclosure responsibilities). See also *Chiarella*, 445 U.S. at 233 (rejecting “a general duty between all participants in market transactions to forgo actions based on material, nonpublic information”). Constructive insiders are also thought to have a special relationship with their counterparties by way of their common relationship to the issuing firm that would require greater candor for the morality of the market. See William K.S. Wang, *Stock Market Insider Trading: Victims, Violators and Remedies—Including an Analogy to Fraud in the Sale of a Used Car with a Generic Defect*, 45 Vill L. Rev. 27, 46–48 (2000) (discussing the classical special relationship triangle); accord CFTC Report, *supra* note 94, at 7 (explaining an officer or director “generally is perceived to owe a fiduciary duty to the issuer of the security and to the purchasers or sellers of the security”).

¹⁹⁰ *United States v. O’Hagan*, 521 U.S. 642, 652 (1997) (holding that “[t]he ‘misappropriation theory’ holds that a person commits fraud ‘in connection with’ a securities transaction, and thereby violates § 10(b) and Rule 10b-5, when he misappropriates confidential infor-

Nor is the absence of shareholders dispositive. Some forms of insider trading do not involve buying from or selling to shareholders at all. Consider an executive who uses a tip to buy bonds¹⁹¹ or who obtains stock options—rights to *buy* stock, but which are not considered to *be* stock themselves.¹⁹² While there was once doubt,¹⁹³ it is now plausible that the law forbids insider trading in bonds,¹⁹⁴ and certain that the same is forbidden for stock options.¹⁹⁵

If bonds and options can be the subject of insider trading, provided that the information was misappropriated, then a similar duty and breach can be found in many commodities trading instances. The executives in *Texas Gulf Sulphur* traded on confidential mining data, violating their duties as agents and keepers of corporate property. Those duties do not disappear if the executives instead (or additionally) trade minerals.

mation for securities trading purposes, in breach of a duty owed to the source of the information”).

¹⁹¹ Jonathan Fuerbringer, Ex-Economist at Goldman Pleads Guilty to Insider Trading, N.Y. Times (Nov. 12, 2003), <http://www.nytimes.com/2003/11/12/business/12CND-GOLD.html> (discussing insider trading in U.S. Treasuries).

¹⁹² See *Tex. Gulf Sulphur*, 401 F.2d at 839–42 (finding that executives obtained stock options).

¹⁹³ Regarding bonds, see Michael Lewis, *Liar’s Poker: Rising Through the Wreckage on Wall Street* 215–17 (1989) (describing how Michael Milken traded bonds in a context in which, allegedly, bonds were not subject to the prohibition on insider trading); Harvey L. Pitt & Karl A. Groskaufmanis, A Tale of Two Instruments: Insider Trading in Non-Equity Securities, 49 Bus. L. 187, 188 (1993); William K.S. Wang, A Cause of Action for Option Traders Against Insider Option Traders, 101 Harv. L. Rev. 1056, 1057–58 & 1058 n.11 (1988); Yadav, *supra* note 14. Regarding options, see Steve Thel, Closing A Loophole: Insider Trading in Standardized Options, 16 Fordham Urb. L.J. 573, 575 (1988) (“If insider trading is illegal or wrong simply because insider traders violate duties they owe to corporate security holders, there is little reason to object to insider trading in options.”).

¹⁹⁴ 18 Langevoort, *supra* note 183, at § 3:12 (“With very few exceptions—for example, the situation where the issuer is aware of the trading before it occurs—the misappropriation theory is fully adequate to reach abuses in the trading of debt securities.” (footnote omitted) (citation omitted)); cf. Stephen M. Bainbridge, *Insider Trading Law and Policy* 79–81 (2014) (citing *In re Worlds of Wonder Sec. Litig.*, 1990 WL 260675 (N.D. Cal. 1990) (arguing first that the classical theory of insider trading should not apply to debt securities, second that asserting that the only successful insider trading actions concerning debt securities involved equity-like convertible debt, but third that the misappropriation theory might nevertheless support liability for insider trading in bonds, at least when not practiced by the issuer itself. Note, however, that Professor Bainbridge does endorse the application of misappropriation theory to bonds); Wang, *supra* note 5, at 264 (calling debt insider trading “one possible example” of a case where the classical theory of insider trading would not be available).

