



## Episode 1,177: Insider Trading: A Crime?

Guest: Bill Anderson

**WOODS:** Let's talk about Martha Stewart in particular, and then we'll talk about insider trading more generally. I've got a lot of young people who won't remember the Martha Stewart case, so I guess we'd like to start with the background. But for right now, where is Martha Stewart? What kind of sentence did she wind up getting?

**ANDERSON:** She ended up serving about five and a half months over at the Alderson prison in West Virginia. They call it Camp Cupcake. But I've had another friend who was incarcerated there on some really specious charges, and no prison is a country club, no matter what they tell you. But she served about five and a half months there, and she is back in business. I mean, people like Martha Stewart don't really allow even this kind of stuff to ruin their lives.

**WOODS:** I was just wondering if she was back in public life, because I'm so out of it, I wouldn't even have noticed one way or the other.

**ANDERSON:** Yeah, she is. She's back in public life. It's a little bit different, but she's definitely been in public life. I don't follow her as much as I used to back in the day; you know, they had all the Martha Stewart Collection and all that. But I think she's still quite active, and I say: once an entrepreneur, always an entrepreneur.

**WOODS:** Well, let's talk then about what got her in trouble. And I don't know if it was actually insider trading or whether it was lying to Congress.

**ANDERSON:** Well, actually, it was neither. What had happened was that a CEO of a company called ImClone, ImClone was about to have a drug called Erbitux turned down by the Food and Drug Administration, and so when that happened, when it was about to happen, the stock price would go down. Well, the CEO unloaded a bunch of his own stock, and her broker said, Hey — and all of a sudden, I can't think of — Waksals, Sam Waksal, he says, Hey, Waksal is selling some stock. You may want to find out what's going on. And so she tried to contact him and couldn't, and then they decide we'd better go ahead and sell. So she sold \$4,000 in ImClone stock, and then the word came out, the stock price went down, the CEO ended up going to jail for insider trading, and ironically, the company, ImClone came back up again. So whoever bought the shares that Martha Stewart sold ended up making money [laughing]. So I mean, you know, it was kind of a happy ending for that.

But the word got out, and so what ultimately happened was that the FBI decided to bleed her. And what they were doing — and this is a really insidious thing that happened, something that, even today several years later, still makes me really upset. But they started leaking

stuff about their investigation, which is illegal, highly illegal. And they started leaking it, and the purpose was to knock down the price of Martha Stewart Living, stock price. And so her company was taking hit after hit, and the FBI was illegally tossing out this grand jury information.

And so anyway, she finally agreed to meet with the FBI. Now, you have to understand that an FBI interview is like none other. Nobody takes notes. Even if your attorney's present, they can't say anything. You can't take notes. Nothing is recorded. Nothing is memorialized. It's all about the agent's memory. So Tom, you can go in there at age and serial number or whatever, and they could come out and they could allege that you said this and that, and there wouldn't be a thing to do about it because everybody knows the FBI always tells the truth.

So she had that interview with them, and they charged her with lying to the FBI. And also, she had thought about, had discussed not telling the truth or at least kind of fudging some of the information on I think some sort of certificate regarding the sale of the stock but decided not to. But she also, just by having uttered this thought of maybe we ought to alter this or whatever — I forget what it was that she wanted to alter — that they charged her with that too.

Now, there was another charge that they brought that the judge dropped. And Tom, this tells you something about the mentality of James Comey. Understand that James Comey at the time was the U.S. Attorney for the Southern District of New York, which included Manhattan, which this was where Martha Stewart was put on trial. And they charged her with securities fraud. And why did they charge her with securities fraud? They said that she was giving false statements, trying to artificially hold up the price of Martha Stewart Living. Now, understand that the FBI was breaking the law leaking information to the press to depress the stock price of her company. And Stewart was saying publicly, "I have not engaged in insider trading." They never charged her with insider trading, but they said that by saying she was not involved in a crime that the FBI never charged her with, that she was committing securities fraud.

Now, this, as I pointed out, was a rather novel approach to securities fraud, and on some other show if we ever talk about federal criminal law, you have a situation in which, even though we do not have — criminal law cannot fall into the area of common law in the United States. The Supreme Court nearly 200 years ago ruled against that. But the Feds essentially do that practice. They find ways almost using common law logic to turn any kind of activity into a crime. But that's for another discussion.

But at any rate, that was the heart of the whole thing, that Stewart, they started floating the stuff about insider trading, even though she actually had not engaged in insider trading. Just because her broker had information that somebody was selling stock, that is not — she knew nothing about the company, nothing about Erbitux being turned down by the FDA. She knew nothing about that. That's the sort of thing that would have fallen under the purview of insider trading. All she knew was that Sam Waksal was dumping his stock and maybe she should sell some of her stock too. And so the FBI manipulated that whole thing, essentially moved her into a trap, into what we would call the perjury trap — except it's not even perjury because you're not under oath. That's another thing too. Nobody's under oath at these things. You're just being interviewed by the FBI, and if they decide that you've lied — and the only proof of course is the agent's memory. So that essentially is the thing in a nutshell.

