DUTY-FREE INSIDER TRADING?

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Until recently, the enforcement of insider trading violations was generally less robust outside the United States because of the limited sanctions, resources, and powers available to regulators abroad. This situation is slowly changing, especially in the United Kingdom, where the Financial Services Authority has begun to police the offense vigorously. However, the approaches to regulating insider trading and market abuse differ fundamentally across the Atlantic.

In the United States, the offense is not statutorily defined. It is based on judicial and administrative interpretations of a broad securities antifraud statute and accompanying U.S. Securities and Exchange Commission rules, which is reminiscent of a common law approach. The offense can be either criminal or civil, and because it is derived from an antifraud statute, it has been interpreted by courts as requiring a showing of intent. In the European Union, the offense of insider dealing was defined in a detailed statutory directive known as the Market Abuse Directive, which has been implemented through legislation by the EU Member States. In addition to defining the offense statutorily, the

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U.K. and EU regimes differ from the U.S. antifraud framework in that the offense is premised on the concept of parity of information; there is no requirement that there be deceptive or misleading conduct, or breach of a fiduciary duty or similar relationship of trust and confidence. The parity-of-information approach was urged by the Securities and Exchange Commission but explicitly rejected by the U.S. Supreme Court in Chiarella v. United States *as too broad in scope, given that Rule 10b-5, the rule allegedly violated, is grounded in fraud. Under the parity-of-information approach, the focus is on the information the person trading has, not how he or she obtained it from his or her source, or whether or not he or she intended to violate the law.*

Recent cases in the United Kingdom and in the United States highlight how punishable behavior in one regime may not constitute a violation in the other. Given the inefficiency of overlapping and conflicting regulations, the growing globalization of markets, and the tendency to apply antifraud prohibitions extraterritorially, the strengths and weaknesses of the U.S. and U.K. regimes should be evaluated with an eye to adopting a common approach in an area critical to market integrity. We conclude that the United States should enact a statutory rule of law based on the parity-of-information approach in the European Union, being sensitive, however, to protecting trading activity based on information obtained through legitimate and socially valuable independent research, a goal addressed by the U.K. framework.

I. INTRODUCTION

The strong stance taken by the United States against insider trading—an offense commonly referred to as "insider dealing" in foreign countries—has led these other jurisdictions to ban the offense as well. Until recently, the enforcement of insider trading violations was generally less robust outside the United States because of the limited sanctions, resources, and powers available to regulators, and their reluctance to use rigorous criminal enforcement. This situation is slowly changing. As Jamie Syminton, Head of Wholesale Enforcement at the Financial Services Authority ("FSA"), recently explained, in the United Kingdom "a few years ago it would have been near impossible to imagine that . . . people in the general public would have known about or been interested in what insider dealing is, or that there is a body called the FSA that polices it."[1] However, today "the FSA has become a visible and credible force combating insider dealing. . . . [It is] determined to crack down on market abuse and capable of doing so."[2] In 2012 alone, the FSA issued a total of eleven decisions involving civil market abuse violations and secured ten criminal convictions, including the highest ever jail term of four years.[3] The United States also increased the number of insider trading

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1 Jamie Syminton, Head of Wholesale Enforcement, FSA, Speech at the City and Financial Market Abuse Conference: Challenging the Culture of Market Behaviour (Dec. 4, 2012), *available at* http://www.fsa.gov.uk/library/communication/speeches/2012/1204-js.

2 *Id.*

3 The four-year jail term was for James Sanders, who ran Blue Index, the specialist brokerage. Brooke Masters, *FSA Targets Market Abuse*, FIN. TIMES, Jan. 2, 2013, http://www.ft.com/intl/cms/s/0/ed6433f8-54d5-11e2-a628-00144feab49a.html#axzz2KQLfMrhm.

enforcement actions in 2012, with highly publicized criminal convictions making headline news, including those of Raj Rajaratnam, the founder of Galleon Group, and Rajat Gupta, the former director of Goldman Sachs.[4]

However, the approaches to regulating insider trading and market abuse differ fundamentally across the Atlantic. In the United States, the offense is not statutorily defined. It is based on judicial and administrative interpretations of a broad securities antifraud statute and accompanying Securities and Exchange Commission ("SEC") rules, which is reminiscent of a common law approach.[5] The offense can be either criminal or civil, and because it is derived from an antifraud statute, has been interpreted by courts as requiring a showing of intent.[6] In the European Union, the offense of insider dealing was defined in a detailed directive known as the Market Abuse Directive ("MAD"), which has been implemented by the EU member states.[7] Because MAD was a minimum directive, the United Kingdom treated it as a floor and implemented a stricter, so called "gold-plated" regime, which includes both criminal and civil penalties.[8] In addition to defining the offense statutorily, the U.K. and EU regimes differ from the U.S. antifraud framework in that the offense is premised on the concept of parity of information; there is no requirement that there be deceptive or misleading conduct. The parity-of-information approach was

4 Since 2009, the U.S. Attorney's offices in New York alone have prosecuted sixty-six people for insider trading. *See* Gemma Tombs, *Insider Dealing v Insider Trading*, CORKER BINNING BLOG (Apr. 18, 2012) [hereinafter Tombs, *Insider Dealing/Trading*], http://www.corkerbinning.com/blog/2012/04/insider-dealing-v-insider-tradi ng/#.URaI_aXNnFI; *see also* Kara Scannell, *US Steps Up Probes on Insider Trading*, FIN. TIMES (Oct. 2, 2012, 10:00 PM), http://www.ft.com/intl/cms/s/0/46fb6cb4-0c20-11e2-8032-00144feabdc0.html#axzz2KQLfMrhm.

5 Chiarella v. United States, 445 U.S. 222 (1980).

6 *Id.*

7 Council Directive 2003/6, 2003 O.J. (L 96) 16 (EC).

8 TIMOTHY EDMONDS, HOUSE OF COMMONS LIBRARY, MARKET ABUSE DIRECTIVE, 2011-2, H.C. SN/BT/3271, at 7 (U.K.) [hereinafter MARKET ABUSE DIRECTIVE BRIEFING], *available at* http://www.parliament.uk/briefing-papers/SN03271.pdf.

urged by the SEC but explicitly rejected by the U.S. Supreme Court in *Chiarella v. United States* as too broad in scope, given that Rule 10b-5, the rule allegedly violated, is grounded in fraud.[9] Under the parity-of-information approach, the focus is on the information possessed by the person doing the trading, not how he or she obtained it from his or her source.[10] As a result of these differences, the same conduct might violate one but not the other regime. This difference raises interesting questions in the context of securities that are listed and traded in multiple jurisdictions.

Recent cases such as *Einhorn*[11] and *Hannam*[12] in the United Kingdom, and cases such as *Cuban*,[13] *Dirks*,[14] *Wyly*,[15] and *Steffes*[16] in the United States highlight how punishable behavior in one regime may not constitute a violation in the other. Given the inefficiency of overlapping and conflicting regulations, the growing globalization of markets, and the tendency to apply antifraud prohibitions extraterritorially, the strengths and weaknesses of the U.S. and U.K. regimes should be evaluated with an eye to adopting a common approach. We conclude that the United States should enact a statutory rule of law based on the parity-of-information approach in the European Union, being sensitive, however, to immunizing trading activity based on information

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9 *Chiarella*, 445 U.S. at 234.

10 CLEARY GOTTLIEB STEEN & HAMILTON LLP, COMMUNICATION WITH FINANCIAL ANALYSTS AND RELATED DISCLOSURE ISSUES 23 (2012), *available at* www.cgsh.com/files/News/908521b8-a7ca-4993-8f12-25abed3c4464/Presentation/NewsAttachment/117c943c-b150-44fa-aa1a-277c812d5f76/CGSH%20Alert%20-%20Communication%20with%20Financial%20Analysts%20and%20Related%20Disclosure%20Issues%20.pdf.

11 Einhorn, FSA Decision Notice (Jan. 12, 2012) (U.K.) [hereinafter Einhorn Decision], *available at* http://www.fsa.gov.uk/static/pubs/decisions/dn-einhorn-greenlight.pdf.

12 Hannam, FSA Decision Notice (Feb. 27, 2012) (U.K.) [hereinafter Hannam Decision], *available at* http://www.fsa.gov.uk/static/pubs/final/ian-hannam.pdf.

13 SEC v. Cuban, 620 F.3d 551 (5th Cir. 2010).

14 Dirks v. SEC, 463 U.S. 646 (1983).

15 SEC v. Wyly, 788 F. Supp. 2d 92 (S.D.N.Y. 2011).

16 SEC v. Steffes, 805 F. Supp. 2d 601 (N.D. Ill. 2011).

obtained through legitimate and socially valuable independent research.

II. THE *EINHORN* CASE AND THE EU/U.K. REGULATORY REGIME

In this Article, we focus principally on the U.K. implementation of the EU minimum harmonization directive relating to market abuse. We take this approach because the United Kingdom currently has the most developed legal framework and the most rigorous enforcement of insider dealing regulation in the European Union, making it an appealing system to compare to that of the United States. Before discussing the *Einhorn* case, some background on the U.K. and EU regulatory framework is necessary. The European Union's market abuse regime is currently comprised of a framework directive called MAD,[17] three European Commission directives (the Market Manipulation Definitions Directive,[18] the MAD Implementing Directive,[19] and the Market Practices and Disclosure Directive[20]), and a Commission regulation called the MAD Implementing Regulation.[21] On October 20, 2011, the Commission adopted legislative proposals to reform the market abuse regime. These proposals consist of a new regulation on insider dealing and market manipulation called the Market Abuse Regulation Proposal ("MAR Proposal")[22] and a directive

17 *See* Council Directive 2003/6, 2003 O.J. (L 96) 16 (EC).

18 Commission Directive 2003/124, 2003 O.J. (L 339) 70 (EC).

19 Commission Directive 2003/125, 2003 O.J. (L 339) 73 (EC).

20 Commission Directive 2004/72, 2003 O.J. (L 162) 70 (EC).

21 Commission Regulation 2273/2003, 2003 O.J. (L 336) 33 (EC). This information is drawn principally from EDWARD F. GREENE ET AL., U.S. REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVES MARKETS § 7.01, at 142 (10th ed. 2012 & Supp. forthcoming 2013) (on file with authors).

22 *Proposal for a Regulation of the European Parliament and of the Council on Insider Dealing and Market Manipulation (Market Abuse)*, COM (2011) 651 final (Oct. 20, 2011) [hereinafter *Market Abuse Proposal*], *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0651:FIN:EN:PDF.

titled Criminal Sanctions for Insider Dealing and Market Manipulation ("CSMAD Proposal").[23] However, the new regime is unlikely to enter into force before early 2015.[24]

Before MAD was adopted and transposed into U.K. law, the U.K. markets were subject to the Financial Services Market Act of 2000 ("FSMA"), which prohibited market abuse and was enforced by the FSA.[25] In addition to FSMA, the FSA also created a Code of Market Conduct ("the Code"), to provide guidance as to how it would interpret the statutory provisions in FSMA.[26] While the Code represents only the views of the FSA and does not have the power of law, it is followed as a quasi-rulebook in practice, given that the FSA not only authored the Code but also enforces the laws that the Code interprets.[27]

As previously noted, when MAD was adopted, the United Kingdom decided to transpose MAD into national law in a manner that went beyond the minimum standards required by MAD.[28] Two main areas in which the United Kingdom went beyond MAD relate to (1) its scope (it includes instruments trading on markets other than regulated markets) and (2) its retention of those existing market abuse prohibitions in FSMA which are not addressed in MAD.[29] In

23 *Market Abuse Proposal*, *supra* note 22, at 73.

24 GREENE ET AL., *supra* note 21, at 143, 157 ("Negotiations are still ongoing within the [European] Council and the Parliament separately. May 20–23, 2013 are the indicative dates for consideration of the MAD II legislative proposals by the Parliament in its plenary session.").

25 SLAUGHTER & MAY, THE EU/UK MARKET ABUSE REGIME—OVERVIEW 1 (2011) [hereinafter U.K. MARKET ABUSE REGIME], *available at* http://www.slaughterandmay.com/media/39260/the-eu-uk-market-abuse-regime-overview.pdf.

26 *Id.* at 14.

27 *Id.* at 14–15 (noting that the Code "is not an exhaustive description of all types of behaviour [sic] which may or may not constitute market abuse" and "[c]onduct which falls outside the Code will be assessed directly" under the FSMA).

