[Washington University Journal of Law & Policy](https://openscholarship.wustl.edu/law_journal_law_policy)

Volume 56 *INSIDER TRADING*

2018

The Road Not Taken: A Comparison of the E.U. and U.S. Insider Trading Prohibitions

Franklin A. Gevurtz
Distinguished Professor of Law, University of the Pacific, McGeorge School of Law

The Road Not Taken: A Comparison of the E.U. and U.S. Insider Trading Prohibitions

Franklin A. Gevurtz*

My introduction to the prohibition on insider trading came as a law student in Berkeley in 1976. My notes indicated that the prohibition's scope under U.S. law—we did not think much about foreign law—was uncertain. They also pointed out, however, that authority from the Second Circuit, particularly the landmark decision in *SEC v. Texas Gulf Sulphur*,[1] stated that the prohibition reached anyone in possession of material nonpublic information. Four years later, the United States Supreme Court, in *Chiarella v. United States*,[2] disagreed. Instead, the Supreme Court redirected the prohibition on insider trading under United States law into a narrower and more complex approach.[3]

One wonders what would have happened if the Supreme Court had seen things differently and upheld the Second Circuit's broad prohibition in *Chiarella*. Comparative law sometimes allows us to explore the impacts of different choices regarding legal rules without performing a gedanken experiment, searching the multiverse for another Earth on which this particular law is different, or watching the movie *Sliding Doors* as made by lawyers.[4] Conveniently, the European Union's adoption of a rule similar to the Second Circuit's pre-*Chiarella* approach makes this one of those times.

This essay explores the different paths taken by the U.S. and the E.U. with respect to who is subject to the prohibition on insider trading. Part I provides an overview of the different approaches taken by U.S. and E.U. law. Part II moves from the general to the specific by exploring the different outcomes that would occur under U.S. versus E.U. law in several high profile cases of recent years. Part III explores a practical implication of this divergence by discussing the jurisdictional reach of each regime's prohibition. Finally, Part IV considers what normative lessons we can draw from this real world experiment in taking different paths.

---

* Distinguished Professor of Law, University of the Pacific, McGeorge School of Law.

1 401 F.2d 833, 848 (2d Cir. 1968).

2 445 U.S. 222, 235 (1980).

3 *See infra* Part I.A.

4 *See e.g.,* SLIDING DOORS (Miramax 1998).

I. OVERVIEW OF U.S. AND E.U. INSIDER TRADING PROHIBITIONS

A. The U.S. Prohibition

Early in the 1960s, the U.S. established what appears to be the world's first prohibition of trading on inside information.[5] This occurred when the Securities and Exchange Commission held that the Cady, Roberts brokerage firm violated Section 10(b) of the 1934 Securities Exchange Act,[6] as well as Rule 10b-5 promulgated by the Commission pursuant to that section,[7] by selling stock in a corporation after getting advance word from a director that the corporation was cutting its dividend.[8]

For most of the next two decades, the law remained uncertain regarding who was subject to the prohibition on insider trading under U.S. law. *Cady, Roberts* and decisions from the Second Circuit suggested, however, that the prohibition could reach anyone in possession of material information to which the public lacked access.[9] *Cady, Roberts* explained that the obligation to disclose or abstain was not limited to traditional categories of insiders (officers, directors and controlling shareholders).Rather, the obligation arose from: 1) a relationship that allows access, directly or indirectly, to information intended only to be available for a corporate purpose and not for the personal benefit of anyone, and 2) the unfairness of one party taking advantage of information that he or she knows is unavailable to those with whom he or she is dealing. Similarly, in condemning the trading on inside information in *Texas Gulf Sulphur*, the Second Circuit explained that the policy of Rule 10b-5 is to protect the expectation that all investors have relatively equal access to material information. To achieve this, the court held that "anyone

5 *E.g.*, Franklin A. Gevurtz, *The Globalization of Insider Trading Prohibitions*, 15 TRANSNAT'L L. 63, 64-65 (2002); *In re* Cady, Roberts & Co., 40 S.E.C. 907, 909 n. 6.