¹⁹⁵ Congress acted to ban insider trading in options. Securities Exchange Act of 1934, 15 U.S.C. § 78t(d) (2012) (making option trading illegal whenever informed securities trading would be illegal).

These are still valuable secrets with which the executives have been entrusted on behalf of their employer and in their individual capacities.¹⁹⁶

Policy considerations undergirding the existence of a duty apply almost identically in both commodities and securities markets.¹⁹⁷ In either market, trading can distract executives,¹⁹⁸ distort their business decisions,¹⁹⁹ encourage slower and worse disclosure,²⁰⁰ allow them to increase their compensation without negotiation,²⁰¹ and to expropriate the valuable intellectual property owned by another.²⁰²

¹⁹⁶ What if the employer authorizes the trading? See *infra* Part IV.

¹⁹⁷ Others, besides executives and directors, may owe a duty of confidentiality, again for similar reasons. As Judge Richard Posner explained, “[W]e would be surprised to find anyone saying a good word for insider trading by a broker; the only information he exploits is his knowledge of his customers’ intentions.” *United States v. Dial*, 757 F.2d 163, 169 (7th Cir. 1985).

¹⁹⁸ James D. Cox, *Insider Trading and Contracting: A Critical Response to the “Chicago School,”* 1986 *Duke L.J.* 628, 646.

¹⁹⁹ Brudney, *supra* note 18, at 373–74; Easterbrook, *supra* note 53, at 332 (arguing that insider trading may lead to excess volatility); Saul Levmore, *Securities and Secrets: Insider Trading and the Law of Contracts*, 68 *Va. L. Rev.* 117, 149 (1982) (“[T]he temptation of profit might actually encourage an insider to act against the corporation’s interest.”). But see Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 *Stan. L. Rev.* 857, 874–76 (1983) (arguing risk-averse managers need such incentives, and their team dynamics limit how far things can go without a leak); Jesse M. Fried, *Insider Signaling and Insider Trading with Repurchase Tender Offers*, 67 *U. Chi. L. Rev.* 421, 425 n.18 (2000) (“The prospect of insider trading profits can . . . encourage insiders to invest in projects that are difficult for outsiders to assess, whether these projects are otherwise desirable or not, in order to increase the information asymmetry between themselves and public shareholders . . .”).

²⁰⁰ Easterbrook, *supra* note 53, at 333; Robert J. Haft, *The Effect of Insider Trading Rules on the Internal Efficiency of the Large Corporation*, 80 *Mich. L. Rev.* 1051, 1054–55 (1982) (“Subordinates would stall the upward flow of critical information to maximize their opportunities for financial gain.”); Roy A. Schotland, *Unsafe at Any Price: A Reply to Manne, Insider Trading and the Stock Market*, 53 *Va. L. Rev.* 1425, 1437 (1967). But see Stephen M. Bainbridge, *Insider Trading*, in 3 *Encyclopedia of Law and Economics* 772, 787–88 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000), <http://encyclo.findlaw.com/5650book.pdf> (arguing that delay is unlikely).

²⁰¹ See Stephen Bainbridge, *The Insider Trading Prohibition: A Legal and Economic Enigma*, 38 *U. Fla. L. Rev.* 35, 56 (1986). But see Carlton & Fischel, *supra* note 199, at 861–62 (praising unilateral compensation adjustment).

²⁰² Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition*, 52 *Wash. & Lee L. Rev.* 1189, 1192 (1995); Wang & Steinberg, *supra* note 17, at 33 & n.95. Other theories criticize “property” theory, see Kim, *supra* note 24, at 976–77 (criticizing property view), but still share many key elements for the purposes of this taxonomy.

While employees have no incentive to intentionally injure their employer in order to trade in commodities,²⁰³ they may divert corporate resources or their own attention to producing tradable information.²⁰⁴ And trading commodities poses a serious threat of spilling the beans on company secrets.²⁰⁵ If the *Texas Gulf Sulphur* executives had bet on falling copper prices, it could have signaled the nature of the recent discovery, making it harder for TGS to buy up mining land. This signal would have been even clearer if they had *also* traded in their company's securities. A falling copper price and a rising TGS stock price might together send a clear signal to speculators where they ought to begin grabbing up land—copper-producing regions TGS has been exploring.