28 MARKET ABUSE DIRECTIVE BRIEFING, *supra* note 8, at 7.

29 HM TREASURY, EXPLANATORY MEMORANDUM TO THE FINANCIAL SERVICES AND MARKETS ACT 2000 (MARKET ABUSE) REGULATIONS 2005 paras. 7.5–7.6 (U.K.), *available at* http://www.hm-treasury.gov.uk/d/MAD explanatoryMemoMain_240205.pdf.

certain areas the United Kingdom intentionally used language different from that included in MAD. For example, MAD requires member states to "prohibit any person . . . who possesses inside information from *using* that information," without defining what "using" entails.[30] In its implementation, the United Kingdom chose to use different language. It prohibits trading "on the basis of" insider information[31] instead of prohibiting "use" of insider information in connection with a trade.[32] A European Court of Justice ("ECJ") decision, discussed in more detail below, has clarified and expanded the meaning of "using" under MAD, bringing it closer in line with the U.K. effort to expand the scope of liability.[33]

Under FSMA, as amended, insider dealing occurs when "an insider deals, or attempts to deal, in a qualifying investment or related investment on the basis of inside information relating to the investment in question."[34] For general investments,[35] insider information is defined to be information:

> [O]f a precise nature which—(a) is not generally available, (b) relates, directly or indirectly, to one or more issuers of the qualifying investments or to one or more of the qualifying investments, and (c) would, if generally available, be likely to have a significant

30 Council Directive 2003/6, art. 2, 2003 O.J. (L 96) 16, 21 (EC) (emphasis added), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:096:0016:0025:EN:PDF.

31 The United States uses the term "insider information," while the United Kingdom and the European Union use the term "inside information." For purposes of this Article we have used the U.S. term in all places except where we are providing direct quotes that contain the U.K./EU terminology.

32 U.K. MARKET ABUSE REGIME, *supra* note 25, at 20.

33 Case C-45/08, Spector Photo Grp. NV v. CBFA, 2009 E.C.R. I-12073.

34 Financial Services and Markets Act ("FSMA"), 2000, c. 8, § 118(2)–(4) (U.K.).

35 Under FSMA the definition of "insider information" is different depending on whether it is used with respect to commodity derivatives or other investments. *See id.* § 118C(2)–(3).

> effect on the price of the qualifying investments or on the price of related investments.[36]

FSMA further provides that information is "precise" if it:

> (a) indicates circumstances that exist or may reasonably be expected to come into existence or an event that has occurred or may reasonably be expected to occur, and (b) is specific enough to enable a conclusion to be drawn as to the possible effect of those circumstances or that event on the price of qualifying investments or related investments.[37]

The United States requires that information be "material" in an insider trading case; the U.K. statutory language, quoted above, does not use that term. Rather, it requires that disclosure of the information would have a significant effect on the price of the qualifying investment.

An "insider" is defined much more broadly in the FSMA statute than in the United States, where the status of an insider requires that he or she owes a fiduciary duty to the shareholders of the company whose instruments are involved in the trade, or a fiduciary or similar duty to the source of the information not to misuse it.[38] Under FSMA, an "insider" includes any person who possesses insider information as a result of: (1) being part of the administration, management, or supervisory bodies of an issuer; (2) holding the capital of an issuer (i.e., a share- or debenture holder); (3) having access to the information through the exercise of his or her employment, profession, or duties (including outside counsel, and even contract cleaners); (4) engaging in criminal activities; or (5) obtaining the information through other means by which he or she knows, or could reasonably be expected to know, that the information is insider information.[39]

Operating within this regulatory framework and applying these definitions, the FSA brought a controversial case

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36 *See* FSMA, 2000, c. 8, § 118C(2) (U.K.).

37 *See id.* § 118C(5).

38 *See, e.g.*, Chiarella v. United States, 445 U.S. 222 (1980).

39 FSMA § 118B.

against Greenlight Capital, Inc., a hedge fund located in the United States, and its owner and sole portfolio manager, David Einhorn. The result was fines and profit disgorgements of over £3 million for each.[40] The FSA argued that Einhorn had caused Greenlight to trade shares in a U.K.-listed company, Punch Taverns ("Punch"), when he was in possession of insider information.[41]

The sequence of events is as follows: in June 2009, prior to Punch's announcement of an imminent equity issuance, Punch's corporate broker, Andrew Osborne, approached Greenlight, a significant U.S. investor, and asked whether it would agree to be "wall crossed" (agreeing to receive confidential information in return for a promise not to trade on the basis of it) to discuss a potential issuance of equity by Punch.[42] Greenlight explicitly declined to be wall crossed, but nevertheless, a conference call was subsequently conducted on a non-wall-crossed basis.[43] During this call, the Punch management made no reference to an actual transaction and also made no definite statement regarding the size of the contemplated issuance.[44] They also made it clear that no definite decision to go ahead with an equity offering had been made and that other alternatives were under active consideration.[45] However, Einhorn did learn during the conversation, from Punch's broker who participated in the call, that Punch was considering an equity offering of *around* £350 million, and that if Greenlight were wall crossed, the trading blackout period would be less than one week.[46] Immediately following the call, Einhorn

40 Einhorn Decision, *supra* note 11, at 1.

41 *Id.* at 14.

42 *Id.* at 2–3.

43 *Id.*

44 *Id.* at 7–9.

45 *Id.*

46 According to the FSA:

> Mr Einhorn was told that the amount of any possible equity issuance would need to be about £350 million in order to repay the convertible and create 10% headroom in

directed Greenlight traders to sell Punch shares on the London Stock Exchange, lowering Greenlight's holdings of Punch shares from approximately 13.3% to 9%.[47] After the official announcement of the equity offering on June 15, Punch's share price fell 29.9%, allowing Greenlight to avoid losses of approximately £5.8 million.[48]

The FSA determined that insider information was conveyed on the conference call and that Greenlight traded "on the basis of" that information in violation of U.K. market abuse rules.[49] The FSA found that Einhorn was an insider because he had access to the information through the exercise of his employment at Greenlight, which is one of the

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the securitizations [sic]. This information was offered by the Broker:

> Einhorn: *So, would you—as you pencil that out, what do those amounts turn out to be?*
> The Broker: *Something like 350 sterling.*
> Einhorn: *350 million sterling?*
> The Broker: *If you were—if you were roughly to sort of work on the basis that you kinda took out the—the converts and that's something that gives you, say, 10 percent headroom in within both of the covenants, filed covenants.*

This disclosed that the principal purpose of the issuance would be to repay the convertible bond and create headroom in the securitisations [sic], and that the sum of the issuance under consideration was of a very significant size; Punch was not considering a small equity issuance in the sum of, for instance, around £50 million. Whilst the Broker did not give the sum of £350 million as a definitive figure, what he said to Mr Einhorn made it clear that the transaction was to raise a sum of equity that would be of considerable size relative to Punch's market capitalisation [sic] (Punch's market capitalisation [sic] at the time of the Punch Call was approximately £400 million).

Einhorn Decision, *supra* note 11, at 7–8.

47 *Id.* at 2–3.

48 *Id.*

49 *Id.* at 14.

ways in which the FSMA statute defines insiders.[50] The FSA also found that trading in the shares constituted dealing in a "qualifying investment" under the statute.[51] Additionally, the FSA found that although the information was general, and there was "no single statement of inside information,"[52] as a whole it conveyed insider information as that term is used in the statute because it was: (1) not generally available; (2) related to Punch and its shares; (3) sufficiently precise, since the offering was reasonably likely to occur in the near future (which Einhorn deduced from the length of the one-week trading blackout to which he would have been subject to if wall crossed), and the information regarding its potential size was specific enough to enable him to draw the conclusion that the offering would negatively impact the price of Punch shares (i.e., given that Punch had an existing market capitalization of £400 million, an additional offering of around £350 million would likely impact share price negatively); and (4) the information would have had a *significant* impact on the share price had it been generally available.[53] The FSA explained that:

> Given Mr Einhorn's position and experience, it should have been apparent to him that the information he received on the Punch Call was confidential and price sensitive information that gave rise to legal and regulatory risk. The Punch Call was unusual in that it was a discussion with management following a refusal to be wall crossed. In the circumstances Mr Einhorn should have been

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50 Einhorn Decision, *supra* note 11, at 10. Under FSMA, an insider is any person who has inside information "as a result of having access to the information through the exercise of his employment, profession or duties." Financial Services and Markets Act, 2000, c. 8, § 118B(c) (U.K.).

51 Einhorn Decision, *supra* note 11, at 10.

52 Arguably, the statement made by the broker about the approximate size of the offering would be sufficient to count as insider information on its own. Had the broker for Punch disclosed this information in the United States without extracting a confidentiality agreement, he very likely would have violated Regulation FD by selectively disclosing material nonpublic information.

53 Einhorn Decision, *supra* note 11, at 10–13.

> especially vigilant in assessing the information he received. It was a serious error of judgement on Mr Einhorn's part to make the decision after the Punch Call to sell Greenlight's shares in Punch without first seeking any compliance or legal advice despite the ready availability of such resources within Greenlight.[54]

The FSA then concluded:

> [R]easonable investors are expected to interpret comments made to them in an appropriate manner, which may sometimes mean understanding more than the precise words spoken, or interpreting certain comments in light of the context.[55]

In other words, although the FSA acknowledged that Einhorn acted without intent (i.e., did not believe he was violating insider dealing laws), he should have been more diligent in ensuring that he was not violating the law before trading. This is the case even though Andrew Osborne, the broker, and Punch's management provided Einhorn with the information on a non-wall-crossed basis, which typically means that the parties intend for no insider information to be exchanged. The FSA focused heavily on the context in which the information was transmitted and also on the knowledge, position, and experience of Einhorn in deciding whether the information was sufficiently precise.[56] Interestingly, the FSA went even further than charging just Einhorn and Greenlight with violations. It also sued Osborne[57] (the broker mentioned above) and fined him for improperly disclosing "inside information to another person otherwise than in the proper course of the exercise of his employment, profession or duties."[58] The FSA even went

54 Einhorn Decision, *supra* note 11, at 15.

55 *Id.* at 17.

56 *Id.* at 3.

57 Osborne, FSA Final Notice (Feb. 15, 2012) (U.K.), *available at* http://www.fsa.gov.uk/pubs/final/andrew_osborne.pdf.

58 This violation, which is part of the market abuse regime, is known as the offense of "improper disclosure" under Section 118 of the FSMA. Financial Services and Markets Act, 2000, c. 8, § 118(3) (U.K.).

after Greenlight's U.K. compliance officer, Alexander Ten-Holter, and fined him on the grounds that he failed to make reasonable inquiries to satisfy himself that the trade order was not based on insider information before selling the Greenlight shareholdings in Punch.[59]

III. *EINHORN* AS A NONSTARTER IN THE UNITED STATES

The FSA's response came as a surprise, not only to Einhorn—who claimed that his trades "resemble[ ] insider dealing as much as soccer resembles football"[60]—but also to many attorneys in the United States. Einhorn, and the other defendants for that matter, likely would not have suffered the same fate in a U.S. court or SEC administrative proceeding because the necessary breach of duty—to either the source of the information or the corporation and its shareholders—required to prosecute insider trading under Rule 10b-5 in the United States was lacking. On the other hand, it would have been unlikely that the information would have been passed to Einhorn in the United States without an agreement to be wall crossed because of Regulation FD, which prohibits an issuer from providing material nonpublic information selectively without releasing it to the public simultaneously.[61]

In the United States insider trading has been defined to occur when any person or entity (1) trades in any security (2) on the basis of (3) material (4) nonpublic information (5) that has been obtained in breach of a fiduciary duty or in breach of trust or confidence owed to the person or entity disclosing

59 Ten-Holter, FSA Final Notice (Jan. 26, 2012) (U.K.), *available at* http://www.fsa.gov.uk/static/pubs/final/ten-holter-greenlight.pdf.

60 Lindsay Fortado & Ben Moshinsky, *Greenlight's David Einhorn Ordered Insider Trades "Within Minutes" of Tip*, BLOOMBERG (Jan. 25, 2012, 7:00 PM) http://www.bloomberg.com/news/2012-01-26/greenlight-s-david-einhorn-ordered-insider-trades-within-minutes-of-tip.html.

61 17 C.F.R § 243.100 (2013).

the information.[62] The term "security" is very broad, encompassing—but not limited to—common and preferred stock, treasury stock, notes, bonds, options, and any security-based swap (a type of derivative instrument).[63] The requirement of trading on "the basis of" material nonpublic information is satisfied if the person trading was *aware* of the material nonpublic information at the time he or she purchased or sold the security.[64] Information is considered "material" if a reasonable investor would consider it as having significantly altered the mix of information already publicly available.[65] Although no bright-line test for materiality has been adopted, examples of material information include, for example, specific earnings information and information about proposed nonpublic mergers, acquisitions, tender offers, changes in control, and bankruptcies.[66]

The duty requirement in the United States stems from the judicial construction of Rule 10b-5, which was promulgated by the SEC under the authority granted to it by the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934. Section 10(b) prohibits the use of "any manipulative or deceptive device or contrivance" in connection with "the purchase or sale of any security."[67] Additionally, Rule 10b-5 states:

> It shall be unlawful for any person, directly or indirectly . . .

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62 Harry S. Davis, *Overview of the Law of Insider Trading*, *in* INSIDER TRADING LAW & COMPLIANCE ANSWER BOOK 2013, at 2 (Harry S. Davis ed., 2013).

63 *Id.*

64 17 C.F.R. § 240.10b5-1(b) (2013).

65 TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988) (adopting the materiality standard for Section 10(b) and Rule 10b-5 violations as outlined in *TSC v. Northway*).