6 15 U.S.C. § 78j (2012).

7 17 C.F.R. § 240.10b–5 (2010).

8 *In re* Cady, Roberts & Co., 40 S.E.C. 907 (1961).

9 SEC v. Texas Gulf Sulphur, 401 F.2d 833, 848 n. 7.

in possession of material inside information'' must disclose the information or abstain from trading.[10]

In its 1980 decision in *Chiarella*, the Supreme Court upended this broad view. Chiarella worked for a financial printing company and, based upon information obtained through his job, purchased the stock of companies targeted for tender offers by the printing company's customers.[11] He was found guilty of violating the U.S. prohibition on insider trading by a jury who, consistent with the approach in the Second Circuit, was instructed to convict if they found Chiarella traded on material nonpublic information.[12] The Supreme Court reversed the conviction, holding that there was no duty to disclose or abstain simply because one has material information not publicly available.[13]

If mere possession of material nonpublic information is insufficient to create a duty to refrain from buying or selling stock without disclosing what one knows, then the inevitable question becomes what, if anything, creates such a duty. To answer this question, the Supreme Court in *Chiarella* came up with a rationale that it would later refer to as the "traditional" or "classical" theory.[14] Under this theory, because corporate insiders have a fiduciary relationship with their company's shareholders, they commit fraud if they trade in their own company's stock without disclosing to shareholders material nonpublic information.[15] Since Chiarella did not work for the companies whose stock he bought—rather he worked for a printing company, which, in turn, worked for parties planning to buy stock in the companies whose stock he purchased—his purchases were not prohibited under classical theory.

While the classical theory attempts to rationalize the prohibition's scope, it does not address the factual scenario of *Cady, Roberts*, in which the brokerage firm traded on information coming from an insider, but was not itself an insider. The Supreme Court filled this gap in *SEC v. Dirks*.[16] In *Dirks*, the Supreme Court reasoned that, since it is illegal for an insider

10 401 F.2d 833, 848 (2d Cir. 1968).
11 Chiarella v. United States, 445 U.S. 222, 224 (1980).
12 *Id.* at 236.
13 *Id.* at 235.
14 U.S. v. O'Hagan, 521 U.S. 642, 651 (1997).
15 445 U.S. at 228–30.
16 463 U.S. 646 (1983).

to profit by trading on inside information, it is also illegal for the insider to profit by passing on information for another person's use in trading—thereby accomplishing indirectly what the insider cannot legally do directly. Hence, tipping is illegal when a party who cannot legally trade receives some personal benefit (such as a payment or even the ability to make a gift without spending money) from providing inside information for another person's trading.[17] If the recipient of the information ("the tippee") knows or should have known he or she received the information illegally, then the tippee is liable for participating in the insider's breach if the tippee trades.[18]

Finally, in 1997, the Supreme Court completed the basic edifice for the U.S. insider trading prohibition by adopting, in *United States v. O'Hagan*,[19] the so-called misappropriation theory as an alternate basis for liability. Under the misappropriation theory, parties commit fraud in connection with the purchase or sale of a security when they trade on non-public material information obtained in a deceptive manner—most commonly through the pretense that the trader could be trusted not to abuse information received in confidence (such as through a fiduciary relationship).[20]

B. The E.U. Prohibition

While various European nations gradually followed the U.S. in prohibiting insider trading,[21] it was not until 1989 that the E.U. directed all member nations to prohibit such activity. The 1989 E.U. directive on insider trading[22] was not radically different from U.S. law. It required member nations to prohibit trading by persons who gain inside information through management or board positions with, or by being a shareholder of, the issuer, or through their employment, profession or

17 *Id.* at 659–64.
18 *Id.* at 659–60.
19 521 U.S. 642, 653 (1997).
20 *Id.* at 651–52.
21 *See* Gevurtz, *supra* note 5.
22 Council Directive 89/592 of November 13, 1989 Coordinating Regulations on Insider Dealing, 1989 O.J. (L 334) 30.

duties.[23] While lacking the overarching reference to fiduciary relationships that undergirds the U.S. law, the E.U. categories largely picked up the same sort of insiders and parties misappropriating information reached by the U.S. prohibition. The principal difference between the 1989 directive and U.S. law involved the liability of tippees. The 1989 directive prohibited parties from trading if they had received information from anyone who could not trade[24]—thereby adopting the sort of tainted fruit approach to tippee liability that the U.S. Supreme Court rejected by establishing the personal benefit test in *Dirks*.