A farmer, mine, or refinery has no obvious duty to disclose information that it lawfully obtains through research or operations. To prohibit such trading, it would be necessary either to imply widespread disclosure duty to all counterparties, or to invent a prohibition that made no reference to duty whatsoever. By some accounts, liability in the securities regime was once available under the equal access theory under precisely these circumstances. But that is no longer the securities doctrine, and it would not be under a harmonized commodities insider trading rule. It is true that commodities traders have no general duty of disclosure, but that is also true for securities market participants, effectively minimizing differences with respect to duty.

The nature of the information, participants, and duties simply do not drive a conclusive wedge between commodities and securities markets. Perhaps other reasons could be considered. It has sometimes been argued, for example, that the securities regime is a disclosure regime while the commodities markets do not set disclosure as a goal. This response begs the question, since the present inquiry is whether we ought, as a policy matter, to regard commodities as subject to a different approach.

²⁰³ Cf. CFTC Report, *supra* note 94, app. IV-A at 15 (“Normally, incompetent management of a firm that trades futures will not itself lead to profitable trading opportunities in the futures traded by the firm.”).

²⁰⁴ Many firms that banned insider trading did so because of potential distraction. *Id.*

²⁰⁵ See also Mark J. Sitzmann, CFTC No. 96-5, 1997 WL 82610, at *2 (Feb. 26, 1997) (discussing misappropriation of nonpublic and proprietary company information).

Moreover, it is also a false claim. The CEA includes numerous public disclosure requirements.²⁰⁶

If insider trading in commodities is somehow different from insider trading in securities, it is not for the reasons commonly accepted. Similarities dominate the relationship between these two markets, leading to the conclusion that they are substantially similar for the purposes of insider trading regulation, and calling for harmonization of these two regimes. If the restrictions of the securities market are broadly correct, then the CFTC is right to assert and enforce a misappropriation standard, akin to that found in the securities regime, in commodities markets.

So are the restrictions in the securities market broadly correct? This is no easy question. The boundaries of insider trading in securities are not static.²⁰⁷ Nor are those boundaries entirely clear. Congress has never defined “insider trading,”²⁰⁸ leaving courts to do so. To address the finer points of the law, the SEC and lower courts must read tea leaves in the few Supreme Court decisions,²⁰⁹ a process that has lately found the SEC taking very aggressive postures.²¹⁰ The major themes set out by the Supreme Court, such as the existence and importance of the misappropriation theory, have emerged largely because of the need for doctrine to be couched in the language of manipulation or fraud—the only things actually prohibited by Section 10(b) of the Securities Exchange Act. The fact that the present doctrine rests largely on the misappropriation theory, and that misappropriation theory covers the cases that it does, is partially

²⁰⁶ See, e.g., Large Trader Reporting Program for Physical Commodity Swaps, 76 Fed. Reg. 43,851, 43,851 (July 22, 2011) (to be codified at 17 C.F.R. pt. 15 and 20); Disclosures of Material Information, 17 C.F.R. § 23.431 (2012) (mandating swap dealers to disclose material information, including their own financial incentives, to trading counterparties). See generally Gregory Scopino, *Regulating Fairness: The Dodd-Frank Act’s Fair Dealing Requirement for Swap Dealers and Major Swap Participants*, 93 Neb. L. Rev. 31, 34–35 (2014) (describing customer conduct rules).

²⁰⁷ See *supra* Part II.

²⁰⁸ Peter J. Henning, *Insider Trading Case Could Push Congress to Define a Murky World*, N.Y. Times: DealBook (Feb. 23, 2015), http://www.nytimes.com/2015/02/24/business/dealbook/insider-trading-case-could-push-congress-to-define-a-murky-world.html?_r=0.

²⁰⁹ Cf. *United States v. Whitman*, 904 F. Supp. 2d 363, 371 n.6 (S.D.N.Y. 2012) (calling Second Circuit “somewhat Delphic”).