At the trial — this is something else. Number one, it's a highly prejudicial trial all the way through, and the media of course did a lousy job of covering it. I had an article on the Mises page right after verdict. I had titled it "Wealthy Beyond a Reasonable Doubt." And one of the jurors — and he tended to be sort of a leader in the jury room and spoke to the press afterwards. His name was Chappell Hartridge. He lied on his jury application in hopes that he could get on the jury so that he could vote to convict no matter what. So that should have been right there grounds for overturning the verdict. Of course this is the United States of America and that kind of justice just doesn't go on in the federal courts.

So at any rate, that's sort of some of that stuff in a nutshell, Tom. I hope you're still awake. I hope you and the listeners are still awake after all of that.

**WOODS:** Well, try and explain exactly the distinction here between the laws being unjust and the application and enforcement of the laws being unjust. Do we have a case of both of those things going on here?

**ANDERSON:** Absolutely. Here's the thing about insider trading, and everybody — I want people to understand that federal criminal law, so criminal law in general and especially federal criminal law, is statutory. Statutory means that you have a specific law that has been broken. Insider trading laws are purposely vague that, when Congress wrote the law that the people behind it — not John Conyers. He was really an arrogant congressman from around Detroit. He was there for many, many years. He's not there now. But he was the one who authored the statute. He said outright that we are not going to clearly define insider trading because then people will then use it as a roadmap. John Dingell. John Dingell was his name.

But in other words, so here's the thing, that the way that they've purposely written the criminal statutes for insider trading is that you don't really know if you're involved in it, or chances are you don't know if you're violating the law until afterwards whether or not the prosecutors decide to charge you. So think about that. In other words, you have a law that's purposely vague. This isn't by accident. This is Congress being purposely vague. So the idea is to put everybody on notice that we may decide to charge you with a crime if we don't like you.

**WOODS:** And you know what? More and more, as I look around I find that there are a whole bunch of laws that actually can be used that way. This whole thing that's coming out of the EU, this GDPR regulation, series of regulations is so open-ended and imprecise about exactly what's expected of you that they could find an infraction really from anyone, and so therefore everybody's held hostage, because at any moment, you could be brought up on charges on this. You think, oh, that's the EU; it doesn't affect me. They have ways of making your life miserable.

**ANDERSON:** Oh, yeah.

**WOODS:** So it really is a way of being able to target anybody, because it's impossible to comply with because the language is so vague. It's insane and ridiculous. It's times like this I'm glad I'm just a small fry. But now let's talk about the subject of insider trading more generally and the economics of it and indeed the justice of it, because people will say that — basically the argument against insider trading is an egalitarian argument, that everybody should have more or less equal access to information, and if somebody has information that's not available

to other people and then acts on that in a way that turns out to be profitable, this is not fair because we have an unequal access to information.

**ANDERSON:** Yes.

**WOODS:** Now, that sounds plausible I think to most people, that I'm on the inside, I got some tip, and it made me some money, and meanwhile other people didn't have that tip and they lost money — that just doesn't seem right to some people.

**ANDERSON:** Yeah, you know, it's an interesting point, because we always hear, well, the markets are rigged, the markets are unfair, we've got to make the markets more fair. But the truth of the matter is that in all sorts of things, all ways of life, that you and I have to depend on specific information, including anything that we would call insider information. I mean, let's do *reductio ad absurdum*, and that is that, if we outlaw this sort of information hoarding or gaining in the sale of stock securities or any type of financial security there, should we also outlaw something else? Should we outlaw regarding automobiles, if you know something about a car that somebody else doesn't. I mean, your mechanic knows more about your car than you do. Should he be charged with insider trading? And so on. And doctors know a whole lot more about things. Should we try to say doctors shouldn't have so much information when you go into a hospital? You want people that are involved in this thing to have information.

Now, one of the interesting points that Daniel Fischel wrote in his book — there's a book that came out a little over 20 years ago called *Payback*, and it was about the Wall Street prosecutions and Rudy Giuliani and Michael Milken and the sale and issue of some junk bonds. And one of the things he pointed out was that a lot of what you call insider trading issues came about with mergers and acquisitions, and the reason that this even came about in the first place was because of the Williams Act passed in 1968, Senator Harrison Williams, who later went to prison on the Abscam charges that came about in 1980. And you have to now have this announcement; there was a period of time in which you can't move and all that. And it's basically to keep companies from having to subject themselves in the discipline of the marketplace by, you know, they have the public sale of a stock but they want to restrict who can buy it.

