

# THE CAPITALIST ADVISOR

TOP DOWN INSIGHTS...BOTTOM LINE RESULTS

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## The Injustice of Insider-Trading Rules

Insider-trading rules punish *innocent* and *productive* behavior – and *destroy shareholder wealth*. The case against ImClone's Sam Waksal is only the most recent historical example of this. Nearly \$5 billion of ImClone's market value (or 90% of its peak) has been destroyed by U.S. regulators: by the fraudulent acts of both SEC and FDA officials. Investors must consider *regulatory risk*.

This report examines the ImClone-Waksal case – as well as the broader issue of insider trading rules and why they undermine the stock market.

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## The Spectral Evidence Against Sam Waksal

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In late-17<sup>th</sup> Century America, unpopular women were captured, tortured and murdered for the crime of practicing “witchcraft” – and used as *scapegoats* for society’s ills. The Salem Witch Trials accepted so-called “spectral evidence”<sup>2</sup> of alleged wrong-doing – then punished the “perpetrators.” The charges and trials at Salem were based on *superstition, mysticism* and *religion* – and innocent people suffered for it.

In modern times there is an *equally* superstitious religion of hate that’s being used to punish innocents: a quasi-religion of *envy* and *anti-greed*. And today an equally unjust set of “judicial procedures” – antitrust and insider-trading rules – is being used to persecute alleged demons. In today’s world the persecuted innocents are not women *per se* but *successful American entrepreneurs*. Victims have included Michael Milken, Leona Helmsley and Bill Gates – and most recently Dr. Samuel Waksal, founder of ImClone. Waksal recently pled guilty to charges of modern-day witchcraft (insider trading). Martha Stewart may well be next.

**The sabotage of Erbitux.** The injustice of “insider trading” rules – which are based on ignorance and superstition no less than were the decrees against “witchcraft” – is illustrated in the recent ImClone case. ImClone is a mid-sized bio-tech firm that has applied the latest discoveries in the science of biology to create technologies to solve real world medical problems. ImClone’s brainchild and major product is Erbitux, a drug aimed at making chemotherapy more effective. Unlike chemotherapy – which often *poisons the entire body* in order to kill *some* cancer cells – Erbitux introduces no poisons and

prevents the growth of future cancer cells after chemotherapy has been introduced. According to *BusinessWeek*:

ImClone’s Erbitux is aimed at making chemotherapy more effective. These new drugs represent an important shift in cancer treatment. For much of the last 30 years, the advances have been incremental. Radiation and the tried-and-true chemo therapies each have their own toxic side effects. Recently, however, oncologists have developed ways to “sensitize” a tumor, making chemo or radiation more effective at shrinking a cancerous mass while minimizing damage to healthy cells...Erbitux is one of four or five drugs targeting a protein called epidermal growth factor receptor, which exists on the surface of cancer cells and plays a role in their proliferation.<sup>3</sup>

Last December the FDA dealt a severe blow to ImClone shareholders *by refusing even to review Erbitux*. The firm’s market capitalization has been heavily dependent on the successful launch of the drug. In doing this the FDA has *not* shown that Erbitux is unsafe; it has not even denied that the drug has proven *effective in clinical trials*. In fact, the FDA’s bureaucrat-priests *have conceded that Erbitux is beneficial – but, they sniff, not beneficial enough*.

Although Erbitux *proved beneficial in extending some patients’ lives*, the FDA decided the single-arm trial was *inadequate* and *refused to even consider the drug*. Now, the company faces the prospect of re-doing the trials, which *would add years and millions of dollars to the approval process*.<sup>4</sup> (emphasis added)

**The FDA oath: “First, do harm.”** For centuries the Hippocratic Oath has implored physicians: “First, do no harm.” *Erbitux does no harm*. In fact, it has the potential to *enormously help* cancer patients. But *the FDA doesn’t really care about patients – or stock-*

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<sup>2</sup> The dictionary defines “spectral” thus: “Of, pertaining to, or like a specter.” It defines “specter” as “a ghost or apparition.” It defines an “apparition” as “a visual appearance of a disembodied spirit; phantom; ghost.” And it defines *evidence* as “That which serves to prove or disprove something; that which is used for demonstrating the truth or falsity of something.” Thus “spectral evidence” is a *contradiction in terms*, an *impossibility* – if *facts* and *logic* are to govern one’s methods.