²¹⁰ See Stephen Bainbridge, *U.S. v. Newman: A Big Win for Coherence and Fairness in Insider Trading Law* (Dec. 11, 2014), <http://www.professorbainbridge.com/professorbainbridgecom/2014/12/us-v-newman-a-big-win-for-coherence-and-fairness-in-insider-trading-law.html>.

an accident of history and text.²¹¹ The Court might well have adopted different theories of liability if it were operating within a broader market-protection or fairness statute, rather than an antifraud statute. The securities regime assuredly did not emerge from first principles as the best of all policy-sensitive plans. Given the securities doctrine's less than venerable provenance, it is not surprising that numerous scholars argue that a better insider trading rule would cover more, less, or different conduct.²¹² What does this mean for proposals to regulate insider commodities trading?

These observations do not bear on the *general* proposal that securities and commodities laws should be harmonized with respect to insider trading. An advocate for tougher insider trading laws in securities can view this Article as advocating those same tough laws for commodities, just as the partisan for decriminalization can see in this Article a reason to legalize the few sorts of insider trading currently prohibited in commodities. The main argument for harmonization should stand or fall regardless of the regnant securities doctrine.

Worries are more legitimate about the *specific* harmonization approach of adopting the misappropriation standard. To the degree that the law governing securities is both descriptively and normatively unsettled, epistemic modesty is warranted. One must admit the possibility that harmonization might take commodities in the wrong direction. But that modesty is not reason for inaction. It would be a shame to transplant to commodities an excessively restrictive rule, if that is what the securities regime truly has, but it would also be a shame to leave commodities unrestricted if the securities rule is already insufficiently restrictive.

Most of all, any argument that commodities laws resemble securities laws is also an argument for making securities laws better, since even more is now at stake. And commodities markets can help in that endeavor. With the help of commodities markets, the odds increase somewhat of rational consensus as to securities insider trading. That is because data from commodities markets can inform important insider trading theories within the securities literature, as the following Part will demonstrate.

²¹¹ See generally Wang & Steinberg, *supra* note 17, §§ 4, 5 (discussing misappropriation theory).

²¹² *Id.* § 2 (summarizing policy debate).

IV. INTERMARKET DIALOG

Due to misconceptions about the nature of the commodities markets, normative debates about insider trading in the securities space have neither informed nor been informed by commodities markets. Now, comparison and dialog are possible. This Part is a down payment on such inquiries, indicating the sort of contribution that comparative research might make by noting commodities' importance for two important debates within the securities literature.

One debate concerns the effect of insider trading on market health. Scholars often argue that trading costs rise—injuring everyone—when insider trading is rife.²¹³ This is because insiders' gains tend to come at the cost of *market makers*, those frequent traders who stand ready to buy or sell assets on a moment's notice.²¹⁴ Market makers lose in just the way that a bookie loses if some of her clients *knew* which athletes were secretly injured. When market makers lose to insiders in this way, they pass their losses on to other investors in the form of higher trading fees.²¹⁵ Arguments of this sort are often said to emphasize *adverse selection* because of the tendency for these higher fees to *select* for the most *adverse* of trading partners—the only ones who will happily pay the higher fees are the insiders who know their trade is going to be profitable.²¹⁶ In extreme cases, adverse selection can even lead to the collapse of a market, so its relationship to insider trading is very important.²¹⁷

A related concern is that widespread insider trading might impair the dissemination of vital market research. It would be irrational to spend much time researching securities (or paying someone else to do the

²¹³ E.g., Nicholas L. Georgakopoulos, Insider Trading as a Transactional Cost: A Market Microstructure Justification and Optimization of Insider Trading Regulation, 26 Conn. L. Rev. 1, 1–2 (1993).

²¹⁴ Note that the actual counterparty may often *benefit* from trading with the insider, since she obtains a slightly better price than she would otherwise have gotten, particularly if she is a time-sensitive trader who was going to trade at a given moment no matter what. Manne, *supra* note 52, at 102. In such cases, the real victim may be an unidentified preempted or induced trader. Wang, *supra* note 189, at 29–31.