66 Selective Disclosure and Insider Trading, Securities Act Release No. 7881, 73 SEC Docket 3 (Aug. 15, 2000).

67 15 U.S.C. § 78j(b) (2012).

> (a) To employ any device, scheme, or artifice to defraud,
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> (c) To engage in any act, practice, or course of business which operates or would *operate as a fraud or deceit upon any person,*
>
> *in connection with the purchase or sale of any security.*[68]

The breadth and generality of the rule and the line of cases interpreting its provisions have given rise to a common law-like body of U.S. insider trading law that continues to evolve to this day. The Supreme Court in *Chiarella* interpreted Section 10(b) of the 1934 Act as a catchall antifraud provision prohibiting insider trading.[69] However, the Court expressly rejected the parity-of-information approach recommended by the SEC, in favor of what has become known as the "classical theory" of insider trading liability.[70] The Court found that the duty to either abstain from trading on the basis of material nonpublic information or disclose the information in advance of the trade exists only if the person trading has a fiduciary duty to the corporation and its shareholders.[71] Later cases determined that the fiduciary duty is not confined to corporate insiders, such as officers and directors, but also extends to "temporary insiders."[72] These individuals are not per se insiders but rather have a special relationship with the corporation by virtue of direct or indirect access to material nonpublic

68 17 C.F.R § 240.10b-5 (2013) (emphasis added).

69 Chiarella v. United States, 445 U.S. 222 (1980).

70 *Id.* at 234.

71 *Id.* at 228.

72 SEC v. Lund, 570 F. Supp. 1397, 1403 (C.D. Cal. 1983) (classifying a business associate and long-time friend of an insider as a "temporary insider").

information that is intended only for corporate purposes.[73] Some examples of such "temporary insiders" include lawyers, accountants, and investment bankers retained by the corporations.

Subsequent to the *Chiarella* decision, the courts and the SEC have adopted what is known as the "misappropriation theory" of insider trading.[74] This theory prohibits a person from trading on the basis of information misappropriated from its source, even if the source of the information is not a corporate or temporary insider of the issuer whose securities are traded.[75] Although no breach of fiduciary duty by a corporate or temporary insider is required to find liability under this theory, at a minimum, a fiduciary or similar duty of trust or confidence to the source of the information must be established.[76] This is the case even though there is no duty to the market or shareholders of the company whose securities were traded.[77] The requisite duty under the misappropriation theory exists whenever there is a mutual expectation of trust and confidence running between the source of the information and the person misusing or improperly acquiring the information.[78] In order for the misappropriation theory of liability to fit under the umbrella of Section 10(b) and Rule 10b-5, the information must be misappropriated from the source in a *deceptive* manner and used "in connection with the purchase or sale of a security," as the statute requires.[79] Deception exists when the source of the information legitimately expects that the information

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73 *Lund*, 570 F. Supp. at 1403.

74 United States v. O'Hagan, 521 U.S. 642, 653–54 (1997) (endorsing the misappropriation theory of insider trading and imposing criminal liability on an attorney for misappropriating a client's confidential information about a forthcoming tender offer).

75 *Id.*

76 17 C.F.R. § 240.10b5-2(b)(1) (2013) (codifying the SEC's approach to fiduciary and fiduciary-like relationships).

77 *O'Hagan*, 521 U.S. at 655.

78 17 C.F.R. § 240.10b5-2(b)(1) (2013).

79 *See id.* § 240.10b-5; *O'Hagan*, 521 U.S. at 655.

will not be misappropriated and used to trade for personal gain.

Applying the U.S. approach to the *Einhorn* case, it seems clear that Greenlight, and by extension Einhorn, did not violate a duty to Punch or its shareholders under the classical theory, since they were only minority shareholders of Punch (if they were controlling shareholders a fiduciary duty could be found to exist). They also did not take on any additional role that would imply a fiduciary or similar duty of trust or confidence to the source as required by the misappropriation theory of liability. This conclusion is based on the fact that Einhorn expressly declined to sign the confidentiality agreement, stating that he had no interest in becoming an insider or limiting his ability to trade. Without a finding of a duty of trust or confidence, Einhorn's behavior would not be punishable as insider trading in the United States. Thus, the significant differences between U.K. and U.S. law highlighted by this case are: (1) the definition of an "insider" for the purposes of FSMA is much broader than it is under the U.S. securities laws; and (2) "in contrast to the US, the UK approach does not require that there be a fiduciary or fiduciary-like relationship . . . between the source of the information and the recipient of it;" instead, the United Kingdom applies the parity-of-information approach, which says "if a person is an insider and possesses inside information, *however obtained*, that person is prohibited from dealing in the relevant securities."[80]

The *Cuban* case illustrates the uncertainty and disarray of the common law approach to the insider trading offense in the United States, and it again provides a stark contrast to the clarity of the U.K. and EU regimes.[81] In this case, the defendant, Mark Cuban, owner of 600,000 shares of Mamma.com, sold his entire position in the company after a phone conversation with the CEO, avoiding losses of over

80 John H. Sturc et al., *Differences Between US and UK Market Abuse Regimes*, HARV. L. SCH. F. ON CORP GOV. & FIN. REG. (Apr. 7, 2012, 10:30 AM), http://blogs.law.harvard.edu/corpgov/2012/04/07/differences-between-us-and-uk-market-abuse-regimes/ (emphasis added).

81 SEC v. Cuban, 620 F.3d 551 (5th Cir. 2010).

$750,000.[82] During the phone call, the CEO told Cuban about a planned private investment in a public equity offering ("PIPE offering") and asked him whether he wanted to participate.[83] Cuban declined to participate in the contemplated offering and apparently ended the call (just minutes before he sold his position) with the statement, "Well, now I'm screwed. I can't sell."[84] The SEC brought insider trading charges based on the misappropriation theory and claimed that the deception required under the statute occurred through a breach of a confidentiality agreement.[85] According to the SEC, there was an oral agreement of confidentiality because the CEO began the conversation by saying that he had confidential information and Cuban agreed that he would keep the information confidential.[86]

The SEC argued that even where a fiduciary-like relationship did not precede the contractual agreement, the agreement itself was enough to create such a relationship.[87] Therefore, the SEC construed SEC Rule 10b5-2—which states that there is a duty of trust or confidence owed to the source when a person agrees to keep information confidential or when "the source of the information expected that the person would keep the information confidential"—as a sufficient basis for imposing Section 10(b) liability, even in the absence of a preexisting fiduciary-like duty or an agreement not to trade.[88] In his defense, Cuban argued—with the support of five academics—that there had to be a

82 CLEARY GOTTLIEB STEEN & HAMILTON LLP, DISMISSAL OF SEC'S INSIDER TRADING CASE AGAINST MARK CUBAN MAKES NEW LAW 1 (2009), *available at* http://www.cgsh.com/files/News/40199625-e766-4fb4-beb1-cde3561c3b16/Presentation/NewsAttachment/21d18fb0-08c6-4a08-a9ed-d29072b91d8d/CGSH%20Alert%20-%20Cuban%20Insider%20Trading%20Dismissal.pdf.

83 *Id.*

84 *Id.*

85 *Cuban*, 620 F.3d at 553.

86 *Id.* at 555.

87 *Id.* at 553.

88 17 C.F.R. § 240.10b5-2 (2013).

preexisting relationship of trust and confidence to bring a valid claim under the theory of misappropriation for the breach of a contractual duty.[89] He argued that to the extent Rule 10b5-2 imposed liability without such a preexisting relationship, it was not a valid rule that the SEC had authority to promulgate or rely on.[90]

The district court disagreed, finding that an agreement to keep information confidential could create a relationship of trust and confidence, and that the undisclosed breach of a promise not to misuse another's information amounted to the requisite deception under the statute.[91] More specifically, it held that a confidentiality agreement, coupled with a duty to refrain from trading on the confidential information, could create the relationship necessary to bring insider trading charges on a misappropriation theory; no preexisting duty was needed.[92] The district court still dismissed the SEC's complaint, however, on the grounds that a confidentiality agreement alone was not sufficient to establish a breached duty on those facts; an additional agreement to refrain from trading on the confidential information would be necessary.[93] The district court indicated that Rule 10b5-2 was defective to the extent it relied solely on a duty of confidentiality as the basis of prosecution—whether or not that agreement also expressly included a promise not to trade. Thus, the SEC could not rely on Rule 10b5-2 to prosecute the case successfully.[94]

The Fifth Circuit's subsequent reversal of the district court illustrates the continuing uncertainty in U.S. law. On appeal, the court determined that the SEC's complaint alleged sufficient facts to plausibly infer that Cuban had agreed not to trade on the basis of the confidential information, *and* that there was no need for both an explicit confidentiality agreement and an additional non-use

89 SEC v. Cuban, 634 F. Supp. 2d 713, 718–19 (N.D. Tex. 2009).

90 *Id.*

91 *Id.* at 728.

92 *Id.*

93 *Id.* at 730.

94 *Id.* at 731.

agreement in order for the case to go to trial.[95] In particular, the court focused on the fact that Cuban gained confidential access to knowledge of the PIPE offering only after he told the CEO that he could no longer sell his stock.[96] Based on these facts, the court held that a factfinder could find that an agreement not to trade existed, and remanded the case for further proceedings without addressing the issue of the validity of Rule 10b5-2.[97]

On remand the district court, like the appellate court, declined to address the analysis and legal conclusions in its initial decision, "including [the] court's determination that liability under the misappropriation theory of insider trading could arise where there was an express or implied agreement to maintain the confidentiality of material, nonpublic information."[98] Instead, the court focused on the adequacy of the SEC's complaint and again denied Cuban's motion for summary judgment. Specifically, the court held that, based on those facts, a reasonable jury could find: (1) an agreement to keep information confidential and an agreement not to trade both existed (even if only implicitly); (2) the information amounted to nonpublic information that was confidential; and (3) that the information transmitted was material.[99] Therefore, the SEC was permitted to try the case. Although the decisions sensibly removed the unnecessary technicality of requiring both confidentiality and an agreement not to trade in that particular case, they left the source and scope of the duty of trust and confidence, and the validity of Rule 10b5-2, as confused as before.

The *Cuban* case would have been much simpler if it had been brought in the United Kingdom. After the *Einhorn* case, it is clear that someone in the position of Mark Cuban would be considered an "insider," irrespective of the existence of a contractual, fiduciary, or other duty of trust

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95 SEC v. Cuban, 620 F.3d 551, 557 (5th Cir. 2010).

96 *Id.*

97 *Id.* at 558.

98 SEC v. Cuban, No. 3:08-CV-2050-1, 2013 WL 791405, at *2 (N.D. Tex. Mar. 5, 2013).

99 *Id.* at *6, *10, *12.

and confidence. The information was clearly material—in fact, even more so than in Einhorn's case, where his sophistication and ability to piece together fragments of nonmaterial information collectively made the information material.[100] Additionally, unlike Einhorn, whom the FSA acknowledged acted without intent to violate any rules, Cuban expressly indicated that he knew he should not trade, and in fact acknowledged that he was "screwed" because he now could not sell his position in the company.[101] In contrast to Cuban, Einhorn explicitly refused to keep any information confidential by declining to be wall crossed.[102] Even with these factors potentially mitigating against culpability, Einhorn was found civilly liable in the United Kingdom. It is therefore no stretch to conclude that Cuban would have been found liable there as well.

IV. TIPPER AND TIPPEE LIABILITY

Another area of divergence between U.K. and U.S. law can be seen in their respective treatment of tippee and tipper liability. *Tippers* are individuals who pass along material nonpublic information to other *tippees*. As defined in *SEC v. Dirks*, tipper liability exists in the United States when an insider provides material nonpublic information to an outsider without a legitimate business justification for doing so, and the outsider-tippee then buys or sells securities based on this information.[103] Tippee liability is derivative in the United States and exists only where three elements are met.[104] The first is that the tippee received a tip from an insider tipper who is knowingly breaching his or her fiduciary duty to the corporation, or his or her relationship of trust and confidence to the source of the information.[105] In *Dirks*, the Supreme Court held that for purposes of tippee

100 Einhorn Decision, *supra* note 11, at 9.

101 *Cuban*, 2013 WL 791405, at *4.

102 Einhorn Decision, *supra* note 11, at 2–3.

103 Dirks v. SEC, 463 U.S. 646, 651 (1983).

104 Davis, *supra* note 62, at 16.

105 *Dirks*, 463 U.S. at 662–64.

liability, an insider tipper only breaches this duty when the insider, directly or indirectly, personally benefits (monetarily, reputationally, or otherwise) from providing the information.[106] Today, the courts have substantially watered down the "personal benefit" requirement, for example, by finding the standard satisfied where the tippee and tipper were merely college friends.[107] The second element for finding tippee liability requires that the tippee knew or should have known that there was a breach of a duty by the insider in disclosing the information.[108] The third element requires that the tippee used the tip to trade securities.[109] If these three elements are met, then the tippee may not trade on the basis of the tip without violating the law.