<sup>3</sup> David Shook, “Lessons from ImClone’s Trial – and Error,” *Business Week*, February 14, 2002.

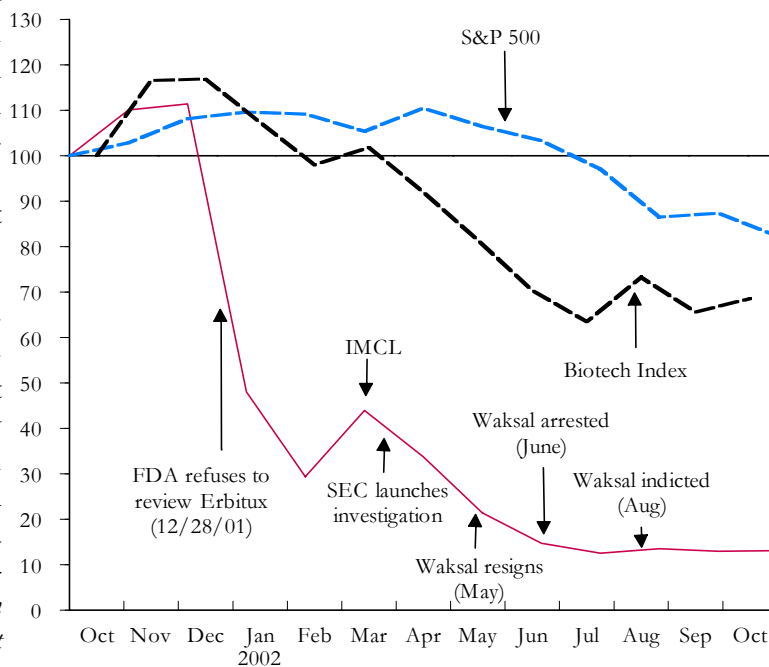
<sup>4</sup> *Ibid.*

holders. Even if the FDA *had* reviewed Erbitux – and even if it *had* provided *evidence* that the drug was unsafe or caused some harmful side-effects – there would have been *no justification* for preventing potential users from *knowingly* and *willingly* taking the risks (and potentially receiving the *benefits*) associated with the drug. But Erbitux *is* safe and effective. As one op-ed writer has put the (tragic) point: “What does the FDA have against saving lives?”<sup>5</sup>

Figure One shows how ImClone’s stock collapsed surrounding the FDA’s announcement late last December that it wouldn’t consider Erbitux – and how the stock today is now nearly 90% lower. ImClone had achieved a peak market value of \$5.4 billion in early December – up from \$1.5 billion a year-earlier on *the market’s knowledge of Erbitux’s value* and on *the expectation that not even lug-headed bureaucrats would blithely ignore that value*. But that’s exactly what the bureaucrats did – and ImClone’s stock has suffered accordingly.

Anticipating the FDA’s pending move last December, Sam Waksal realized that ImClone’s stock might take a hit. He still believed in Erbitux but couldn’t trust the FDA to do it any justice. Although Waksal *didn’t sell any of his own shares* in the days before the FDA’s announcement, he did advise his daughter and father to sell some of *their* shares. They did so (on December 27th and 28th). ImClone’s stock price had reached an intra-day (and all-time) high of \$75/share on December 6, 2001; but a week later it closed at \$69.6/share – more than 7% below its peak and 3% points worse than the broader market. Even before the FDA’s irresponsible decision the *market* – and not Sam Waksal alone – *was beginning to smell a rat* at the FDA. The market was right, of course.

Figure One  
The FDA & SEC Destroy \$4.9 Billion  
in Shareholder Wealth at ImClone  
Stock prices indexed to 100 in October 2001



As shown in Figure One, ImClone’s stock-price decline has had little to do with the decline that’s been seen in the broader market (S&P 500) or in biotech stocks generally. ImClone has underperformed *both* indexes, due to the specific nature of the regulatory assaults it has suffered. But the fact that *most* biotech stocks *also* have underperformed the S&P 500 suggests that there’s been a *further fall-out* from the FDA’s assault on ImClone: if the FDA can act so destructively against *one* biotech drug and firm, markets know *it can do so against many*.