In 2003, the E.U. issued a new directive (the Market Abuse Directive, or "MAD").[25] While MAD took a very different approach, it is possible to miss the significant change in a quick reading. Article 2 of MAD retained the same categories of persons prohibited from trading on inside information by the 1989 insider trading directive; to which, however, MAD also added a new category—those obtaining information from criminal activities—thereby adopting the broad misappropriation theory advocated by Justice Berger in *Chiarella*.[26] The critical change occurred in Article 4. It abandoned the tainted fruit approach to tippee liability found in the 1989 directive and replaced it with a broad prohibition reminiscent of the Second Circuit's pre-*Chiarella* approach. Specifically, Article 4 directed member nations of the E.U. to prohibit trading on inside information when the person trading "possesses inside information while that person knows, or ought to have known, that it is inside information."[27] This provision reduces the impact of Article 2's categories simply into a question of culpable intent: persons in Article 2's categories need not know or should have known that they are trading on inside information, whereas anyone outside of the categories must have such knowledge or negligence.

---

23 *Id.* at art. 2(1).

24 *Id.* at art. 4.

25 Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), 2003 O.J. (L 96) 16.

26 445 U.S. 222, 241–42 (Berger, C.J. dissenting)(explaining that Section 10(b) should be read to prohibit use of information obtained by "unlawful means").

27 "Inside information" does not mean that the information came from sources inside the corporation. Rather it is information that has not been made public. MAD, *supra* note 25, at art. 1(1).

In 2014, E.U. law changed again. The Market Abuse Regulation ("MAR")[28] replaced MAD. A key difference between MAR and MAD is their mechanism for implementation: a regulation under E.U. law is directly binding law, whereas a directive is an instruction to member nations of the European Union as to what their national laws must contain.[29] While there are other differences between MAD and MAR, MAR's insider trading prohibition, the essential scope of which is defined in Article 8, remained the same as MAD's.[30] Hence, European law is pretty much what the law in the United States appeared to be before Chiarella.

II. The Impact of The Differring U.S. and E.U. Prohibitions as Illustrated in Cases

To fully appreciate the difference in the U.S. and E.U. approaches, it is helpful to compare the results they produce in some relatively recent high profile cases.

A. Cuban and Einhorn

The actions brought by the SEC against Mark Cuban[31] and by the English Financial Services Authority (FSA) against David Einhorn[32] provide a powerful illustration of the different results under the U.S. and E.U. insider trading prohibitions. The conduct in both cases was remarkably similar. In both, CEOs contacted a large shareholder (Cuban) or the manager of a large institutional shareholder (Einhorn, who managed

28 European Parliament and Council (EU) Regulation 596/2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC, 2014 O.J. (L 173) 1.

29 *E.g.*, RALPH H. FOLSOM, RALPH B. LAKE & VED P. NANDA, EUROPEAN UNION LAW AFTER MAASTRICHT: A PRACTICAL GUIDE FOR LAWYERS OUTSIDE THE COMMON MARKET 5 (1996).

30 Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), 2003 O.J. (L 96) 16, art. 8.