²¹⁵ Insider trading could also raise capital costs because insider trading raises the cost to market makers in a firm's securities relative to other firms, and lowers the expected return to uninformed shareholders. Morris Mendelson, The Economics of Insider Trading Reconsidered, 117 U. Pa. L. Rev. 470, 477–78 (1969) (reviewing Manne, *supra* note 52). But see Bainbridge, *supra* note 200, at 788.

²¹⁶ See generally Dolgoplov, *supra* note 141, at 83 (discussing adverse selection in market making).

²¹⁷ Glosten & Milgrom, *supra* note 181, at 74.

same) when other traders are learning far juicier secrets by just asking their executive friends.²¹⁸ Market analysts spend their days evaluating the quality of securities, and they share some of this information publicly in order to acquire business for themselves and their employers.²¹⁹ The rise of insider trading might undermine the analysts who would otherwise inform the public.

The effect on market health, in the form of trading costs and analyst vitality, is an empirical question. Empirical claims are informed by data, and commodities markets constitute a many-decades-long experiment in the effect of insider trading on market health. So what do the data indicate?

Studies of commodities trading indicate low trading costs,²²⁰ oftentimes much lower than securities trading costs.²²¹ Likewise, commodi-

²¹⁸ David D. Haddock & Jonathan R. Macey, A Coasian Model of Insider Trading, 80 Nw. U. L. Rev. 1449, 1451–52 (1986).

²¹⁹ See Goshen & Parchomovsky, *supra* note 181, at 1262–65.

²²⁰ It is somewhat difficult to determine trading costs in commodities futures, which were once traded exclusively in chaotic trading pits, and still conduct substantial volume in “open outcry” venues. Bid-ask spreads are not recorded in open outcry markets. Xiaoyang Wang et al., The Behavior of Bid-Ask Spreads in the Electronically-Traded Corn Futures Market, 96 Am. J. Agric. Econ. 557, 557–58 (2014). Moreover, trading costs differ by commodity. See Ian Lang, Interest Rate Derivatives, *in* Financial Derivatives: Pricing and Risk Management 136 (Robert Kolb & James A. Overdahl eds., 2010); see also John A. Labuszewski & Lori Aldinger, Liquidity Monitor, CME Group, 6–8 (Apr. 10, 2013), <http://www.cmegroup.com/education/files/liquidity-monitor-2013-q1.pdf> (detailing bid-ask spreads for various commodities). Many, like corn, trade for just a fraction over the minimum legal trading cost. Compare Wang et al., *supra*, at 573 (0.08% average trading cost), with Corn Futures Settlements, CME Group, http://www.cmegroup.com/trading/agricultural/grain-and-oilseed/corn_quotes_settlements_futures.html (last visited Mar. 11, 2016). Prices fluctuate so there may be a bad week to run a comparison, but only large fluctuations will undermine the proposition here.

²²¹ Minimum trading cost for shares is 1 cent per share. SEC Final Rules and Amendments to Joint Industry Plans, 17 C.F.R. § 242.612(a) (2015). Many will soon increase to 5 cents. U.S. Sec. & Exch. Comm’n, Plan to Implement a Tick Size Pilot Program Submitted to the SEC Pursuant to Rule 608 of the Regulation NMS Under the Securities Exchange Act of 1934, at 14 (Aug. 25, 2014), <http://www.sec.gov/divisions/marketreg/tick-size-pilot-plan-final.pdf> [<https://perma.cc/SNL4-53EX>]. If all stocks traded with spreads equal to the minimum tick size, trading costs for corn would be lower for any stocks worth less than \$12 per share; under the pilot program, corn is cheaper to trade than stock worth up to \$60 per share. One penny per \$12 is about eight basis points, which is the price paid for a \$12 commodity position. Note that Regulation National Market System (“NMS”) regulates the tick size that may be quoted, but not the size that may actually be traded. As a result, highly liquid stocks often trade with a mere three basis point spread, or less than half of the realized spread for corn. Half of all stocks under \$100 have spreads *greater* than 1 penny. See Ana Avramovic & Phil Mackintosh, Credit Suisse, Inside the NBBO: Pushing for Wider—and Narrower!—

ties markets somehow maintain a rich analyst community, which seems to cover commodities with appropriate vim.²²²

It is certainly possible that trading costs would be even lower, and analyst coverage even richer, if insider trading were inhibited.²²³ But another reasonable interpretation is that market health is not greatly threatened by insider trading, and that arguments based on such predictions are correspondingly unpersuasive.