**Who really defrauded ImClone?** After the close of trading on Friday, December 28<sup>th</sup> the FDA announced its refusal to review Erbitux; ImClone closed at \$55.25/share. *Since* then more than \$4.5 billion in total shareholder wealth has been dissipated at ImClone. Waksal family members sold Im-

<sup>5</sup> “Bullying ImClone: What Does the FDA Have Against Savings Lives?” *Opinion Journal*, from *The Wall Street Journal* editorial page, February 13, 2002 (available at <http://www.opinionjournal.com/editorial/feature.html?id=100001677>).

<sup>6</sup> “According to the House Energy and Commerce Committee, 46 ImClone directors, officers and employees sold \$244 million worth of shares in *the two months before* the Food and Drug Administration rejected ImClone’s application to sell a new cancer-fighting drug, Erbitux. Sales by ImClone founders Harlan and Samuel Waksal accounted for \$165 million of the total. The remaining directors, officers and employees sold \$79 million worth during the period. It is not illegal for insiders to sell shares, but it is illegal if they sell because of information not available to the public. ImClone stock had been trading in the \$60 to \$70 range just before the FDA’s Dec. 28 rejection of Erbitux. By the end of January, the stock was below \$20 a share.” (Greg Farrell, “Forty-Six Insiders Sold ImClone Stock Before FDA Decision,” *USA Today*, October 10, 2002).

Clone stock worth (at the time) about \$150 million – or 3% of the total wealth that has been destroyed.<sup>6</sup> But it's clear that *shareholder wealth at ImClone was destroyed by the FDA – not by Waksal (or by any other seller)*. ImClone's stock hasn't plunged by more than 80% so far this year because Waksal advised some holders to sell last December; it has plunged because the FDA refused even to review ImClone's great product and because this year the SEC piled on further by forcing Waksal's removal from ImClone's management

Sam Waksal certainly didn't "defraud" anyone. Every shareholder of ImClone knew full well – or *should* have known – that the firm's market value was heavily dependent on Erbitux and that the drug's approval was at the

mercy of an arbitrary FDA. Even *the buyers of shares sold by the Waksal family* should have known these risks. Any investor who happened to buy *the same ImClone shares that were sold by insiders* (on Friday, December 28<sup>th</sup> or in the days prior) easily could have turned around and sold them *the very next trading day* (on Monday, December 31<sup>st</sup>) – *after* the FDA announcement was widely-known – at a 13% (one-day) loss.

Is the SEC trying to protect such *day traders*? Those are the only discernable "losers" who could be said to have suffered at the hands of the Waksals. After all, an investor who initially bought the stock just *five months earlier* (in August 2001) wouldn't have recorded *any* loss by selling on December 31<sup>st</sup> (*after* the FDA's announcement and the Waksal family sales) – and investors who bought ImClone *anytime before May 2001* actually would have registered a *capital gain* by selling on December 31<sup>st</sup>.

If Sam Waksal really did commit securities fraud, one would expect the government to prepare a settlement – to pay *restitution* to specific "victims." But *it isn't doing that*.

**S** am Waksal certainly didn't "defraud" anyone. And Waksal family members did not cause the 83% stock price decline. The FDA did.

Clone stock in this period – *did not cause this 83% stock price decline*. The FDA and SEC did.

**The one-two regulatory punch.** On the heels of the FDA's wealth-destroying decision last December, the

Waksal family members weren't the *only* ones who sold ImClone shares – but they're the main target of the government because Sam Waksal himself is a convenient scapegoat, to deflect attention from the FDA's wealth destruction. It's true that ImClone's stock price fell 13% from December 28<sup>th</sup> to December 31<sup>st</sup>. But then it fell *another* 58% by the end of January, *another* 55% through the end of June and *another* 11% from the end of June to yesterday. That's a total decline (year-to-date) of 83%. Certainly the *Waksal family members* – who sold *no Im-*

SEC piled on last April by launching an insider trading case against Waksal – a case which, by forcing his resignation, *destroyed still more shareholder wealth* than the FDA *already* had. Waksal resigned in May and was arrested in June. By early July he was being formally charged. Notice in Figure One (page 3) that ImClone's stock began to plunge on *two* separate occasions: *first* when the *FDA made its irresponsible decision* in December and *again* after *the SEC made its irresponsible decision* in April. Damaging as the first decision was, ImClone's stock price actually had begun to *recover* last March. But the SEC quickly put an end to *that*. The *one-two regulatory punch* effectively sabotaged *both* ImClone's major product *and* its major executive.

