Research Handbook on Insider Trading

Edited by Stephen M Bainbridge

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Book review by Sally Ramage

> *'Secrecy-the first refuge of incompetents- must be at bare minimum in a democratic society…'*

These words were by the United States House Committee on government operations in their 1960 report which detailed the malignant influence of excessive secrecy and its corruption of good intentions.[1]

The contributors to Edward Elgar's fabulous book titled *Research Handbook on Insider Trading* blow out of the water all that lawyers need to know about insider trading, a subject on which there is a dearth of information. These contributors are

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[1] Bok, S. (1989) *Secrets: on the ethics of concealment and revelation*, New York: Vintage, at p.171.

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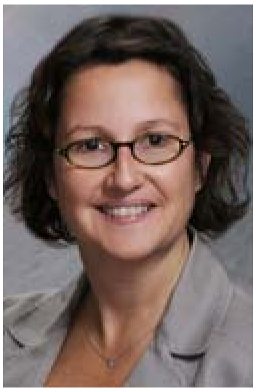

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As Professor Stephen Bainbridge said in the first chapter of *Research Handbook on Insider Trading,* insider trading '*is the most common violation of the securities laws'*. Yet few are prosecuted and even fewer are unsuccessful in defending cases against them. Insider trading is a form of market abuse, and Professor Langevoort, in chapter 3, explores the state of mind, motivation and causation in insider trading.

Insider trading often goes hand in hand with fraudulent accounting practices; obtaining money or property by means of false statement of a material fact; nondisclosure[2], fraud and government agency incompetence. [3]

As to secrecy practised by many and the 'duty to disclose', the court in *Dirks* said that 'proper and adequate disclosure of significant corporate developments can only be effected

[2] The Securities Exchange Act 1934 primarily regulates transactions of securities in the secondary market (sales that take place after a security is initially offered by a company (the issuer)). These transactions often take place between parties other than the issuer, such as trades that retail investors execute through brokerage firms. The Exchange Act operates somewhat differently from the Securities Act. To protect investors, Congress crafted a mandatory disclosure process that is designed to force companies to make public information that investors would find pertinent to making investment decision.

[3] See footnote 7 of *Dirks.*

by a public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favouring any special person or group', citing caselaw *In re Faherge, Inc.*[4]

The court held that there were two elements for establishing a violation of § 10(b) and Rule 10b-5 by corporate insiders are the existence of a relationship affording access to inside information intended to be available only (Securities Exchange Law 1934) for a corporate purpose, and the unfairness of allowing a corporate insider to take advantage of it.

In United States federal law, the issue of who are deemed 'insiders' is far from settled as is the issue of the 'duty of confidentiality' as in the case law *Dirks v Securities Exchange Commission*[5]. The court said that the duty that insiders owe to the corporation's shareholders not to trade on inside information *differs* from the common law duty that officers and directors also have to the corporation itself not to mismanage corporate assets, of which confidential information is one.[6]

It is to be noted that there are conflicting views as to whether 'information' is indeed 'property.'

English law, a common law system like that of the United States, has long recognised that an equitable 'duty of confidentiality' may arise out of a relationship under which information is imparted, giving rise to circumstances in which breach may give rise to a claim, as evidenced by the cases *Moorgate Tobacco Ltd v Philip Morris Ltd*[7] and *Seager v Copydex Ltd* [8]on whether confidential information may be regarded as property.

Since equity acts on the conscience, the conduct of a person who obtains confidential information improperly is deemed to be as reprehensible to the conscience as that of a person who violates the confidence in which he received it. The court reminded us that 'a significant purpose of the (United States Securities) Exchange Act (1934) was to *eliminate* the idea that use of inside information for personal advantage was a normal emolument of corporate office'.

Professor Bainbridge examined the caselaw of *S.E.C. v Lund*, [9] noting that the court failed to inquire into whether Lund (whom the court decided was a constructive insider of the issuer) had 'agreed' to keep the information confidential'. It is clear that he did not obtain the information by accident or by dishonest or discreditable means, but he may orally have made such an agreement. If he did not, is the offence not to be laid only at the feet of the person who gave him the confidential information and since this person no longer worked for the

[4] 45 S.E.C. 249, 256 (1973).
[5] *Dirks*, 463 U.S. 646 (1983) No. 82-276. Dirks, While serving as an officer of a broker-dealer, petitioner, who specialised in providing investment analysis of insurance company securities to institutional investors, received information from a former officer of an insurance company that its assets were vastly overstated as the result of fraudulent corporate practices, and that various regulatory agencies had failed to act on similar charges made by company employees. Upon petitioner's investigation of the allegations, certain company employees corroborated the fraud charges, but senior management denied any wrongdoing. Neither petitioner nor his firm owned or traded any of the company's stock, but, throughout his investigation, he openly discussed the information he had obtained with a number of clients and investors, some of whom sold their holdings in the company.
[6] See footnote 10 of *Dirks.*
[7] (1984) 156 C.L.R. 414, 438 per Deane. J.
[8] [1967] 1 W.L.R. 923, 931 per Lord Denning, M.R.
[9] 570 F. Supp. 1397 C.D. California 1983).

particular insurance company, should the court not have sought to illicit whether there was a confidentiality agreement signed between the ex-employer and the insurance company which had employed him?

There is often a severance agreement signed between the employer and the leaving employee, and in the severance agreement, if a clause to that effect does not already exist in the terms of employment, signed by the employer and the then new employee, then there should have been provision by which he would undertake to keep confidential and not to disclose any confidential information, which would have been defined in the severance agreement to identify all such information that is trade secret or otherwise to be kept secret. Most of such clauses state that they will cease to apply to information which comes into the public domain otherwise than by the leaving employee's own act.[10]

The above is a taster of this fascinating and tremendously useful book, for legal academics in post graduate and post doctoral studies band especially for practicing lawyers around the world, not just in the United States, in this age of international securities trade, facilitated by the ubiquitous Internet.

Finally, a special mention must be made about chapter 15 contributed by Professor Laura Nyantung Beny, titled: 'The political economy of insider trading laws and enforcement vs. politics? International evidence,' which includes a fascinating table of comparative experiences of every country's year of establishment of main stock exchange; of the year insider trading law was enacted and of the year of first enforcement of insider trading law.

This handbook will save hours of a lawyer's time as it represents a compact summary of the world's insider trading laws with all their foibles.

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[10] See Ramage, R. (ed) *Kelly's Legal Precedents*, 20th edition, (2010 and annual supplements), London, LexisNexis: chapter 10 on employment agreements, termination agreement on pages 533-537 and confidentiality clauses on pages 493/4.