Recent decisions in U.S. courts have slowly started diluting the antifraud standards for tippers and tippees with respect to, among other things, the requisite intent of the person tipping or trading. For example, in *SEC v. Obus*, although the court adhered to and reinforced the antifraud requirements, including the need to show that the tipper received a personal benefit, it relaxed the culpability necessary to prove fraud by holding that recklessness (though not negligence) could be sufficient to establish breach of the requisite duty.[110] This decision means that even if the tipper did not knowingly breach his or her duty, a showing of recklessness is sufficient to satisfy the first element. Indeed, the court held that a tipper could be found to have breached his or her duty if the disclosure was made with reckless disregard of the confidential, nonpublic nature of information that was material, and reckless disregard of his obligation not to disclose it improperly.[111] Furthermore, the court held that a tippee could be found to have the requisite knowledge of a breach of duty where circumstantial

106 *Dirks*, 463 U.S. at 662–64.

107 SEC v. Obus, 693 F.3d 276, 291 (2d Cir. 2012). *See also* Davis, *supra* note 62, at 16.

108 *Dirks*, 463 U.S. at 651.

109 *Id.* at 659.

110 *Obus*, 693 F.3d at 286.

111 *Id.*

evidence of red flags, combined with the sophistication of the tippee as an experienced investor, permitted the inference that he or she should have known the information was disclosed improperly.[112] This brings to mind the *Einhorn* decision in the United Kingdom, which emphasized David Einhorn's sophistication and ability to perceive that the information as a whole was material.[113]

Additionally, another court found that proof of the tippee's willful blindness or conscious avoidance of the fact that the tipper's disclosure was in exchange for a personal benefit could be sufficient to find the requisite scienter.[114] Judge Jed Rakoff explained that "proof that the defendant was aware of a high probability that an insider was improperly disclosing inside information for personal benefit, and . . . deliberately avoid[ing] learning the truth" could be sufficient to establish knowledge.[115] Judge Rakoff further interpreted *Obus* to find that a showing of the tippee's knowledge that the "disclosure of inside information was unauthorized is sufficient for liability in misappropriation cases."[116] Only by watering down the standards in this way could the courts produce the correct result of blocking a tippee from avoiding liability simply by not asking his source—who he fears is not authorized to provide him information—where the information came from. By stark contrast, the United Kingdom requires no showing of intent whatsoever to impose civil liability on either tippees or tippers.

The *Dirks* case established the derivative nature of tippee liability in the United States. In that case, a security

112 *Obus*, 693 F.3d at 286.

113 Einhorn Decision, supra note 11, at 9.

114 United States v. Whitman, 904 F. Supp. 2d 363, 372 (S.D.N.Y. 2012).

115 WILLKIE FARR & GALLAGHER LLP, GOVERNMENT'S BURDEN IN INSIDER TRADING CASES CLARIFIED 3 (2012), *available at* http://www.willkie.com/files/tbl_s29Publications%5CFileUpload5686%5C4173%5CGovernments_Burden_in_Insider_Trading.pdf (citing Transcript of Record at 2953:2-9, *Whitman*, 904 F. Supp. 2d 363 (No. 12 Cr. 125 (JSR))).

116 *Whitman*, 904 F. Supp. 2d at 370.

analyst learned of Equity Funding Corporation's massive fraud from Secrist, an insider at Equity Funding.[117] Dirks passed information on to his clients, who dumped their stock and avoided huge losses, and he then helped expose the fraud to the markets shortly afterwards.[118] The court held that Dirks had no duty to disclose or abstain in this case because the tipper, Secrist, revealed information not for personal gain, but rather to expose a fraud.[119] Without a finding of personal benefit on the part of the tipper, there could be no derivative liability for the tippee. This case would have been decided differently in the United Kingdom, where it is sufficient to show that the tippee realized he or she was receiving material nonpublic information, irrespective of whether the tipper's conduct would incur liability.[120] How the information was obtained, and even whether there was actually trading on the basis of the tip, is irrelevant in the United Kingdom for establishing a violation by the tipper, as illustrated in the *Hannam* case, discussed in more detail below.[121]

Uncertainties associated with the derivative nature of liability for tippees in the United States are illustrated in the way that courts have reduced the personal benefit test to a mere formality in some cases. In the *Obus* case, the court ruled that the term "personal benefit" has a "broad definition" and that the "bar is not a high one."[122] Indeed, the court in *Obus* found the fact that the tipper and the tippee were friends from college was sufficient to permit the question of whether there was a personal benefit to the tipper to survive a motion for summary judgment.[123] This development is important, given that the only way to find tippees liable for the trades they make on the basis of insider information is to first find the tipper liable for breaching a

117 Dirks v. SEC, 463 U.S. 646, 649 (1983).

118 *Id.* at 650.

119 *Id.* at 671.

120 *See* Financial Services and Markets Act, 2000, c. 8, § 118B (U.K.).

121 Hannam Decision, *supra* note 12.

122 SEC v. Obus, 693 F.3d 276, 292 (2d Cir. 2012).

123 *Id.* at 291.

duty and receiving a personal benefit. The justification for the personal benefit test is that it provided a means of distinguishing non-culpable unauthorized disclosures by tippers—such as in the *Dirks* case—from culpable disclosures. However, by tying the liability of the tippee and tipper together, the absence of culpable intent by one party can exonerate his or her culpable counterparty.

To illustrate, imagine a waitress accepting a job at a restaurant, where she knows many important CEOs dine, with the intention of gathering insider information. The waitress makes an effort to eavesdrop on the conversations of her guests and overhears a CEO speaking over lunch about an upcoming equity offering that will lead to a massive decline in his company's stock. The waitress then proceeds to trade on this information, resulting in a sizable profit. Since the tipper in this case, the CEO, tipped her unintentionally, and certainly expected no personal benefit in return for the disclosed information, this would be a poor case for imposing liability under Rule 10b-5. Such was the case in *SEC v. Switzer*, where a football coach overheard a key executive, Platt, discussing insider information with his wife, and then traded on the basis of this information.[124] The court found no liability because the information "was not intentionally imparted to Switzer by [ ] Platt, nor was the disclosure made for an improper purpose."[125] However, this outcome seems unfair. The waitress should not be able to escape liability just because the tipper had innocent motivations, because she took advantage of a favorable situation with the calculated intent to use this information. At the very least, it should be agreed that this is not the type of behavior society wants to incentivize.

By contrast, in the United Kingdom each party is punished for its own culpable behavior, irrespective of the culpability of the counterparty. The waitress would likely be found to be liable as an "insider" under Section 118B of the FSMA as a result of obtaining and trading on the basis of

124 SEC v. Switzer, 590 F. Supp. 756 (W.D. Okla. 1984).

125 *Id.* at 766.

information that she knew, or could reasonably be expected to have known, was insider information.[126] This category of insider under the FSMA is the only one that has a scienter requirement. The Code explains that an individual would fall into this category if a normal and reasonable person in the position of the individual should have known that the information obtained was privileged.[127] In the aforementioned example, since the waitress took her job expecting access to potential insiders and insider information, she would be liable under U.K. law even though the tipper himself probably would not be.

The *Hannam* case further illustrates how the U.K. approach to market abuse carefully separates tippee and tipper liability, by punishing tipping whether or not the tippee actually trades.[128] In that case, the FSA focused on emails sent by Ian Hannam, a former JP Morgan banker, to two of his clients who were not wall crossed. The emails contained information concerning Heritage Oil, another client of Hannam's employer, JP Morgan.[129] At the time, JP Morgan was acting on behalf of its client Heritage by assisting it with a sale of the company. In September 2008, Hannam sent an email telling one of his clients that an offer for Heritage of £3.5 to £4 a share had been made. He also stated, "I am not trying to force your hand, just wanted to make you aware of what is happening."[130] Subsequently, Hannam sent another email saying that Heritage had "found oil and it is looking good."[131]

Although the FSA found Hannam acted without intent, and stated that his "honesty and integrity is not in question," it nonetheless fined Hannam £450,000 for improper

126 Financial Services and Markets Act, 2000, c. 8, § 118B (U.K.).

127 Insiders: Factors to Be Taken into Account, 2000, MAR 1.2.8E (U.K.), *available at* http://fsahandbook.info/FSA/html/handbook/MAR/1/2#D46.

128 Hannam Decision, *supra* note 12.

129 *Id.*

130 *Id.* at 3.

131 *Id.* at 4.

disclosure under FSMA Section 118(3).[132] This result is especially surprising because neither Hannam nor the "tippees" ever traded on the disclosed information.[133] A similar outcome would not occur in the United States if he were charged with violating Rule 10b-5. Liability under Rule 10b-5 requires a connection with the "purchase or sale" of securities, meaning a tippee would actually have to trade on the tip before liability could be imposed on the tipper.[134] However, if Hannam acted as a representative of JP Morgan (and therefore not in his individual capacity), it is possible that he could have violated Regulation FD in the United States for providing selective disclosure on behalf of the issuer Heritage.[135]

The U.S. standard, requiring tippees to trade on the basis of material nonpublic information, and the U.K. standard, requiring that tippees trade on the basis of "precise" information, create a potential loophole in both jurisdictions, enabling tippers and tippees to escape liability in certain circumstances. As one journalist noted, if a broker were to call a customer and say, "'Listen, you've got to get out of this stock, it's going down the tubes,' the customer doesn't have

132 Hannam Decision, *supra* note 12, at 12.

133 Helia Ebrahimi, *Top JP Morgan Banker Ian Hannam Resigns over £450,000 Fine for Market Abuse*, TELEGRAPH (Apr. 3, 2012, 7:30 PM), http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/918286/Top-JP-Morgan-banker-Ian-Hannam-resigns-over-450000-fine-for-market-abuse.html.

134 *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (establishing that standing to sue for monetary damages under Section 10(b) and Rule 10b-5 is available only to plaintiffs who have purchased or sold securities in connection with an alleged manipulative or deceptive act or omission).

135 Regulation FD applies to public issuers and to any person "acting on behalf of the issuer." 17 C.F.R. § 243.100 (2013). Note that there are no private actions for violations of Regulation FD; only the SEC can bring enforcement actions. Additionally, the consequences for violations are fines and injunctions, together with the obligation to disclose the information to the public immediately. *See* GERD D. THOMSEN, MORRISON & FOERSTER LLP, FREQUENTLY ASKED QUESTIONS ABOUT REGULATION FD (2010), *available at* http://www.mofo.com/files/Uploads/Images/FAQs-Regulation-FD.pdf.

any liability, because the customer didn't have any material non-public information."[136] This is true because the tippee is not told the actual material information; rather, he or she is just given a vague hint, which does not amount to precise or material information.

A problematic question arises as to how specific the information conveyed by a tipper must be before liability can attach. An illustration of this uncertainty is found in the FSA's action against Nicholas Kyprios, which focused on tipper liability.[137] In that case, Kyprios, European head of credit sales at Credit Suisse, was fined £210,000 by the FSA for indirectly but deliberately revealing information about upcoming deals in which Credit Suisse was involved to two fund managers who had not agreed to be wall crossed.[138] According to the FSA, Kyprios invited the fund managers to guess the information during a "game of charades" by saying, "You're going to be my charades partner," or "[you are] getting warmer" when the fund manager began guessing the name of the relevant issuer, Unitymedia. Kyprios also told a manager where in the alphabet to focus his guesses and hinted that the issuer had alternative names.[139] When a fund manager guessed Unitymedia correctly, Kyprios signaled the manager was correct by repeatedly saying, "[T]he line is breaking up," when it was not, and the fund manager confirmed he understood by saying, "I can't get the unity in my hearing."[140]

Kyprios tried to defend himself by arguing that the information he provided was not "actionable," but the FSA rejected this defense and held that the information was price sensitive and precise enough with respect to the investments

136 Catherine Valenti, *The Slippery Slope of Insider Trading*, ABC NEWS, June 24, 2012, http://abcnews.go.com/Business/story?id=87085&page=1&singlePage=true.

137 Kyprios, FSA Decision Notice (Mar. 13, 2012) (U.K.) [hereinafter Kyprios Decision], *available at* http://www.fsa.gov.uk/static/pubs/final/nicholas-kyprios.pdf.

138 *Id.*

139 *Id.* at 3.

140 *Id.* at 3–4.

in question.[141] Those investments, however, did not amount to "qualifying investments," and therefore, no improper disclosure or other market abuse could be alleged by the FSA in the case. Instead, it resorted to finding that Kyprios breached Principles 2 (skill, care, and diligence) and 3 (market conduct) of the Statements of Principles for Approved Persons.[142]

However, even after this decision there remains uncertainty as to which types of borderline communications amount to market abuse. To remedy this problem, the new MAR proposal in the European Union seeks to extend the prohibition of insider dealing and other market abuse to "natural persons who take part in or [merely] *influence* the decision to carry out" the impugned transaction.[143] This proposal would allow a finding of market abuse for a tipper in a case with facts similar to *Kyprios*, where the information provided is extremely cryptic. Attaching liability to the actions of a tipper who "influences" a trade simplifies disciplining the culpable tipper who conveys no information directly but knowingly achieves the same harmful result as if he were providing the information itself. Liability under the new MAR proposal would not be excessive since it only affects the tipper. It will remain difficult, however, to prosecute a tippee who trades on the basis of a tip containing no specific information other than a communication that he or she should buy or sell.