Instead of going to trial in a *court of law* – and *perhaps suffering the same injustice afforded the Erbitux "trial"* – this week Waksal succumbed to the back-room arm-twisting of government prosecutors and pled "guilty" to six out of thirteen initial counts against him: for violating the SEC's vague and arbitrary trading regulations and "obstructing justice." Waksal now faces *fines and a cruel-and-unusual punishment of 6-9 years in prison*.<sup>8</sup>

<sup>8</sup> "Ex-ImClone Chief Admits Some U.S. Charges," *The New York Times*, October 16, 2002, p. C1.

Notice the perverse injustice involved here. The FDA *obstructed the launch of a good product*; then the SEC *forced the termination of that product's primary creator*. Yet it's not any regulator but the *creator* – Sam Waksal – who faces jail time *for trying to launch a product and for helping his family mitigate regulatory destructiveness*.

***The FDA obstructed the launch of a good product; then the SEC forced the termination of that product's primary creator. Yet it's not any regulator but the creator – Sam Waksal – who faces jail time.***

In addition to being unjustly persecuted for selling, the Waksal-family sellers have been ridiculed for it. According to says Ken Johnson, a legislative spokesman for the House Energy and Commerce Committee of the U.S. Congress (which investigated the ImClone case): “If all of these people really believed that Erbitux was the next miracle drug, then why were they selling instead of buying?”<sup>9</sup> Johnson's abject indifference to the facts of the case are patent. No matter *how good* a product may be, *no* shareholder can profit from it – or rationally persist in holding a long position in the stock – if *irrational regulators block* its introduction.

**Criminalizing innocent behavior.** Having considered some of the “spectral” evidence against Sam Waksal, let's now consider the mindless superstition that underlies the Byzantine rules being cited to justify his incarceration.

Investors should recognize that “insider trading” is a *victim-less crime*; it's an *innocent* act that should be *legal*. (See “Why Insider Trading Should Be Legal”, page 8). But worse than being a victim-less crime, “insider trading” is *a crime that has never been defined in law*.<sup>10</sup> Thus even though “it” is illegal, there is no real way to know if one has engaged in “it.” This permits regulators to *persecute whomever they wish* – at *anytime* – for *any* reason they may choose. To face *jail time* for an *undefined crime* is characteristic of a *dictatorship* – not a free society. There are legitimate

laws against securities fraud – but, as mentioned, *Waksal defrauded no one*.

The persecution of Sam Waksal – for alerting his loved ones to the government's pending destruction of their wealth – is unconscionable. According to a rational code of morality Waksal's actions were *the right ones* to take; he suspected that something harmful would affect his loved ones and he helped them out. But according to the U.S. government *that's a crime* – because this government believes those who act on *private* knowledge must be made to suffer for the harm done by government policies. According to the government, Waksal should have waited until *other people* sold the stock *before he let his family know* – or he should have told *others first* so they could benefit (or avoid harm) *before he could*.

What *right* does the U.S. government have to obstruct ImClone from selling *its own products* – products that ImClone *alone* created by *its own* efforts? And what *right* does it have to obstruct ImClone employees from using knowledge they've gained as a result of working for the firm? In fact, *it has no such rights* – and it acts immorally by claiming that it does (or worse, when it proceeds to abuse those “rights”). *Products*, like firms and CEOs, *should be considered innocent until proven guilty* – not the other way around. Government bureaucrats have no moral right to block producers from selling drugs (or any other products) to willing consumers and no right, either, to block consumers from purchasing them.

<sup>9</sup> Cited by Greg Farrell in “Forty-Six Insiders Sold ImClone Stock Before FDA Decision,” *USA Today*, October 10, 2002.