Consider second how commodities might bear on an idea that is one of “the truly seminal events in the economic analysis of corporate law.”²²⁴ The late Professor Henry Manne famously argued that insider trading opportunities could constitute an appropriate means of paying employees, by compensating hard-to-observe innovation.²²⁵ An employee may be more likely to improve the business if she can buy large amounts of stock upon realizing that her improvement worked.²²⁶

Professor Manne and his critics seemingly gave little thought to commodities,²²⁷ yet many of the innovations Manne would like to re-

Spreads (May 15, 2013), <https://edge.credit-suisse.com/edge/Public/Bulletin/Servefile.aspx?FileID=24397&m=-971730490>.

²²² In case the reader has not noticed the availability of expert commodities commentary on television news stations, the author has on file numerous written commodities reports from major banks, trading houses, researchers and price reporting firms.

²²³ Bryant & Haigh, *supra* note 181, at 923 (finding spreads *widen* as computerized trading makes trading more anonymous, and so makes it easier for informed trades); Craig Pirrong, Market Liquidity and Depth on Computerized and Open Outcry Trading Systems: A Comparison of DTB and LIFFE Bund Contracts, 16 J. Futures Mkts. 519, 520 (1996) (finding spreads *narrow* as computerized trading allows traders with up-to-date information to make markets). If the CFTC ever brings an insider trading case, we may await further information. See Utpal Bhattacharya & Hazem Daouk, The World Price of Insider Trading, 57 J. Fin. 75, 97 (2002) (finding insider trading laws do not influence cost of equity, but enforcement of such laws lowers the cost of equity); John C. Coffee, Jr., Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance, 102 Colum. L. Rev. 1757, 1828 (2002) (“The available empirical evidence suggests that adopting and enforcing a prohibition against insider trading significantly reduces the cost of capital.”).

²²⁴ Stephen M. Bainbridge, Insider Trading: An Overview 5 (2000) (unpublished manuscript, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=132529).

²²⁵ Manne, *supra* note 52 at 138. But see *Dirks v. SEC*, 463 U.S. 646, 653 n.10 (1983) (quoting *Cady, Roberts & Co.*, 40 S.E.C. 907, 912 n.15 (1961)) (rejecting the notion that insider trading is “a normal emolument of corporate office”).

²²⁶ This argument has been enormously controversial. See *supra* notes 197–202.

²²⁷ The CFTC deigned to hold up commodities to Manne’s argument, but their analysis is entirely unresponsive. They concluded that because “managerial gains from insider trading are very likely to come at the expense of third parties unrelated to shareholders. . . such gains . . . cannot be said to be compensation.” CFTC Report, *supra* note 94, app. IV-A at 11,

ward are better compensated by commodities trading than securities trading.²²⁸ The sole mention of commodities in his 1966 book, *Insider Trading and the Stock Market*, is that “new ore discoveries, oil finds” are among the many “events or developments” that “lend themselves peculiarly to exploitation by insiders.”²²⁹ Manne thinks of this exploitation in terms of securities trading, but why not trade on the ore or oil rather than the company? Commodities trading on such information enjoys the enviable characteristic of being lawful.