And so by creating these artificial windows that the getting of insider information became more important. Because what happens, Tom, in these securities markets, these markets and their prices move very, very quickly, and so you don't have many kind of time lags with that. You think about the sale of commodities, sale of stocks and bonds, that information moves so quickly that if you did not have these artificially-built time lags in which all of a sudden it became advantageous for somebody to sneak around and try to find out something, then you probably wouldn't have had near this problem in the first place.

Now, I will add this: that there is a difference when you have somebody who has what we call a fiduciary relationship or fiduciary duty with a firm. Let's say, for example, that you're an attorney, that you work with a certain firm, and you're right in the middle of a negotiation on a merger or acquisition, and you go out and you go buy a bunch of the stock that you're working on in the merger, because you know that if this merger comes through, you're going to make a whole lot of money. Well, if you do that, these types of things, you are sending information through the back channel of pricing, but the kind of information that could very well scuttle the deal. Now, of course, if you did that, you scuttled the deal, managing that

you would end up losing all that money from buying that stock. So there's a certain bit of what we would call built-in moderation.

But Tom, here's the problem: that most of these cases — for example, the Martha Stewart case — did not involve a fiduciary duty. This was not like the CEO of the company unloading his stock, which, by the way, in a free society, he should be allowed to do that. By unloading his stock, he's also weakening his own authority over the company. And so I wonder should there be any insider trading laws at all, and the truth is I don't think there should be. I don't believe that we should have what we call economic crimes. The Soviet Union collapsed in 1991. They're the ones that invented economic crimes. I would prefer that we not follow the lead of the old Soviet Union.

**WOODS:** Well, I've heard it argued by Austrian economists that, leave aside all the emotion and the irrational, knee-jerk response people have to insider trading and just look at what's actually going on, what might be what we might call the social function of insider trading. And what's basically happening is, in light of whatever this information is that this person has, the current stock price is not really where it ought to be and it's not really where it's going to wind up being. By acting on this information, this person is accelerating the move of the stock price to where basically society needs it to be so that it makes sense.

**ANDERSON:** Yes.

**WOODS:** So it pushes it to where it's — this is really an extension of really any kind of speculative behavior that pushes the price where it, in some abstract sense, out to be.

**ANDERSON:** Yeah, I think that's a very good point. In other words, that they're helping move the market. And like I said, in my example, the attorney who goes out and buys stock, if this attorney's actions end up scuttling the deal, why then, he's definitely harmed his firm. Now, here's the thing: should that be a crime or should it be a civil violation or even handled inside the company itself? And a lot of times we criminalize activities that at the very worst, *at the very worst* should be in civil court, not criminal court, and this whole notion that we've got to criminalize all this stuff makes absolutely no sense whatsoever. Yeah, so anyway, that's the bottom line with it, unfortunately. We criminalize things that frankly should not be criminalized.

**WOODS:** Bill, let me read something Bob Murphy wrote, just a little passage from an article of his, just to give people an example with numbers. He says:

"Let's suppose a Wall Street trader and overhears an executive on his cell phone discussing some good news for the Acme Corporation. Then the trader rushes to buy 1,000 shares of the stock, which is currently selling for \$10. When the news becomes public, the stock jumps to \$15, and the trader closes out his position for a handsome gain of \$5,000." So the question is: "Who is the supposed victim in all of this? From whom was this \$5,000 profit taken?"

And here's where Bob really shines here, because people think somehow he's bilked the public. So Bob goes through every possible group or person who could have been bilked by this guy. He says, well, the people who sold the shares to the trader were trying to sell anyway and would have sold it to somebody else even if this guy hadn't entered the market, and in fact, "by snatching the 1,000 shares at \$10, the trader's demand may have held the price

higher than it otherwise would have been. In other words, had the trader not entered the market, the people trying to sell 1,000 shares may have had to settle for \$9.75 per share rather than the 10 they actually received. So the people dumping their stock either were not hurt or actually *benefited*.

"So then the people who held the stock beforehand, and retained it throughout the trader's speculative activities, were not directly affected either. Once the news became public, the stock went to its new level. Their wealth wasn't influenced by the inside trader.

"In fact, the only people who demonstrably lost out were those who were trying to buy shares of the stock just when the trader did so, before the news became public. By entering the market and acquiring 1,000 shares (temporarily), the trader either reduced the number of Acme shares other potential buyers acquired, or he forced them to pay a higher price than they otherwise would have. When the news then hit and the share prices jumped, this meant that this select group made less total profit than they otherwise would have.