<sup>10</sup> “Section 10 of the Securities Exchange Act of 1934 broadly outlawed stock fraud. Eight years later the SEC adopted Rule 10b-5, making the fraud provisions applicable to purchases as well as sales of securities. Section 10 and Rule 10b-5 became crucial to the prosecution of illegal insider trading. *Neither defines it, however.*” (“Whispers Inside; Thunder Outside: A New Hunt Is On For Insider Trading,” *The New York Times*, June 30, 2002, Section 3, pp. 1&14; emphasis added).

In the case of a biotech product *the legal burden should be on the government* – or on some allegedly aggrieved party – to *prove* that a drug is dangerous and that its sale and distribution would violate the rights of others. But today firms are compelled to “prove” to the government that their products are *not unsafe* and *not ineffective*. This not only *presumes guilt* rather than innocence; it also *demand[s] the impossible*: proof of a *negative*.

In a fully free-market – which we *do not* have today – a biotech firm must only convince voluntary consumers and doctors that its drug products are worthy. Who’s more concerned with the consumer’s health and happiness – the *consumer himself and his doctor*, or some *disinterested* bureaucrat with other motives? The answer is obvious. Potential patients – in consultation with a private doctor, if necessary – should be the ones who decide on products; such life-and-death decisions should *not* be made by FDA bureaucrats.

**Justice denied.** There are, of course, legitimate laws against fraud – whether *product-based* or *securities-based*. But there has been *no proven fraud in the ImClone case* – other than *the fraud of the FDA posing as a protector* of the health and safety of patients or *the fraud of the SEC posing as a protector* of investors’ health and safety. In fact, both of these agencies (and many others) act in ways that *inflict harm* on patients and investors. The government *should* prosecute genuine fraud – but it should do so consistent with the principle that *one is innocent until proven guilty*. The only *proper* way to do this is through an *objective legal process* – not *arbitrary*, back-room *regulatory arm-twisting*.

Scores of regulatory agencies have been established over the past century on the *false premise* that product users and securities investors are *incapable of properly judging* such matters – even with the help of professional advisers. But these same consumers and investors, as *voters*, indirectly choose the bureaucrats who make regulatory decisions. They judge bureaucrats or politicians by judging their views and decisions. If consumers and professionals who advise them are deemed *unfit to judge* or select some *product* (like Erbitux), what makes them

any *less unfit* to judge or select *bureaucrat-politicians* who judge the product?

Economically, the difference between a private citizen and a state bureaucrat is this: if a consumer improperly selects a drug or doctor *only he* suffers (and can seek *restitution*); but if he improperly selects a politician-bureaucrat to head, for example, the FDA or SEC – then *millions* of people suffer, *without recompense*. That’s why *socialist* economies like the former Soviet Union have failed so miserably and why relatively *freer* countries have prospered. The freer – *less-regulated* – countries also have delivered safer and more effective products and investments. Erbitux is safe – but ImClone’s stock has *not* been – due to *regulation*, not Sam Waksal.

**Who’s property?** ImClone is *private property*, just as its *creations* are its private property. Government interference in the right of ImClone to sell its products to willing, risk-taking consumers violates the basic principles that originally established America as a free society. If the FDA can decide what ImClone does with its property then ImClone is a slave and the government (or the “public”) its master. *Ownership of property* is meaningless without *control of property*. To decree how Sam Waksal must use the information he discovered – in this case knowledge of the FDA’s intent to cripple the firm he founded and built – is to decree that he, as a producer, must serve as the public’s *slave*. To permit *non-producers* (like the FDA) to blithely sabotage or destroy wealth, at will and with complete immunity, is to make them the *masters*.

The underlying (but false) principle of socialism, applied to the *physical* realm, is that property belongs to the “public” *regardless* of who undertook the effort to *create* the property. The insider trading laws are the *intellectual* corollary of this principle; if government is given the power to take control of the *physical creations of your body*, it is no great stretch to expect it also will be given the power to control the *intellectual results of your mind*, i.e., *knowledge*.