V. MATERIAL AND PRECISE INFORMATION

As illustrated in the *Kyprios* case discussed above, a key issue in both the United States and the European Union is

141 Kyprios Decision, *supra* note 137, at 2.

142 *Id.* In the United Kingdom, individuals who perform "controlled functions" on behalf of an authorized firm must receive FSA approval. Once a person has received FSA approval to perform a controlled function, he or she is required to comply with the Statements of Principles and the Code of Practice for Approved Persons set out in the APER section of the FSA Handbook. Statements of Principle, 2000, APER 2.1A (U.K.), *available at* http://fshandbook.info/FS/html/FCA/APER/2/1A.

143 *Market Abuse Proposal*, *supra* note 22, at 31 (emphasis added).

whether insider information is material. The two regimes take a similar approach, though they articulate the standard differently. In the United States the information at issue must be such that it would change the relative mix of information available to the "reasonable" investor in making an investment decision.[144] In the United Kingdom, insider information must be "likely to have a significant effect on the price of the qualifying investments or on the price of related investments."[145] However, the U.K. statute brings this definition closer to the U.S. definition of materiality by providing that "[i]nformation would be likely to have a significant effect on price if and only if it is information of a kind which a reasonable investor would be likely to use as part of the basis of his investment decisions."[146] The ECJ further elaborated on this definition in the *Spector Photo* case, where it held that the capacity to have a significant effect on price must be assessed ex ante, in light of the content of the information at issue and in the context in which it occurs, independent of whether its disclosure *actually* had a significant effect on price.[147] In addition to affecting market price, information must also be "precise" in the United Kingdom, which means, as previously noted, that it:

> (a) indicates circumstances that exist or may reasonably be expected to come into existence or an event that has occurred or may reasonably be expected to occur, and (b) is specific enough to enable a conclusion to be drawn as to the possible effect of those circumstances or that event on the price of qualifying investments or related investments.[148]

The ECJ expanded the definition of precise in the *Markus Geltl* case, where it held that for events or circumstances

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144 Basic Inc. v. Levinson, 485 U.S. 224, 232 (1988).

145 Financial Services and Markets Act, 2000, c. 8, § 118C(2)(c) (U.K.).

146 *See id.* § 118C(6).

147 Case C-45/08, Spector Photo Grp NV v. CBFA, 2009 E.C.R. I-12073 para. 69.

148 FSMA § 118C(5).

that come about via a protracted process, it is not only the ultimate future event (e.g., approval of a merger) that may be considered precise information, but also the intermediate steps that lead to it (e.g., positions taken in negotiations leading to a merger) that are to be considered as precise information.[149]

The *Einhorn* case exemplifies how important context is in determining the existence of insider information. The FSA explained that the information disclosed to Einhorn in isolation would not be precise enough to amount to insider information, but that "taken together these points did constitute inside information."[150] They elaborated by stating that:

> [T]his [is] a serious case of market abuse by Mr Einhorn, in particular for the following reasons:
> (i) Mr Einhorn occupies a prominent position as President of Greenlight . . . .
> (ii) Mr Einhorn is an experienced trader and portfolio manager. He has had over 15 years of experience running an investment management firm and should therefore be held to the highest standards of conduct and the highest levels of accountability.
> (iii) Given Mr Einhorn's position and experience, it should have been apparent to him that the information he received on the Punch Call was confidential and price sensitive information that gave rise to legal and regulatory risk. . . . In the circumstances Mr Einhorn should have been especially vigilant in assessing the information he received. It was a serious error of judgment on Mr Einhorn's part . . . .[151]

Due to Einhorn's sophistication and position of power, the information was considered to be sufficiently precise to allow

149 Case C-19/11, Geltl v. Daimler, ¶ 56 (June 28, 2012), http://curia.europa.eu/juris/document/document_print.jsf?doclang=EN&text=&pageIndex=0&mode=doc&docid=124466&cid=315878.

150 Einhorn Decision, *supra* note 11, at 9.

151 *Id.* at 3.

him to conclude that a share issuance was reasonably expected to occur (even if he was not told that the issuance would actually proceed). It was also specific enough to enable someone in his position to draw a conclusion about the effect of the issuance on the price of the Punch shares. This approach shows that materiality is an extremely fact-sensitive inquiry, and not a purely objective test. It takes into account the particular facts and circumstances of the situation, and the background and experiences of the individuals involved, which, in the judgment of the regulator or court, would or should have enabled them to put two and two together.

In both the United States and the European Union, the materiality and precision of the information is assessed at the time of trading, rather than in hindsight. Two U.S. cases, the *Wyly* brothers case and the case against David Sokol, demonstrate the fact-specific nature of materiality, and show how information which is obviously material in hindsight may not be so easily identified as material at the time of trading. In the *Wyly* case, the SEC alleged in its complaint that two brothers traded in the shares of a company on the basis of their knowledge that they had plans to suggest to the board of the company, which they controlled, that it should put itself up for sale.[152] The brothers, together with other family members, comprised half of the directors on the board of the company, and "could be confident that they could effectuate any planned sale" due to their position of power and influence over the company's affairs.[153] Therefore, they were classic insiders by virtue of their being board members with fiduciary duties to the company and its shareholders. A district court judge thus rejected their motion to dismiss the insider trading case and held that the intention to seek a sale of the company, under these facts and circumstances, could amount to material

152 SEC v. Wyly, 788 F. Supp. 2d 92, 99–100 (S.D.N.Y. 2011).

153 *Id.* at 123.

nonpublic information, allowing the SEC to push forward with its case.[154]

By contrast, the SEC decided to drop charges against David Sokol, a senior executive at Berkshire Hathaway.[155] Sokol purchased approximately $10 million worth of Lubrizol shares just a week before recommending to Warren Buffett that Berkshire Hathaway should consider acquiring it.[156] Under the direction of Buffett, Berkshire Hathaway followed through with the recommendation and acquired Lubrizol, increasing the value of Sokol's stock by over $3 million.[157] The materiality of the information at the time Sokol made the trade is questionable because he had much less influence over the actual decision to acquire Lubrizol than the Wyly brothers did over the decision to sell their company. Only Buffett had the authority to make such final decisions. Additionally, unlike the *Wyly* case, the SEC would have had to bring any potential charges under the misappropriation theory of liability, since Sokol was not an insider of Lubrizol, the company in whose securities he traded. The SEC would have had to show a breach of a duty of trust and confidence owed to Berkshire Hathaway, which likely did not exist at the time of his purchase.

The *Wyly* facts probably would have resulted in the same outcome in the United Kingdom as they did in the United States. The logic behind imposing liability in that case was that the information was material at the time of trading—due to their control of the board and their ability to effectuate their plans—and it should not make a difference whether the shares were purchased in advance of or after the decision to sell became finalized, given its certainty. On the other hand, the outcome of a case like Sokol's in the United Kingdom/European Union is a little less predictable. After *Photo Spector*, which emphasized the potential ex ante effect

154 *Wyly*, 788 F. Supp. at 125.

155 Reynolds Holding, *Sokol's Escape Further Fogs Insider Trading Laws*, REUTERS BREAKINGVIEWS, Jan. 4, 2013, https://a.next.westlaw.com/Document/Ia6ad82b0568e11e288e094097549a847/View/FullText.html.

156 *Id.*

157 *Id.*

of information on share prices, it is possible that this would be a clearer case of materiality in the European Union, since "[a]ny hint in the market that Berkshire Hathaway might be interested in a company would have an immediate impact on a company's stock price."[158] As a matter of fact, the new MAR proposal initially contained a catchall category of nonpublic information that would have extended insider dealing to cover a "broad range of information which investors find relevant, even if not precise or price sensitive."[159] The proposal defined as insider information all nonpublic information that, if made available to a reasonable investor, would be regarded by that investor as relevant in deciding the terms on which transactions should be affected.[160] An investor would certainly find it relevant to know that Sokol, given his influential position at Berkshire Hathaway, intended to recommend a purchase of Lubrizol to Buffett and thus, in light of the breadth of the MAR catchall provision, liability could easily extend to Sokol and other similarly situated individuals. However, after reviewing the MAR proposal, the European Council deleted this dangerously broad provision in the general approach to MAR ("MAR General Approach") presented by the Council on November 30, 2012.[161] The MAR General Approach stresses that information can only be considered as insider information where it is "of a precise nature"—a result that is probably very wise, and suggests that a borderline situation like Sokol's may escape liability in the European Union as well.[162]

158 Peter J. Henning, *The Materiality of Merger Negotiations*, N.Y. TIMES DEALBOOK (Apr. 4, 2011, 3:50 PM), http://dealbook.nytimes.com/2011/04/04/the-materiality-of-merger-negotiations/.

159 CLIFFORD CHANCE LLP, MARKET ABUSE: EUROPEAN COMMISSION PROPOSES NEW EU REGIME 2 (2011), *available at* www.cliffordchance.com/publicationviews/publications/2011/10/market_abuse_europeancommissionproposesnewe.html (follow "Download Full Report" hyperlink).

160 *Market Abuse Proposal*, *supra* note 22, at 1.

161 GREENE ET AL., *supra* note 21, at 151.

162 *Id. See also Proposal for a Regulation of the European Parliament and of the Council on Insider Dealing and Market Manipulation (Market Abuse)—General Approach*, Doc. 17380/12 (COD), at 8 para. 12(a) (Dec. 5,

VI. USE OR POSSESSION DEBATE

Another issue, briefly touched on already, is whether possessing insider information is enough to find liability, or whether, in addition, actual "use" of the information (i.e., reliance on the material nonpublic information) needs to be proven as an element of the offense. The issue in the United States led to a circuit split in which the Second Circuit endorsed a possession standard while the Ninth and Eleventh Circuits endorsed a more rigorous use standard.[163] Following the reasoning of the Second Circuit that "[u]nlike a loaded weapon which may stand ready but unused, material information cannot lie idle in the human brain,"[164] the SEC addressed the circuit split by promulgating Rule 10b5-1, which requires proof only that the person trading was "aware" of material nonpublic information, not that the information was used or relied upon.[165] The rule also provides affirmative defenses, such as exempting those trades that were made in good faith pursuant to a preexisting plan, contract, or instruction.[166] But even with this clarification, the standard applied in the United States is still relatively hazy. For example, recent courts, as in the *Rajaratnam* case, have not pressed the possession standard. Rather, the jury is charged that it must be "persuaded beyond a reasonable doubt that material, non-public information given to the defendant was a factor, however

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2012) [hereinafter *MAR Proposal—General Approach*], *available at* http://register.consilium.europa.eu/pdf/en/12/st17/st17380.en12.pdf.

163 Audrey Strauss, *Recent Insider Trading Jury Charges: "Possession" vs. "Use"*, N.Y. L.J., July 7, 2011, *available at* http://www.friedfrank.com/siteFiles/Publications/NYLJ-Audrey%20Strauss%20July%202001.pdf.

164 United States v. Teicher, 987 F.2d 112, 120 (2d Cir. 1993).

165 17 C.F.R. § 240.10b5-1(b) (2013).

166 *See id.* § 240.10b5-1(c)(1)(i)(A). Note as well that *Teicher* was a criminal case, which required a showing of intent, and therefore possibly raised the bar for what constitutes a showing of "use" of material nonpublic information.

small, in the defendant's decision to purchase or sell stock."[167]

In the European Union, MAD requires member states to "prohibit any person . . . who possesses inside information from *using* that information," without defining what "use" entails.[168] The definition of what exactly constitutes use of insider information is left for member states to define, subject to very rare and very broad ECJ case law. This state of affairs has led to varying interpretations across the member states. For example, France adopted a possession-only standard, while the United Kingdom adopted language different from the directive by prohibiting insider trading "on the basis of" insider information,[169] and interpreting the MAD standard as requiring a causal link between the possession and the insider dealing activity.[170] The causal link may no longer be necessary in the United Kingdom after the ECJ's decision in *Spector Photo*, which addressed the definition of "use" under MAD and attempted to strike a balance between the approaches of the different member states.[171] The ECJ held that once possession has been established, a presumption is created of "an intention on the part of the author" to use the information, which is subject to rebuttal by the person trading.[172]

Following this decision, the United Kingdom—more specifically, the FSA—declined to revise the Code and held

167 Strauss, *supra* note 163, at 2 (citing Transcript of Record at 5624, United States v. Rajaratnam, 802 F. Supp. 2d 491 (S.D.N.Y. 2011) (No. 09 Cr. 1184 (RJH))).

168 Council Directive 2003/6, art. 2, 2003 O.J. (L 96) 16, 21 (EC) (emphasis added).

169 HERBERT SMITH FREEHILLS LLP, THE ECJ RULES THAT "USE" OF INSIDE INFORMATION MAY BE PRESUMED WHEN A PERSON IN POSSESSION OF SUCH INFORMATION DEALS (2010), *available at* http://www.lexology.com/library/detail.aspx?g=69de2202-5dbd-4059-8486-0fda21c6a6a7.

170 U.K. MARKET ABUSE REGIME, *supra* note 25, at 20.

171 *Id.* at 20–21.