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

32 *Decision Notice*, FIN. SERV. AUTHORITY (Jan. 12, 2012) (U.K.), *available at* http://www.fsa.gov.uk/static/pubs/decisions/dn-einhorn-greenlight.pdf; *Final Notice*, FIN. SERV. AUTHORITY (Feb. 15, 2012), *available at* http://www.fsa.gov.uk/static/pubs/final/greenlight-capital.pdf.

the Greenlight fund) to solicit support for planned stock offerings to raise money for their corporations. Both Cuban and Einhorn objected to the respective offerings, and, when unable to persuade the CEOs to change plans, dumped the shareholders' stock in the corporations prior to announcement of the stock offerings.[33] In both instances, the corporation's stock sank upon announcement of the offering, meaning that Cuban's and Einhorn's decisions to trade prior to public announcement of the stock offerings avoided substantial losses.

The SEC proceeded against Cuban based upon the misappropriation theory. Specifically, the SEC alleged that Cuban gained details regarding a proposed stock offering from Mamma.com by promising its CEO that Cuban would not trade before the offering; then, in breach of the CEO's trust created by this promise, Cuban sold his Mamma.com stock.[34] Ultimately, while an appellate court found the SEC's complaint alleged a viable claim,[35] the SEC was unable to convince a jury that Cuban had, in fact, promised not to trade.[36] As a result, there was no violation of the U.S. insider trading prohibition.

In the *Einhorn* case, there was no claim that Einhorn promised not to trade. Indeed, when an investment banker acting on behalf of the English company, Punch, contacted the Greenlight fund and requested its agreement not to trade, Einhorn explicitly refused to have Greenlight agree. Nevertheless, the investment banker arranged a call between Einhorn and Punch's CEO with the understanding that Greenlight had not agreed to abstain from trading.[37] Punch's CEO discussed with Einhorn the possibility of a stock issuance, but held back details unless Greenlight agreed not to trade for a week (by which time Punch presumably would have publicly announced the stock issuance). Einhorn declined and the

33 *Cuban*, 620 F.3d at 552; FSA, *supra* note 32 at 2.

34 *Cuban*, 620 F.3d at 552.

35 *Id.* at 551.

36 *E.g.*, Erin Fuchs, *Why the SEC Lost its Big Case against Mark Cuban*, BUS. INSIDER (Oct. 17, 2013), http://www.businessinsider.com/how-mark-cuban-defeated-the-sec-2013-10 (noting additional problems for the SEC's case, including testimony disputing whether information was material and not publicly known).

37 FSA, *supra* note 32, at ¶ 3.21

conversation ended.[38] Immediately after the conversation, Einhorn ordered Greenlight to sell all its shares in Punch.[39]

It seems clear that Greenlight's sales would not have violated U.S. law. The effort to get Greenlight's agreement not to trade shows that Punch's CEO was not tipping Einhorn in order to gain some personal benefit from passing on the information for trading. Einhorn's refusal to agree not to trade shows that Einhorn did not misappropriate the information from Punch through pretense that he could be trusted with the information. Nor did Einhorn misappropriate the information from Greenlight, since Greenlight, not Einhorn, traded. Further, Einhorn was not an officer, director or other fiduciary of Punch. Perhaps one could argue that Greenlight's large shareholdings in Punch (thirteen percent) made Greenlight a fiduciary. However, there is no indication that Greenlight exercised any control over Punch; indeed, Einhorn expressed strong opposition to Punch issuing stock during his conversation with Punch's CEO—advice that the CEO blithely ignored. Moreover, the efforts of Punch's CEO to gain Greenlight's agreement not to trade and refusal to provide further details about the proposed issuance without such an agreement suggest that the CEO did not view the conversation as providing information to a controlling shareholder in confidence.[40]

Showing the difference from U.S. law, in 2012, the FSA imposed a £3.6 million fine on Einhorn and Greenlight. Much of the FSA's discussion in the notice of the fine focused on whether the information Einhorn received in the phone call (given its lack of details) constituted price sensitive (material) non-public information. In evaluating whether there was any duty not to trade on inside information, the FSA relied on

---

38 *Id.* at Annex 2.