The government should leave Sam Waksal and other corporate “insiders” free to reap the benefit (or mitigate the harm) of information gained as a

result of their position. They *earned* it. “Inside” information about any firm – its trade secrets, strategies, etc – are *assets that belong solely to shareholders* (and to *shareholding-executives* too, if *other* shareholders approve of such a policy). A *firm’s owners* should have the *exclusive right* to decide how their employees use information gained from employment in the firm. These assets do not “belong” to the “public” – or to the U.S. government. If that *was* the case, we’d have *public ownership of the means of production (socialism)* – and in today’s “information economy,” *information is a crucial means of production.*

**The facts they love to hate.** In a division-of-labor society it’s *inevitable* that some individuals will discover and act on information *before* (and *better than*) others do. Such differences are the inevitable consequence of the fact that the human mind is *individual* by nature. Just as there’s no such thing as a “collective mind,” there is no such thing as “collective information.”

To grasp information the individual must expend *effort*; he must either *create* the information or *discover* it. After he does this, he may well choose to *trade* it with others or *give it away* in some act of charity (just as he may do so with his *tangible* assets). But he should not be *obligated* (nor compelled by law) to do these things. Morally, he doesn’t “owe” *his* knowledge (or wealth) to *anyone*. The primary moral obligation rests on *others*: they should be obliged to *keep their hands off such assets* and *not destroy or steal them* (or elect *government officials* to do so). These are the *facts of reality* against which regulators *militate*.

***Government interference in the right of ImClone to sell its products to willing, risk-taking consumers violates the basic principles that originally established America as a free society.***

The anti-American, ethical code of *altruism* – of allegedly-noble self-sacrifice – is at the root of the claim that the creators of knowledge and wealth owe it to the non-creators. In Marxist terms this code means that wealth and information must be seized “from each according to his ability” and handed over “to each according to his needs.” The need of the non-producers is said to take precedent over the greed of the producer. Who is exploiting whom? Sam Waksal created wealth at ImClone; he was greedy. The FDA’s ir-

responsible dismissal of Erbitux shouldn’t have been allowed to occur in the first place. But having done this – and having destroyed wealth – the government *adds insult to injury* by blaming and jailing *the victim*.

If *anyone* deserves to face a trial today – to be handcuffed, “perp-walked,” indicted, convicted and incarcerated – it is the *regulators*, those unelected dictators who routinely violate private property rights and destroy wealth (and careers) in the process. These are the witch-hunters of the 21<sup>st</sup> Century, the politicians and bureaucrats who claim “spectral evidence” against *creative producers* – and *loyal family men* – like Sam Waksal. These are the *real perpetrators*, against which *real evidence* can be amassed and *real justice* should be done.

*Will* real justice be served? It’s unlikely. The underlying ideas must change for the better. Meanwhile, entrepreneurial heroes like Waksal (and others) will be forced to *suffer* – and shareholders like those who own ImClone (and others) will be forced to *lose*.

## Why Insider Trading Should Be Legal<sup>11</sup>

Richard M. Salsman, CFA<sup>12</sup>

In a proper, capitalist system consisting of objective laws that protect private property and voluntary contracts, so-called “insider trading” is perfectly legal and moral – not, as it has become in modern times, a murky, ill-defined crime concocted by statistes as a pretext for arbitrarily fining and jailing businessmen. In fact, in its first 150 years of existence, the US government did *not* classify “insider trading” activity as illegal. This was an era when capital markets in the US established a record of integrity, grew swiftly, surpassed London, and financed an industrial revolution. None of this could have happened if insider trading truly “undermined confidence in the market,” as is alleged today.

Let us first understand how a capitalist stock market operates, since this is the market where “insider trading” is said to occur most and where government prosecutions are usually focused. *Capitalists* invest their savings in the shares of a corporation, which represent a partial ownership of the firm. The invested capital is deployed by the firm’s *entrepreneurs* – consisting of the CEO and his management team – who use it to pay themselves, to hire other employees, and to purchase materials, equipment, and other assets.

The capitalists do not participate directly in the entrepreneurs’ daily decisions. They do, however, hire a *board of directors* to oversee and monitor the entrepreneurs’ performance. Among its many functions, the board sets the entrepreneurs’ compensation and, when necessary, replaces existing entrepreneurs with better ones. The board also hires an outside, independent auditor to check the work performed by a firm’s internal accountants, to ensure the accuracy and objectivity of the firm’s financial statements.