172 Case C-45/08, Spector Photo Grp. NV v. CBFA, 2009 E.C.R. I-12073 para. 38, http://curia.europa.eu/juris/document/document_print.jsf?doclang=EN&text=&pageIndex=0&part=1&mode=lst&docid=77184&occ=first&dir=&cid=323222.

instead that the provisions of the Code that give examples of dealings which are not "on the basis of" insider information are to be read as examples in which the *Spector Photo* presumption of use is rebutted.[173] These examples include situations where a "decision to deal or attempt to deal was made before the person possessed the relevant inside information," or where the dealing is "to satisfy a legal or regulatory obligation which came into being before he possessed the relevant inside information."[174] The Code further states:

> In the opinion of the FSA, if the inside information is held behind an effective Chinese wall, or similarly effective arrangements, from the individuals who are involved in or who influence the decision to deal, that indicates that the decision to deal by an organisation [sic] is not "on the basis of" inside information.[175]

After the *Spector Photo* case, the approaches of the United States and United Kingdom are very similar in that the SEC and FSA have created a presumption of use upon a finding of possession that can be rebutted by certain safe harbor defenses. One complication that arises with applying the possession approach in the United States is that it "seek[s] to sidestep the need for proof of intent, apparently as a matter of administrative convenience,"[176] because the possession standard is based upon an assumption that people with insider information would not be able to disregard it when making a trading decision (i.e., the approach of the Second Circuit). Critics in the United States argue that "how people generally act does not justify effectively reading the intent and causation elements out of

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173 U.K. MARKET ABUSE REGIME, *supra* note 25, at 22.

174 Factors to Be Taken into Account: "On the Basis of", 2005, MAR 1.3.3E(1), (2) (U.K.), *available at* http://fshandbook.info/FS/html/handbook/MAR/1/3.

175 *See id.* MAR 1.3.5E.

176 Strauss, *supra* note 163, at 3.

the statute."[177] This complication does not arise in the United Kingdom, where intent is not necessary to find market abuse in a civil action.

VII. CRIMINAL ENFORCEMENT AND A MOVE TOWARD EU COORDINATION

While all criminal prosecutions in the European Union and the United Kingdom require a showing of intent, just like in the United States, there is no standard criminal procedure applied across Europe.[178] Under MAD, criminal penalties are neither required nor consistent across the EU, which has made the enforcement of market abuse violations extremely weak and uncoordinated.[179] To illustrate, some member states currently do not impose criminal sanctions for market manipulation while others do, and one member state does not apply any criminal sanctions to insider dealing by primary insiders at all.[180] The limited level of harmonization of key concepts, such as how to define "use" of insider information, has led to great inconsistencies and exacerbates the enforcement challenges.

To this end, in addition to replacing the MAD regime with a new regulation (MAR) that will be directly applicable without the need for transposition into member state law,[181] a new directive (CSMAD), is also in the works.[182] CSMAD

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177 Strauss, *supra* note 163, at 3.

178 Criminal Justice Act, 1993, c. 36, § 57(1) (U.K.), *available at* http://www.legislation.gov.uk/ukpga/1993/36/section/57.

179 GREENE ET AL., *supra* note 21, at 150.

180 *Id.* at 149–50.

181 Note that while MAR will be directly applicable as a regulation, there are "directive-like" provisions in it that will require transposition before becoming effective. For instance, the provisions on search and seizure in Article 17(2) require enabling legislation by member states. *Market Abuse Proposal*, *supra* note 22, at 39–40.

182 *Proposal for a Directive of the European Parliament and of the Council on Criminal Sanctions for Insider Dealing and Market Manipulation*, COM (2011) 654 final (Oct. 20, 2011), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0654:FIN:EN:PDF.

aims to impose minimum criminal sanctions for insider dealing, and will require member states to extend their criminal sanctions to crimes including inciting market abuse, and aiding and abetting market abuse, as well as attempts to commit such offenses.[183] The goal is to create for the first time a European Union-wide regime for market abuse that removes the inconsistencies in criminal offenses existing between the current regimes of the member states.[184] The European Council has also proposed to include in both MAR and CSMAD a presumption that certain activities would not constitute insider dealing even if the individual is in possession of insider information.[185] At this early stage, the

183 Press Release, European Commission, Market Abuse: Justice Ministers Agree Commission Proposals on Criminal Sanctions (Dec. 7, 2012), *available at* http://europa.eu/rapid/press-release_MEMO-12-963_en.htm?locale= en.

184 *See generally Market Abuse Proposal*, *supra* note 22.

185 For entities and natural persons, such behaviors include that (1) the person acted as a market maker or as a body authorized to act as a counterparty, and the acquisition or disposal of financial instruments to which that information relates is made legitimately in the normal course of the market maker or counterparty's duties, (2) the person authorized to execute orders on behalf of third parties, and the acquisition or disposal of financial instruments to which the order relates is made, carries out such an order legitimately in the normal course of the exercise of his employment, profession, or duties; and (3) the person enters into or withdraws from a commodities derivatives transaction for the sole purpose of covering his direct contractual losses, unless the inside information concerned is required to be disclosed by law, regulation, practice, or reasonable expectation.

Additionally, there is no insider dealing where a person possessing inside information obtained in the conduct of a public takeover or merger uses that information solely for the purpose of proceeding with a merger with, or making a public takeover of, that company, provided that at the point of acceptance of the offer or approval of the merger, any inside information has been made public. More generally, transactions conducted in the discharge of an obligation to acquire or dispose of financial instruments, undertaken in good faith and not as a part of a plan to evade the prohibition of insider dealing, shall not constitute insider dealing where that obligation results from an order placed, or an agreement concluded, or is to satisfy a legal or regulatory obligation, that arose before the person concerned possessed inside information. *MAR Proposal—General Approach*, *supra* note 162, at 58.

United Kingdom has decided not to opt into that element of the new directive, CSMAD, although it has agreed to reconsider this decision once the regulation and the anticipated new proposals are more concrete with respect to permitted activity.[186] The decision not to opt into the directive is based on the U.K. government's belief that its existing laws already cover the scope of the changes implemented by the new directive, even if the language differs from that proposed in CSMAD.

Even with the CSMAD directive, however, the ability to bring criminal (as well as civil) enforcement actions will lag behind that of the United States because the powers of investigation in the United States are superior. For example, U.S. authorities can obtain evidence by wiretapping (a technique used in the *Rajaratnam* trial), while in the United Kingdom the power to intercept communications is "limited to police and intelligence services only."[187] Additionally, there is no power to plea-bargain or settle cases at the EU level, which reduces the possibility of uncovering insider trading networks.[188] The absence of plea-bargaining powers and lack of forceful settlement procedures—as well as limited resources—reduce the number of cases that can be prosecuted.

VIII. CONTINUOUS VERSUS PERIODIC DISCLOSURE REGIME

Apart from ex post enforcement actions, the European Union and the United States both also implemented prophylactic protections to enhance market integrity by reducing the opportunity to engage in insider dealing ex ante. One such protection is the requirement that issuers of

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186 *See* 20 Feb. 2012, PARL. DEB., H.C. (2012) 58WS (U.K.), *available at* http://www.publications.parliament.uk/pa/cm201212/cmhansrd/cm120220/wmstext/120220m0001.htm#1202202000003 (statement of Mark Hoban, Financial Secretary to the Treasury).

187 Tombs, *Insider Dealing/Trading*, *supra* note 4.

188 Pierre-Henri Conac, Address at the Columbia Law School Blue Sky Meeting: Is European Securities Legislation Now Similar to U.S. Securities Legislation? (Feb. 4, 2013).

financial instruments inform the public of material, nonpublic information that directly concerns those issuers. The definition of "material" information is significant since it determines the type of information that must be disclosed. In both the European Union and the United States the definitions are the same for purposes of establishing disclosure obligations and for creating insider dealing liability.

The European Union has implemented a continuous disclosure regime that requires that information considered material be disclosed "as soon as possible" on a continuous basis.[189] This system is enforceable only by the national regulator. In the case of *Hall v. Cable and Wireless*, the U.K. High Court held that the FSMA does not give investors a private right of action for market abuse, including failure to disclose on a timely basis.[190] By contrast, the United States, in part because its private litigation system permits claims for damages related to the timing of disclosures, has resisted such a continuous disclosure approach and relies instead on a periodic disclosure regime.[191] This approach is not likely to change in the United States because a continuous disclosure requirement could expose corporations to excessive liability for failing to make timely disclosures. Uncertainty as to when information becomes material and must be disclosed is often a challenging issue in a continuous regime, and could lead to second-guessing in litigation. For this reason, a continuous disclosure regime is only viable and realistic in markets such as Europe, where enforcement is limited to regulators and not private parties.

189 Council Directive 2003/6, art. 6, 2003 O.J. (L 96) 16, 21–22 (EC).

190 Hall v. Cable & Wireless Plc, [2009] EWHC (Comm) 1793. *See also* Harriet Jones-Fenleigh, *No Private Action for Market Abuse or Breach of the Listing Rules*, IN-HOUSE LAWYER (Nov. 16, 2009, 12:00 AM), http://www.inhouselawyer.co.uk/index.php/banking-and-finance/7533-no-private-action-for-market-abuse-or-breach-of-the-listing-rules.

191 *See generally* 15 U.S.C. § 78m (2011).

IX. PARITY OF INFORMATION AND PROTECTING LEGITIMATE BUSINESS ACTIVITIES

The main criticism of the parity-of-information approach is that liability might reach too far and inhibit even legitimate business practices. In its purest form, liability under the parity-of-information approach is not premised on the finding of a duty. Rather, it is based on the idea that trading on *any* nonpublic material information, *regardless* of how it was obtained, is unfair, jeopardizes market integrity, and should be prohibited. This approach could affect, and thus discourage, behavior such as independent, diligent market research, investigation, and making recommendations to clients. To illustrate, liability could extend to an analyst who goes to a factory and concludes that the shipments made were not consistent with what the company had reported, and who then proceeds to sell stock in that company; or, alternatively, an analyst who contacts suppliers of a company, receives indications that sales are falling, and then proceeds to sell stock in that company. Such behavior should not, in our judgment, lead to insider trading liability. The effect of discouraging this behavior would be to decrease the market efficiency of stock pricing to the detriment of all investors in the marketplace. On the basis of such concerns, the U.S. Supreme Court rejected the parity-of-information approach, and explained that "problems caused by misuse of market information have been addressed by detailed and sophisticated regulation that recognizes when use of market information may not harm operation of the securities markets . . . and [this] is in some tension [ ] with the broad rule of liability we are asked to adopt" under a parity-of-information framework.[192]

Thus, the U.S. regime would protect the actions of the analyst who obtained information by contacting suppliers or observing decreases in shipments. The *Dirks* decision would also preclude liability for the analyst in this hypothetical as a tippee, since tippee liability is derivative of tipper liability,

192 *See* Chiarella v. United States, 445 U.S. 222, 233–34 (1980).

and the tippers (here, the suppliers) breached no duty when they disclosed the information to the analyst. The tipper-suppliers were not insiders of the company whose stock was traded; they were also not breaching any relationship of trust and confidence; and, additionally, they did not receive any personal benefit for providing the information. The tippee analyst may be further immunized from liability in the United States by what the SEC has called the "mosaic theory."[193] The mosaic theory protects investors who "assemble pieces of non-public and immaterial information into a mosaic that reveals a material conclusion."[194]

However, the analyst would also be safe under the U.K. regulatory framework, even though it is based on a parity-of-information foundation. This results because information is considered general information (i.e., not insider information) in the United Kingdom if it is "obtained by analysing [sic] or developing other information which is generally available," or is "obtained by observation by members of the public without infringing rights or obligations of privacy, property or confidentiality."[195] To illustrate non-culpable conduct, the U.K. Code provides an example of a train passenger who observes a burning factory and then uses that information in deciding to sell shares in the company that owns the factory.[196] This rule applies in the United Kingdom even if the observation requires a person to have above average "financial resources, expertise or competence."[197] The United Kingdom, therefore, operates on a limited parity-of-information framework. It follows the parity-of-information concept in that there are no prerequisite duty requirements. However, it simultaneously diverges from the parity-of-

193 David Becker, General Counsel, SEC, Remarks at the 2000 Securities Law Developments Conference: New Rules, Old Principles (Dec. 4, 2000), *available at* http://www.sec.gov/news/speech/spch444.htm.

194 *Id.*

195 Inside Information: Factors to Be Taken into Account, 2000, MAR 1.2.12E(4), (5), (U.K.), *available at* http://fshandbook.info/FS/html/handbook/MAR/1/2.

196 *See id.* 1.2.12G.

197 See *id.* 1.2.13E(2).

information principle that all market players must have equal information, in that it limits the prohibition of insider trading to those who have *unequal access* to material nonpublic information. This limitation protects the analyst who diligently gathers information in the marketplace, as well as the analyst who is lucky enough to see the burning warehouse as he is passing by on the train.