"Once we cast things in this light, it's not so obvious that our trader has committed a horrible deed. He didn't bilk 'the public'; he merely used his superior knowledge to wrest some of the potential gains that otherwise would have accrued as dumb luck to a small group of other investors."

**ANDERSON:** Yeah, exactly. Here's the thing: that there really needs to be harm. If you're going to bring criminal law into it — criminal law is always sort of a nuclear option, but if you're going to criminalize something, at the very least, you need to talk about something that causes real harm to people, not theoretical harm to somebody that you can't — you have to be able to identify who was harmed and how this person was harmed. For that matter, we do that in civil court. You're supposed to come up with amounts of damages and things like that, and we don't do that. And so I think that that's a real problem, and I think we're just — it makes me very sad, because in America we want to criminalize stuff, and what happens? We get a lot of people thrown into prison, we get people killed who shouldn't be killed, we have lives ruined. And for what? To make Americans feel like we have a more egalitarian society? How does that happen? Or that somehow somebody shouldn't be allowed to get wealthy.

And Martha Stewart started out with nothing. She was a poor person. She built a company by taking risks, by moving forward, by seeing opportunities that other people did not see. And she made the world a better place for a lot of people. And for out of this, we're supposed to be resentful of her? Why? Tom, please explain to me why I should be resentful of Martha Stewart's success. How has she harmed me? She has not harmed me at all. She's made life better for people. Why in the world are we supposed to be resentful of her? I don't understand that.

**WOODS:** It's a question I ask myself a lot when I look at the way people respond to successful people.

**ANDERSON:** Yeah.

**WOODS:** And by the way, I can't help pointing this out, but there are some nasty people in the libertarian world who hate to see other people succeed. So maybe it's just hardwired in us.

**ANDERSON:** Yeah, I think it's — the old thing, remember in Russia, the old Soviet Union, that on their last day of life that people asked for all sorts of things, wonderful things for them, and the Russian asked that his neighbor's barn burn down. It's the idea that we resent that somebody has been well off or made better off, and that somehow is taking away from us. Well, if you sit down and think about it, it's not taking away from you or from any of us. There's a real difference between somebody causing harm and somebody just being better off. And I think that, unfortunately, that the egalitarian mindset being what it is, it's very difficult to get past it.

I wrote an article on the press coverage of Martha Stewart, and it was really awful and it was basically built on resentment of a successful. That was really the thing. And it's like my article on her, "Wealthy Beyond a Reasonable Doubt," I quoted from *The New York Times* editorial about that: "The trial depicted a cozy world where insiders routinely use their wealth and connection to benefit from insider information." But there wasn't any of that going on. I mean, the trial never depicted anything like that. This was just *The New York Times* just shooting off, saying ignorant things, because I guess that's what's expected of them.

**WOODS:** Bill, I appreciate your shedding light on all of this, but I think I've decided that you now need to go rest. I cannot believe I've let you do this [laughing].

**ANDERSON:** Oh, this is great.

**WOODS:** This is the single-most heroic thing any guest has ever done in almost 1,200 episodes.

**ANDERSON:** Well, remember this: Tom Woods called, and if I possibly can get to a Skype, I will do it. You know how I am.

**WOODS:** Look, at this point, I may have to call ahead to your family and make sure you're in good health before I have you on the show, because I don't trust you. [laughing] Anyway, I know you've got a couple of articles from the old days about Martha Stewart, so I'll link to those at [TomWoods.com/1177](http://TomWoods.com/1177) that people can take a look at. I thought about this because I'd heard some rumblings about Donald Trump looking to pardon Martha Stewart. Did you read about that?

**ANDERSON:** Yeah, and I'll tell you what: I hope he does. I absolutely hope he does. Tom, that verdict should have been overturned, just by juror misconduct, and that is the worst kind, where a juror lies to get on and then brags about it afterwards. And why wasn't he prosecuted? Why didn't James Comey — you know, James Comey, he's such a Boy Scout, right? And we can't have any — oh, we've got to tell the truth; we have to stand up for the truth. And remember his whole thing: this was about lying. The Martha Stewart case was about lying. Well, guess what: you had a juror who openly lied, who gamed the system, but he came up with a verdict that James Comey liked, so therefore we won't prosecute him. But what if she'd been acquitted and then he found out that a juror lied to get on there to try to — do you think his office would have hesitated to go after this person? Not at all. So I think that there's a lot of stuff going on. I thought it was a ridiculous trial. She should never have been charged in the first place, and I hope Donald Trump does pardon her. I really do.

**WOODS:** Well, I suppose time will tell, but Bill, we're all pulling for your full recovery and good health and that you do get released from prison today —

**ANDERSON:** [laughing]

**WOODS:** — and thanks a lot. We really appreciate it.

**ANDERSON:** All right, Tom, you take care. Thanks.