These are the basic relationships: the entrepreneurs work for the capitalists and are overseen by a board of directors and an outside auditor, both of which are chosen by the capitalists (by direct vote, based on the proportions of total shares held). The relevant body of law, based on British Common Law, is *agency law*, which governs *agent-principal* relationships. In this case, the entrepreneurs act as legal agents on behalf of the board of directors (the principals); the directors, in turn, act as legal agents on behalf of the ultimate principals, the capitalists. Agency law is not the same as *fiduciary* law; the former allows far greater latitude to an agent than the latter does to a fiduciary.

Having established the context, we can now examine “insider trading.” Under capitalism, it’s possible that the entrepreneurs who run a company also will own shares in it. That is, in addition to being entrepreneurs, they also will function as capitalists.

There is nothing improper about an entrepreneur owning shares in the firm for which he works, nor does this engender some inherent “conflict of interest” that necessarily redounds to the harm of any party. In fact, such “entrepreneurial ownership” can be quite advisable, for it more closely aligns the interests of entrepreneurs with those of “outside” shareholder-capitalists. It can strengthen the agent-principal relationship.

Nevertheless, nothing prevents the capitalists from writing into corporate by-laws a prohibition on ownership by the entrepreneurs they’ve hired, or by board members, for that matter. Nor are they prohibited from specifying precisely how the shareholding entrepreneurs divulge material information about the company or even how and when entrepreneurs trade their shares. Of course, to the extent entrepreneurs do hold shares, and thus vote on the

<sup>11</sup> This sidebar commentary first appeared in *The Intellectual Activist* (August 2002, pp. 16-17). It is reprinted with permission. See [www.intellectualactivist.com](http://www.intellectualactivist.com).

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corporate by-laws, they too will have some say in these matters.

Historically, such restrictive by-laws *did* arise under capitalism, but they were rare. The capitalists recognized the positive incentives – and benefits to all involved – associated with hiring entrepreneurs who were also shareholders. They also knew full well that shareholding entrepreneurs could withhold, temporarily, some potentially bullish “inside” news (say, of a pending patent approval), that they could buy more stock (from other, unknowing shareholders) before the news became public, and thereby profit – and that the shareholding entrepreneurs could do the same with potentially bearish news (say, of a pending rejection of a patent application), this time selling the stock or shorting it (to non-shareholders) before the news became public, thereby avoiding a loss.

More often than not, this “insider trading” was seen by capitalists as a form of compensation for the entrepreneurs they hired. The capitalists knew that should this “privilege” be abused, they could restrict it through corporate by-laws – or simply fire the entrepreneurs. They rarely did so, for abuse was rare. The capitalists also knew that, by its very nature, insider trading only moved a stock price marginally, that the far-bigger moves came when the news was publicized; and if the news really was “big news,” it didn’t take long to get out, regardless of insiders’ wishes and actions.

In the meantime, the courts recognized, through a proper application of agency law, that such trading involved no victims. It was held that such proprietary information is clearly an asset belonging to the company – that is, to its owners, the capitalists – that these owners have the *sole right* to regulate its

dissemination and use, and that *no* obligations are owed by an entrepreneur-shareholder to non-shareholders. More generally, they recognized that no one owes anyone else a “right to information” unless specified by contract, that every shareholder must be seen as buying or selling shares based on his own unique purposes and goals – and that the stock market is not a guarantor of omniscience or of financial returns.

So why is insider trading illegal today? Starting in the late 1930s, after the Securities & Exchange Commission was created in 1933, the government began issuing regulations controlling the disclosure and use of corporate information and in time simply prohibited insider trading (in vague language). To this day, the SEC prohibits shareholders from voluntarily permitting, through by-law provisions, insider trading by the entrepreneur-managers they’ve hired. Initially, the courts ruled against such blatant violations of the principles of agency law, but over the years they caved in and now routinely declare the interventions to be acceptable.

The underlying cause of this change is philosophical. Altruist-egalitarian premises dictate that property owners must not be allowed an unequal share of anything, either of wealth or of information, and that corporate managers must answer, not to the corporation's owners, but to the general public, which they are required to serve. Thus, the egalitarians hold that there is a “collective right” to the swift and equal dissemination of private information, especially to the public’s least-informed members – just as they hold that there is a “collective right” to the dissemination of private wealth to the public’s least-productive members.