In practice, the protections provided for legitimate business activities in the United States under the *Dirks* or the mosaic theory may not be much more forceful than those available in the United Kingdom. For example, recent cases appear to have significantly hampered the force of the mosaic theory as a defense in the United States. In the famous *Rajaratnam* case, the jury plainly rejected the defendant's claim that he was trading on a mosaic of public information and not any specific insider information.[198] Other courts have also been increasingly skeptical of the mosaic theory, as is further evidenced by the recent case *SEC v. Steffes.*[199]

In *Steffes*, the SEC filed a complaint against six members of the Steffes family alleging classic insider trading by employees of a company in connection with the \$3.5 billion takeover of Florida East Coast Industries ("FECI").[200] One defendant was a vice president and the chief mechanical officer of the company, while another was a rail yard

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198 One newspaper article explains:

> His lawyers insist that much of Galleon's trading was based on publicly available information. Traders patched together data from equity analysts' reports, company announcements and newspaper articles, a practice known as the "mosaic theory" of investing. Galleon traders also met with company executives. The defense pointed out that Mr Rajaratnam had met Gary Cohn, Goldman Sachs's president, in 2008 to talk about the bank's outlook before selling Goldman stock.

The Mosaic Defence: Raj Rajaratnam Defends His Investment Strategy in Court, ECONOMIST, Apr. 14, 2011, *available at* http://www.economist.com/node/18561025.

199 SEC v. Steffes, 805 F. Supp. 2d 601 (N.D. Ill. 2011).

200 *Id.* at 606.

worker.[201] According to the complaint, the two employees inferred that there would be an impending acquisition of FECI through on-the-job observations—including the unusual number of tours on FECI's premises by people dressed in business suits, a trip by representatives of the would-be acquirer in a special rail car reserved for visitors, and other rail employees' expressions of concern that FECI could be sold, putting their jobs at stake. On their own, none of these facts were necessarily dispositive.[202] Therefore, the case required a careful balancing between an employee's duties not to abuse his or her position of employment for personal gain, and the legitimate practice of using observation and skill to piece together an educated guess. Balancing these countervailing interests, the district court decided to reject a motion to dismiss, giving the SEC a new opportunity to expand the scope of materiality.[203] The court expressly stated:

> Unlike the typical insider trading case, [the defendant] is not alleged to have been part of the confidential merger negotiations, or even directly informed of their existence. Instead, [the defendant] is alleged to have pieced together for himself what was occurring based on information that was available to him as an . . . employee. This is a cognizable theory: it is well established that a defendant can be held liable for insider trading when he or she obtains and acts on pieces of information, which, "pieced together," constitute material nonpublic information. . . .
>
> Here, the SEC identifies what material non-public information [the defendant] is alleged to have possessed (the knowledge that FECI was in the process of being sold), when he possessed this information (by the end of the third week of March

201 *Steffes*, 805 F. Supp. 2d at 604.

202 *Id.* at 604–06.

203 *Id.* at 618.

2007), and how he obtained sufficient underlying facts to reach that conclusion.[204]

This decision thus illustrates that U.S. courts often do not recognize the mosaic theory as a defense at all. In fact, the court here subsumed the mosaic theory in its opinion in much the same way as the *Einhorn* case did in the United Kingdom. In both cases, the individual snippets of information were not per se material or precise, but, given the experience, employment, and ability of the defendants to form a material conclusion based on the information obtained, it all amounted to material nonpublic information.

In the *Steffes* case, the court focused on the defendants' status as employees, and failed to consider the possibility that what they observed could potentially have been observable by outsiders watching from afar. If members of the public could have observed similar information, there is a possibility that *Steffes* would come out differently in the United Kingdom, where the information could be characterized as information "obtained by observation by members of the public without infringing rights or obligations of privacy, property or confidentiality," or information "obtained by analysing or developing other information whichh is generally available."[205] If this were the case, then observant employees who make accurate predictions, such as those in *Steffes*, may be protected from liability in the United Kingdom. Nevertheless, this would depend on facts that were not stated in the case. If the information could only be obtained by virtue of their positions as employees in the company, the defendants would be considered "insiders," and liability would likely have attached in the United Kingdom as well.

The takeaway is that in practice, it is not obvious that the U.S. approach offers any significant, additional protections for legitimate activities than those also available in the U.K.

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204 *Steffes*, 805 F. Supp. 2d at 610 (citations omitted).

205 Inside Information: Factors to Be Taken into Account, 2000, MAR 1.2.12E(4), (5), (U.K.), *available at* http://fshandbook.info/FS/html/handbook/MAR/1/2.

regime. It should also be emphasized that the reach of liability is still much narrower in the United States than in the United Kingdom where even unintentional violations of market abuse are actionable, as was demonstrated in both the *Einhorn* and *Hannam* cases. A shift to a parity-of-information regime would essentially reverse the current U.S. presumption, which favors allowing individuals to use material nonpublic information with limited restrictions, such as where a fiduciary duty exists. Such a shift would subsequently provide greater incentive to explicitly carve out protections for legitimate uses of material nonpublic information.

X. THE UNITED STATES APPROACHING A PARITY-OF-INFORMATION RULE

The renewed focus on the differences between the United Kingdom and the United States raises the question: Which is the better regime? Comparing the two approaches, we conclude that on balance, a statutory framework based upon a "limited" parity-of-information regime—similar to that of the United Kingdom—is the more favorable regulatory structure, provided there is effective enforcement.

The antifraud framework in the United States leaves itself open to ad hoc adjudication and SEC rulemaking questions such as: (1) Does a fiduciary or other relationship of trust or confidence exist; (2) What must be established to prove that the defendant provided a tip for personal benefit; (3) Is the information material; (4) If so, was the recipient of the information bound to keep it confidential; and (5) As will be discussed below, does the offense reach insider trading on the basis of information obtained through criminal activity? Such a framework is certainly not cost effective, and while it "may be tolerable for the United States with its zest for litigation and its abundance of lawyers, regulators, and judges . . . [this] approach . . . justifiably garners little support elsewhere."[206] Most other regimes have followed the

206 Mark I. Steinberg, Address at the International Monetary Fund Seminar on Current Developments in Monetary and Financial Law:

EU/U.K. approach of defining the offense of insider trading statutorily, with detailed definitions of essential terms that comprise the offense.[207] Additionally, countries such as Australia, for instance, do not follow the fiduciary duty standard of the United States, instead basing their regulatory framework on a parity-of-information foundation (or "access" doctrine) comparable to that applied in the European Union and the United Kingdom.[208]

The United States has resisted statutory codification of the offense and, therefore, the precise conduct that constitutes insider trading is purposefully vague. The idea is that the ambiguity of the antifraud approach provides regulators with the flexibility to adapt and extend the parameters of the offense over time, giving them maximum leverage when they choose to litigate cases. However, this type of ambiguity and ex post enforcement discretion leaves individuals and institutional market participants uncertain about their transactional decision making and compliance with insider trading rules ex ante. It has also proved to be more restrictive than flexible for the SEC in the recent development of insider trading law. This is evidenced by the SEC's efforts to minimize restrictive Supreme Court precedent by promulgating rules—such as Rule 14e-3 for tender offers—that effectively impose liability on a parity-of-information basis.[209] It is further evidenced by the pattern of recent case law that not only dilutes the antifraud framework, but also appends the scope of liability.[210] The

Insider Trading—A Comparative Perspective 22 (May 16, 2002), *available at* http://www.imf.org/external/np/leg/sem/2002/cdmfl/eng/steinb.pdf.

207 Steinberg, *supra* note 206, at 17–20. *See also* Elyse Diamond, Note, *Outside Investors: A New Breed of Insider Traders?*, 60 Fordham L. Rev. S319, S355 (1992). Regarding Japan, see J. Mark Ramseyer, *Insider Trading Regulation in Japan* 8 (Harv. L. Econ. & Bus. Discussion Paper No. 705, 2011), *available at* http://ssrn.com/abstract=1915284.

208 Steinberg, *supra* note 206, at 17–20.

209 17 C.F.R. § 240.14e-3 (2013).

210 Dilution of the framework is demonstrated by *Obus*, where the court accepted recklessness rather than actual knowledge as sufficient for finding liability. SEC v. Obus, 693 F.3d 276 (2d Cir. 2012). Expansion of the scope of liability is illustrated in *Cuban*, where the court found a

benefits of the United Kingdom's detailed statutory approach, and its lack of a need to show a fiduciary duty are significant, providing a rationale for a shift by the United States towards a similar model.

SEC v. Dorozhko[211] is a recent example illustrating the U.S. courts' frustration with the confines of the fiduciary duty framework, and their subsequent attempt to reach beyond it. In *Dorozhko*, a court accepted for the first time the possibility of finding an insider trading violation without establishing the existence of a fiduciary or similar duty.[212] The case involved a defendant that hacked into Thomson Financial's servers and stole confidential quarterly earnings reports on a company called IMS Health.[213] Trading on the basis of the stolen information, the hacker realized profits of nearly $287,000.[214] As tempting as it likely was to impose liability, the district court dismissed the action because "Dorozhko did not breach any fiduciary or similar duty 'in connection with' the purchase or sale of a security."[215] He was not an employee of IMS Health—thus there was no duty via the classical theory—and also did not owe any duties (contractual or fiduciary) to the "source" of the information, Thomson Financial. Thus, the court found that misappropriation theory also did not apply.

In a surprising and oft-criticized decision, the Second Circuit reversed the decision on appeal and created a new theory of liability for insider trading that dispensed with any fiduciary or similar duty requirement.[216] The court held that the Supreme Court did not find a "fiduciary-duty requirement as an element of every violation," and instead, a claim could be proper if the fraud involved an affirmative

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contractual duty could be sufficient to find liability even in the absence of a preexisting fiduciary relationship. SEC v. Cuban, 620 F.3d 551 (5th Cir. 2010).

211 SEC v. Dorozhko, 574 F.3d 42 (2d Cir. 2009).

212 *Id.* at 51.

213 *Id.* at 44.

214 *Id.*

215 SEC v. Dorozhko, 606 F. Supp. 2d 321, 324 (S.D.N.Y 2008).

216 *Dorozhko*, 574 F.3d at 48–50.

misrepresentation in the form of a "deceptive" action.[217] Thus the court created a new theory of insider trading liability for affirmative misrepresentations. The court emphasized that deception must involve an affirmative misrepresentation in order to fit under the "deceptive device" language of the statute. For this reason, the question remanded to the district court was whether the hacking that occurred under these facts constituted deceitful behavior.[218] If the hacker lied about his identity, that could be deceitful; however, if he merely exploited a weakness in an electronic code of the computer program, that would not be deceitful, and there would be no basis for an insider trading claim—a bizarre outcome.[219] Although a similar issue in the United Kingdom would have constituted a clear violation of insider dealing rules, the U.S. courts needed to engage in a game of legal gymnastics to achieve the same result.

This case points out an additional problem with a duty requirement. If the court adhered to a strict duty-based approach, the way many argue the court should have, we would be left with an ironic result:

> Had Dorozhko lawfully obtained the earnings information (as the chief financial officer at the company, for instance) . . . he would have been liable for insider trading because he would have had a duty

217 *Dorozhko*, 574 F.3d at 48–50.

218 *Id.* at 51.

219 The Court explained:

> In our view, misrepresenting one's identity in order to gain access to information that is otherwise off limits, and then stealing that information is plainly "deceptive" within the ordinary meaning of the word. It is unclear, however, that exploiting a weakness in an electronic code to gain unauthorized access is "deceptive," rather than being mere theft. Accordingly, depending on how the hacker gained access, it seems to us entirely possible that computer hacking could be, by definition, a "deceptive device or contrivance" that is prohibited by Section 10(b) and Rule 10b-5.

Id.

> to the company not to trade.... However, because Dorozhko had unlawfully obtained the information through theft rather than fraud he effectively shielded himself from liability to the SEC.[220]

Additionally, *even if* Dorozhko had a duty to the source, say, because he was an employee of Thomson Financial, in the unlikely event that he decided to disclose his intention to steal the information to his employer, there could be no insider trading liability. This is because, as the Supreme Court explained in *SEC v. Zandford*,[221] the disclosure to the source of an intention to steal information, or to trade on nonpublic information, would remove the element of deception from the "deceptive device" language required under the U.S. statute. This means that while it might involve a breach of fiduciary duty in connection with a sale of securities, "it would not involve a deceptive device or fraud," and thus there could be no insider trading liability—another anomalous result.[222]

Although illegal behavior such as hacking can be punished outside the securities laws, the problem is that this would only punish half of the crime. Dorozhko not only obtained unauthorized access to confidential information through illegal means, he *also* traded on this information, constituting further punishable behavior. The securities laws therefore should reach this aspect of the crime as well. Once again, none of these complications arise under the U.K. or EU approach, where possessing "inside information as a result of . . . criminal activities" is sufficient on its own to make someone an "insider" under the statute—a much more efficient framework.[223] It is our view that, like in the United Kingdom, insider trading based on information obtained

220 Michael D. Wheatley, *Apologia for the Second Circuit's Opinion in* SEC v. Dorozhko, 7 J.L. ECON. & POL'Y 25, 51 (2010).