39 *Id.*

40 If Punch had been a company registered under the 1934 Securities Exchange Act, Punch's selective disclosures might have violated SEC's Regulation FD (17 C.F.R. § 243.100-243.103 (2011)); but this is not Einhorn or Greenlight's violation. Alternatively, if Punch had been registered under the 1934 Securities Exchange Act, Greenlight's thirteen percent holdings in Punch would have subjected it to Section 16(b) of that Act (15 U.S.C. § 78p(b)). This would have required Greenlight to turn over to Punch the losses Greenlight avoided by its sale of Punch stock; but only for the number of shares, if any, that Greenlight purchased both after becoming a ten percent shareholder and within six months of the sale. *E.g.*, Foremost-McKesson, Inc. v. Provident Sec. Co., 423 U.S. 232 (1976) (purchase that puts shareholder over the 10 percent threshold does not count as a purchase or sale within six months under Section 16(b)).

the fact that Einhorn received the information as a result of his employment managing Greenlight.[41] This seems strange, since Einhorn did not personally trade in violation of any duty to Greenlight; rather he ordered Greenlight to trade. In other words, Einhorn violated English law because he used information received as part of his job with Greenlight in order to carry out his job by using the information on Greenlight's behalf.

For our purposes, however, what is more important than the FSA's theory is what the result would be under MAD and MAR.[42] Einhorn was aware that he was in possession of material non-public information, which makes trading illegal under MAD and MAR.[43] And, of course, if the undisputed lack of any agreement to abstain from trading would not save Einhorn, the lack of such an agreement would not have saved Cuban had E.U. rather than U.S. law applied in the Cuban prosecution.

B. Newman

In *United States v. Newman*,[44] the U.S. prosecuted a pair of hedge fund managers who directed their funds to trade based upon advance knowledge of NVIDIA and Dell earnings reports obtained through a chain of tips. Specifically, insiders at NVIDIA and Dell leaked advance information regarding corporate earnings to casual friends—in one case a person the insider knew through business school and prior employment and in the other case a person the insider knew through attending the same church—who, in turn, passed the information through a chain of stock analysts until the information reached the defendants.[45]

In a much remarked-upon decision, the Second Circuit reversed the defendants' convictions for illegal insider trading. In part the Second Circuit held—the continued validity of which is questionable after the Supreme Court's decision in *Salman v. United States*[46]—that motivation

41 FSA Final Notice, *supra* note 32, at ¶ 4.5.

42 It is not clear why the FSA invoked the bizarre theory it did instead of relying on more relevant provisions of English law.

43 *See supra* Part I.B.

44 773 F.3d 438 (2d Cir. 2014).

45 *Id.* at 439.

46 137 S. Ct. 420 (2016) (rejecting the argument that the tipper, who makes a gift of inside information, does not receive enough benefit to make the tip illegal under *Dirks* unless the tipper expects some sort of tangible quid pro quo).

by mere casual friendship for the tippee was not a sufficient benefit to make the tip illegal under *Dirks*.[47] Of more continuing relevance, the court also found there was insufficient proof that the defendants, who received the information only after it passed through a chain of tips, knew anything about the motivations of the insiders at the beginning of the chain.[48] Thus, the defendants did not knowingly aid a breach of the insiders' duty.[49]

Unlike U.S. law, finding illegality in the *Newman* situation would have been pretty straightforward under MAD or MAR. Even under the 1989 insider trading directive, trading on non-public material information traceable to corporate employees would have been illegal without regard to any personal benefit to the employees from providing the tip.[50] Under MAD and MAR, it is not even necessary that the information be traceable to corporate insiders. Nor are the motivations of the participants in the chain of tipping, much less the defendants' knowledge of any of this, relevant. Instead, the only question in the *Newman* situation would be whether the information was not public and whether the defendants realized or should have realized the information was not public.[51] Well, duh: This was advance knowledge of corporate earnings reports before the reports were released to the public. Even if the defendants were unaware of the route and motivations by which the information reached them, they had to realize the earnings reports were not yet public knowledge.

III. THE JURISDICTIONAL REACH OF THE U.S. AND E.U. INSIDER TRADING LAWS

The difference between the U.S. and E.U. insider trading prohibitions raises a question of practical consequence: Whose law governs specific instances of insider trading in increasingly globalized securities markets?