The viability of commodities insider trading converts an empirical weakness for Manne into a strength. For Manne, insider trading compensation is a major benefit of becoming a publicly traded firm.²³⁰ Manne acknowledged that large, diversified firms pose greater problems in using insider trading for compensation, since individual innovations make proportionally smaller impacts on stock price.²³¹ So how do we account for the fact that many commodity trading and production firms

17. Yet the right to fleece others, and the information to do so, clearly constitute attractive perks.

²²⁸ It has even been suggested that the gains from trading commodities might be great enough that we no longer need a patent system. Jack Hirshleifer, *The Private and Social Value of Information and the Reward to Inventive Activity*, 61 *Am. Econ. Rev.* 561, 571–72 (1971) (“The cotton gin had obvious speculative implications for the price of cotton . . .”). Many scholars have noted the profits available to employees trading the stock of *other* companies. Bruce H. Kobayashi & Larry E. Ribstein, *Outsider Trading as an Incentive Device*, 40 *U.C. Davis L. Rev.* 21, 25–26 (2006) (arguing that such trading is important to compensate producers of intellectual property); see also Ayres & Choi, *supra* note 63, at 315–16 (explaining that companies that interact with a commodities firm may possess nonpublic information that makes it valuable to trade similar to insider trading); Ian Ayres & Joe Bankman, *Substitutes for Insider Trading*, 54 *Stan. L. Rev.* 235, 241–42 (2001) (discussing buying a customer’s stock as the second-best opportunity for insider trading); Jill E. Fisch, *Start Making Sense: An Analysis and Proposal for Insider Trading Regulation*, 26 *Ga. L. Rev.* 179, 216–17 (1991) (describing substitutes for insider trading).

²²⁹ Manne, *supra* note 52, at 55; see also Shlomo Reifman, *America’s Largest Private Companies*, *Forbes* (Nov. 9, 2006, 6:00 PM), http://www.forbes.com/2006/11/09/largest-private-companies-biz_06privates_cz_sr_1109privatesintro.html (noting that of *Forbes*’s top private companies, the number one entry is a commodities firm, and the number two, Koch industries, is heavily involved in commodities).

²³⁰ Manne, *supra* note 52, at 138–41.

²³¹ Manne, *supra* note 49, at 167. Although insider trading in securities is illegal, it still makes sense to consider firm choices as informed by insider trading possibilities, given the likelihood of illegal insider trading and the availability of effectively legal insider trading through the strategic use of 10b5-1 plans. See M. Todd Henderson, *Insider Trading and CEO Pay*, 64 *Vand. L. Rev.* 505, 516–23 (2011).

are privately held, including six of the ten largest trading houses?²³² Even when large, public commodities businesses tend to be part of vast, diversified enterprises,²³³ their employees cannot readily trade securities of their employer.²³⁴

Absent the possibility of commodities insider trading, Manne's position would be weakened by the abundance of firms declining to organize in a way that allows profitable insider trading in securities. It would suggest that firms do not deem insider trading an attractive means of compensation. With the possibility of commodities insider trading, another explanation is available: Many firms are able to properly compensate employees through trading privileges by way of the commodities markets, and can avoid the costs of going public or remaining undiversified.²³⁵

Though preliminary, these discussions of market health and executive compensation demonstrate how the securities literature will be enriched once full stock is taken of data from the commodities markets. It would be premature to draw any final conclusions from this abbreviated discussion, but it is perhaps significant that in both cases, empirically informed arguments against insider trading were somewhat weakened in light of new data from commodities markets. Nonempirical arguments, such as moralistic arguments about the unfairness of informational advantage,²³⁶ or legalistic arguments about the proprietarian nature of intellectual

²³² See Ginger Szala, *10 Top Global Commodity Trading Firms: Smart Money or Bad Boys?*, *Futures* (July 25, 2013), <http://www.futuresmag.com/2013/07/25/10-top-global-commodity-trading-firms-smart-money?t=financials&page=11> (listing the ten largest trading firms). Of these, Mercuria Energy Group, Koch, Trafigura, Cargill, Vitol, and Gunvor are private, and Glencore was private until just recently. *Id.*

²³³ See *Mining Giants - The Top 10 Richest Mining Companies* (Mar. 27, 2014), <http://www.mining-technology.com/features/featuremining-giants—the-top-ten-richest-mining-companies-4203262/> (listing ten largest mining companies). Two are state-owned, and eight are largely diversified groups. *Id.*

²³⁴ The CFTC actually acknowledges greater merit in insider trading as compensation in privately held firms. See CFTC Report, *supra* note 94, app. IV-A at 5 n.3.