221 SEC v. Zandford, 535 U.S. 813 (2002).

222 The Court explained, "If, for example, the broker told his client he was stealing the client's assets, that breach of fiduciary duty might be in connection with a sale of securities, but it would not involve a deceptive device or fraud." *Id.* at 825 n.4.

223 Financial Services and Markets Act, 2000, c. 8, § 118B (U.K.).

through any criminal activity should be prohibited by bright-line legislation.[224] This change would be even more important in light of the proliferation of technology and the associated rise in cybercrime—a type of crime that is particularly dangerous because such crimes are easy, quick to perpetrate, and not expensive to implement. Defendants can carry out "elaborate schemes with [only] one person and a laptop. . . . an individual can gain remote, unauthorized access by himself, bypassing the 'tipper' and the costs associated with obtaining the illicit information."[225] Therefore, aggressive reform is necessary and warranted.

Ironically, the liability of the hacker might be entirely different under the U.S. securities laws if the stolen information related to a transaction structured as a tender offer rather than an equity offering. If a tender offer were the subject transaction, then the hacker would have violated 14e-3 by trading on material nonpublic information, *regardless* of how he obtained the information.[226] This implies that "[l]iterally, an individual can legally retain profits by trading on material inside information or be held liable simply by the fortuity of whether a tender offer is implicated."[227] Under Section 14(e) of the '34 Act, Congress explicitly prohibits insider trading relating to tender offers on a parity-of-information basis.[228] Pursuant to its authority under Section 14(e), the SEC adopted Rule 14e-3, which prohibits insiders of the bidder and the target from divulging confidential information about the tender offer and, in addition, prohibits *any* person with material information about a tender offer—that he or she knows or has reason to know is nonpublic, and which has been acquired directly or indirectly from the tender offeror, the target, or any person acting on their behalf—from trading in that target

224 *See also* Wheatley, *supra* note 220, at 60; Thomas Lee Hazen, *Identifying the Duty Prohibiting Outsider Trading on Material Nonpublic Information*, 61 HASTINGS L.J. 881, 887 (2010).

225 Wheatley, *supra* note 220, at 58.

226 17 C.F.R. § 240.14e-3 (2013).

227 Steinberg, *supra* note 206, at 12.

228 15 U.S.C. § 78n(e) (2011).

company's securities.[229] The justifications for enacting Section 14(e) and Rule 14e-3 are just as relevant to insider trading in general, and further support a move toward a statutory, parity-of-information approach to regulating insider trading.

The Williams Act was adopted in 1968 to amend the '34 Act with respect to its regulation of tender offers. It was enacted in response to Congress's concern about "a wave of hostile coercive takeover attempts, primarily cash tender offers."[230] In an effort to clean up the arena of tender offers and ensure conduct that was as fair as possible, Congress agreed to close the loopholes existing in the 10b-5 framework for insider trading liability. It did this by imposing a statutory bar on all insider trading related to tender offers, with very limited exceptions.[231] In response to the *Chiarella* decision, the SEC promulgated Rule 14e-3 so that no fiduciary duty limitation or other fraud requirement could interfere with efficient enforcement.[232] As a staff member of the enforcement division at the SEC explained, "The purpose of the rule was to remove the *Chiarella* duty requirement in the tender offer context—where insider trading was most attractive and especially disruptive."[233]

If removing the duty requirement was the best way to reach disruptive insider trading behavior and effect maximum market integrity, this speaks volumes for why such a rule should be extended beyond the tender offer context. Even if there are reasons to differentiate tender

229 17 C.F.R. § 240.14e-3.

230 Andrew E. Nagel et al., *The Williams Act: A Truly "Modern" Assessment*, HARV. L. SCH. F. ON CORP. GOV. & FIN. REG. (Oct. 22, 2011, 9:49 AM), http://blogs.law.harvard.edu/corpgov/2011/10/22/the-williams-act-a-truly-%E2%80%9Cmodern%E2%80%9D-assessment/.

231 For example, see 15 U.S.C. § 78m(d)(1) (2011), which, as the court in *Chiarella* highlighted, permits a tender offeror to purchase five percent of the target company's stock prior to disclosure of its plans for acquisition.

232 Thomas C. Newkirk, Associate Director, Div. of Enforcement, SEC, Remarks at the 16th International Symposium on Economic Crime, (Sept. 19, 1998), *available at* http://www.sec.gov/news/speech/speecharchive/1998/spch221.htm.

233 *Id.*

offers from mergers or other material events, it is difficult to imagine that those differences justify, or are in proportion to, the divergent regulatory treatment afforded by Rules 10b-5 and 14e-3. At a minimum, the current state of affairs, where liability can turn on the mere structure of the transaction to which the information relates, severely hampers the legitimacy of the regulatory framework in the United States.

However, a change would not be very easy to effect by rulemaking, and the SEC would most likely need new legislation in order to amend Rule 10b-5 to be more like Rule 14e-3. This is because Section 14(e) "provides a more compelling legislative delegation to the SEC to prescribe rules than does [S]ection 10(b). While [S]ection 10(b) refers to such rules as the SEC 'may prescribe as necessary or appropriate,'"[234] Section 14(e) commands the SEC to prescribe rules that are "*reasonably designed to prevent*[ ] such acts and practices as are fraudulent, deceptive, or manipulative."[235] Thus, the language of Section 14(e) gives the SEC rulemaking authority that reaches conduct outside the contours of fraudulent behavior, providing broad and prophylactic relief. In contrast, Section 10(b) does not contemplate such preventive relief and is limited to fraudulent behavior itself.

Professor Coffee agrees that the U.S. regime needs to be updated, but not through new legislation that would impose a 14(e)-type parity-of-information regime. Instead, he would address the loopholes addressed in the *Dorozhko* and *Cuban* cases through specifically tailored SEC rulemaking.[236] For example, he proposes that the SEC promulgate Rule 10b5-3, which would create a new "Duty Not to Trade on Inadvertent

234 United States v. Chestman, 947 F.2d 551, 561 (2d Cir. 1991) (citing Mark J. Loewenstein, *Section 14(e) of the Williams Act and the Rule 10b-5 Comparisons*, 71 GEO. L.J. 1311, 1356 (1983) ("By comparison, the Commission's rulemaking authority under [S]ection 10(b) does not include the power to define manipulative or deceptive devices or contrivances, nor does it include the power to adopt prophylactic measures.")).

235 15 U.S.C. § 78n(e) (2012) (emphasis added).

236 John C. Coffee, Jr., *Mapping the Future of Insider Trading Law: Of Boundaries, Gaps, and Strategies*, 2013 COLUM. BUS. L. REV. 281 (2013).

or Unauthorized Releases of Material Information."[237] This duty is premised on concepts of common law that govern lost or stolen property so that "a person who overhears material nonpublic information (such as in a public elevator) is functionally equivalent to a 'finder' who discovers lost property, at least when the informational recipient knows that the release of the information has not been authorized."[238] The finder/tippee's duty is then to "hold the information as a bailee and not profit from its conversion."[239] Alternatively, he suggests a less sweeping rule, Rule 10b5-4, which would not cover the "analyst who simply stumbles across new information," even where the analyst knows the information was not authorized to be released or used.[240] Instead of creating a new duty, Rule 10b5-4 would define "deception" to include conduct such as misrepresenting one's identity or accessing information by means of either an affirmative misrepresentation or by means of a covert act or subterfuge.[241] This would reach criminal behavior such as that in *Dorozkho*.

Although rulemaking would avoid the tedious and uncertain process of passing new legislation, we believe SEC rules cannot sufficiently and effectively address the existing loopholes in the U.S. regime. The *Cuban* case illustrated the continuing likelihood that litigants and courts will question the authority of the SEC to pass rules expanding the scope of insider trading law, making it difficult for the SEC to rely on those rules for purposes of litigation.[242] It is precisely the ambiguity and uncertainty created by adopting rules such as those Professor Coffee recommends that lead to more litigation, conflicting opinions, and circuit splits.

There is a much simpler way to deal with this issue. The United States could follow the lead of other countries and implement legislation that precisely defines the offense of

237 Coffee, *supra* note 236, at 304–05.

238 *Id.* at 302.

239 *Id.*

240 *Id.* at 314.

241 *Id.* at 306–07.

242 *See generally* SEC v. Cuban, 620 F.3d 551 (5th Cir. 2010).

insider trading and thus leaves little room for litigants and judges to question the regulator's authority. At a minimum, even without going as far as a 14(e)-type parity-of-information standard, the SEC should submit to Congress proposed legislation that would prohibit trading on the basis of material nonpublic information obtained through criminal activity. Enactment is a realistic possibility and would provide a forum to discuss going further to consider enactment of a statutory approach generally based on parity-of-information principles. It is unlikely that such a discussion of new legislation would result in watering down the current force of Rule 10b-5. In fact, the increased concerns about inexpensive and easy-to-perpetrate hacking and other cyber crimes may make Congress more willing to ensure that laws relating to insider trading cover inappropriate behavior not necessarily involving breached fiduciary or related duties. This may provide an unusual window of opportunity to consider developing a statutory approach.

XI. CONCLUSION

Given the increased enforcement of insider trading rules in both the United States and Europe, companies and individuals have been forced to be much more careful about—and in some cases have had to change—the way they make investments and conduct their businesses. The differences between the laws across various jurisdictions are becoming more evident as increasingly rigorous enforcement leads to additional case law. Moreover, as investors and companies continue to expand globally, they are likely to be faced with conflicting and confusing rules.

On a global scale, the United States is the "odd one out" in the sense that it is one of the few countries that does not have specific and detailed legislation defining the offense of insider trading, relying instead on common law-like interpretations of a broad antifraud statute. The U.S. approach is made even more idiosyncratic through its continued insistence on tying insider trading liability to the breach of a fiduciary or similar duty. Unless the U.S.

approach is superior, which we argue it is not, it may be most efficient to have the United States conform to the rest of the world. Judging by the development of the U.S. regime and the cases discussed above, this is already happening. With respect to insider dealing regulation, the SEC and U.S. courts are finding the contours of the antifraud regime too restrictive and are pushing toward relaxing the standards. As one academic put it, "[D]ealing with insider trading through an antifraud rule is like trying to fit a square peg into a round hole."[243] This pattern of diluting the antifraud framework moves the United States closer to a parity-of-information platform that conforms more closely to most regimes abroad. The only exception to this general trend of convergence is the adherence to the periodic disclosure regime in the United States, which is not likely to be abandoned—nor should it be—in favor of the EU's continuous disclosure model, because of the aggressive private enforcement regime in the United States.

We support this trend in the United States and argue in favor of a detailed statutory approach to insider trading liability based on a parity-of-information framework that is still sensitive to avoiding interference with legitimate independent research. With careful limitations in place, as illustrated to some extent by the U.K. approach, legitimate behavior can be sufficiently sheltered from liability even under a parity-of-information framework. The rationale behind such an approach emphasizes market integrity by virtue of placing all market participants on a level playing field with respect to access to information—while still allowing those producing superior judgments from that same information to get ahead. Professor Coffee proposes that the SEC promulgate new SEC rules instead of having Congress pass new legislation to address the gaps and uncertainties illustrated in the *Cuban* and the *Dorozkho* cases. As explained already, we disagree with this approach and believe that we should follow the rest of the world in achieving clarity through legislative reform. We do not think

243 Hazen, *supra* note 224, at 889.

the concerns about chilling independent research are sufficient given the protections for legitimate market behavior that can be built into any legislative framework. In any case, the courts are bridling with the existing restrictions and moving more and more in the direction of the EU statutory regime.

With the growth of cross-border trading, there are not only multiple listings of securities, but also the possibility of entering into derivatives contracts with respect to those listed securities—such as the option to purchase contracts for differences in the United Kingdom. We believe that, to preserve the integrity of markets, trading in all actual and derivatives instruments should be subject to the prohibition on insider trading. Furthermore, there should be a uniform approach, which we suggest should be based on parity of information, to avoid being able to shift the trade to a market with a less rigorous standard. For example, imagine a situation in which the security in question is dually listed in the United States and the United Kingdom. What would happen where a U.S. investor gains access to material nonpublic information from a U.K. source without being wall-crossed, as in the *Einhorn* case, and then trades in the United States either in the physical securities or by entering into a contract for differences? Since the information originated in the United Kingdom, the FSA could certainly prosecute the U.K. tipper (as in *Hannam*); however, it is not clear if the United Kingdom would be able to prosecute the U.S. tippee who obtained the information from the United Kingdom. How would the U.S. courts respond to a request for extradition? The need to avoid the type of migration that will occur for dually listed securities, where one market permits trading on the basis of nonpublic information while another does not, strongly supports the need for a simplified, common statutory approach, with appropriate scope to protect independent research.

Perhaps the International Organization of Securities Commissions would be a good candidate to consider and recommend a workable statutory regime that would implement a parity-of-information approach, while not chilling independent research, in the hope that it can be applied as uniformly as possible in all markets. Certainly on a domestic level, it is time for the U.S. Congress, in the spirit of international coordination as well as national efficiency, to place its stamp of approval on the shifting nature of insider trading regulation by enacting a statutory framework that frees the United States from the convoluted confines of a duty requirement.