²³⁵ When the CFTC conducted a study in the 1980s, it found that 47% of responding commodities firms had no policy, written or unwritten, restricting futures trading by employees. CFTC Report, *supra* note 94, at 64. And some 10% of those firms indicated that they deemed it appropriate for executives to have unimpinged trading rights. *Id.* An anecdotal survey of firms, on file with the author, reveals no strong increase in the proportion of contractual restrictions on commodities trading. Intermarket dialog underscores the importance of renewed research into contracting practices in commodities markets.

²³⁶ E.g., Alan Strudler & Eric W. Orts, *Moral Principle in the Law of Insider Trading*, 78 *Tex. L. Rev.* 375, 376–77 (1999).

property,²³⁷ are unlikely to be strengthened or weakened by considering commodities markets. Evaluation of commodities stands not only to bolster or dampen the strength of particular arguments, but also to alter advocates' mix of empirical and nonempirical arguments.

CONCLUSION

Securities and commodities futures are both traded in financial markets. The law once permitted unlimited insider trading for both, and now the law is poised to restrict insider trading in both. But for a period of fifty years, insider trading was legal in one but not the other. Even now, when the CFTC has adopted rules partially addressing insider trading, insider trading remains *officially* legal in commodities markets.

It has been common to explain and justify the different legal regimes by emphasizing differences between securities and commodities futures markets, but these differences are not as significant as they have been long assumed to be and do not withstand serious scrutiny. While these markets do differ in some important ways, they do not differ in ways that justify an intellectual moat between the two. To the contrary, it is essential that scholars of securities insider trading both contribute to the analysis of commodities markets and take stock of important descriptive data available there.

Going forward, this project points the way toward important lines of inquiry for subsequent scholarship. First, this Article both *assumed* validity of the present securities insider trading doctrine in Part III, showing what commodities regulation ought to look like if the securities regime is broadly justified, and also *questioned* the validity of the present securities regime in Part IV, problematizing two lines of justification. Further comparison may ultimately validate the current misappropriation standard for both markets or else urge the adoption of some other—more strict or more liberal—regime. Subsequent work should systematically explore empirical and theoretical findings from the commodities world in order to form a decisive judgment on the optimal level and form of harmonized insider trading regulations.

Second, this Article's method was to question purported differences between these two markets in order to show that arguments about insider trading of securities apply a fortiori to commodities markets. Yet insider trading rules are not the only rules that differ between the two markets.

²³⁷ E.g., Bainbridge, *supra* note 202, at 1191–92.

For example, intentional market manipulation is forbidden in both markets, but plaintiffs are required to show a far higher level of intent, or scienter, in commodities cases than in securities cases.²³⁸ In fact, American commodities and securities have always been subject to entirely different regulatory regimes, with different regulators—an arrangement that is distinctly American. Nearly every nation in the world governs all their financial markets through a single set of regulations, enforced by a single national financial regulator.²³⁹ It is a perennial question whether our regime of regulatory silos serves us well, though individual regulatory differences are less frequently questioned. In each case, legal differences may appear to be justified by some purported difference in the markets themselves. By identifying an instance in which widely accepted differences were overstated, this Article serves as a model for healthy skepticism as to orthodox justifications as to other legal issues.

Commodities markets have changed rapidly in recent years. The paradigm instrument has moved from soybeans to interest rate swaps. And the law of commodities has changed too, adopting rules and tools developed in securities markets. At this crucial period, intermarket dialogue is essential. Financial markets will work best and serve us best if they are the product of deliberation and design, rather than unquestioned assumptions and the folklore of capitalism.

²³⁸ Compare *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976) (declining to hold whether mere recklessness constitutes sufficient scienter in a securities manipulation case), with *In re Amaranth Natural Gas Commodities Litig.*, 587 F. Supp. 2d. 513, 530 (S.D.N.Y. 2008) (indicating commodities manipulation requires showing of “specific intent”).

²³⁹ See, e.g., Directive 2014/57/EU, of the European Parliament and of the Council of 16 April 2014 on Criminal Sanctions for Market Abuse, 2014 O.J. (L 173) 179 (establishing minimum standards for criminal sanctions related to insider trading of most financial instruments, including commodities derivatives).