---

47 773 F.3d at 452.

48 *Id.* at 453–54.

49 In addition, the government's case faced another formidable challenge under U.S. law, which the court overlooked. Since the defendants were at the end of a chain of tipping between them and the insiders, conviction under *Dirks* presumably should have required some sort of showing of benefit from all the intermediate tipping as well as the defendants' knowledge that all of the intermediate tips were illegal. Franklin A. Gevurtz, *The Overlooked Daisy Chain Problem in Salman*, 58 B.C.L. REV. E-SUPPLEMENT 18 (2017).

50 *See supra* note 22.

51 *See supra* Part I.B.

In *Morrison v. Australia National Bank*,[52] the Supreme Court sought to establish a rule that would provide a simple answer to this question. The court held that Section 10(b) and Rule 10b-5 only reach purchases or sales of securities that take place in the U.S.[53] Under this approach, whether the U.S. versus the E.U. insider trading prohibition applies would depend upon whether the trade took place on an exchange in the U.S. or in the E.U.

The territorial reach of the U.S. insider trading prohibition, however, turns out to be not so simple. For one thing, it can be challenging to establish the country in which transactions occur when the transactions do not take place over an exchange.[54] Moreover, Congress subsequently acted to overturn *Morrison* when it comes to government prosecutions for violating Section 10(b). Specifically, the Dodd-Frank Act grants jurisdiction to U.S. courts over government prosecutions of securities frauds (which is what insider trading is considered to be[55]) in which conduct constituting a significant step in the furtherance of the fraud occurs in the United States or conduct outside the United States has a foreseeable substantial effect in the United States.[56] How such a test applies to cases of insider trading is unclear and presumably depends upon the facts of the individual case.[57]

In any event, one also must consider the reach of E.U. law. Unlike *Morrison*, the touchstone for MAR's application is not where the purchase or sale takes place. Rather, the touchstone for MAR's application is the relationship of the transaction to financial instruments—such as stocks, bonds, options, derivative contracts or the like[58]—traded on European

52 561 U.S. 247, 266 (2010).

53 *Id.*

54 *See, e.g.*, Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60 (2d Cir. 2012) (adopting a test for locating non-exchange sales).

55 *See supra* notes 6–8 and accompanying text.

56 Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 929P(b)(2), 124 Stat. 1376 (2010). The reference to "jurisdiction," rather than to whether the acts violate Section 10(b), creates an issue as to whether this provision actually succeeds in overturning *Morrison* for government prosecutions. *E.g.*, Richard W. Painter, *The Dodd-Frank Extraterritorial Jurisdiction Provision: Was It Effective, Needed or Sufficient?*, 1 HARV. BUS. L. REV. 195 (2011).

57 *See id.* at 216-20 (discussing possible insider trading prosecutions pursuant to Dodd-Frank's jurisdictional provision).

58 Directive 2014/65, of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, 2014

exchanges.[59] Specifically, MAR reaches any insider trading in financial instruments traded on European markets, even if the trades made on the basis of inside information do not occur on a European exchange (as, for instance, with dual listed stocks or with private transactions in listed shares).[60] MAR explicitly states that it does not matter whether the actions or omissions concerning the financial instruments covered by the regulation take place inside or outside of the European Union.[61]

Even more broadly, MAR also applies to transactions in financial instruments not traded on European exchanges when the prices or values of those instruments depends on or can affect the prices or values of financial instruments traded on European markets.[62] This could pick up insider trading in American Depository Receipts (ADRs) or options for stocks traded on European markets even though the ADRs or options were traded in the United States. This could also pick up insider trading in stocks on U.S. exchanges if the companies issuing the stocks listed other securities, such as bonds, for trading in European markets.[63]

The end result is the potential for overlap between the jurisdictional reach of the U.S. and E.U. laws. While in private litigation this raises a choice-of-law issue in which the court must pick one law or the other, in government prosecutions—which are the predominant enforcement mechanism for insider trading[64]—either or both nations might prosecute under their law unless some doctrine prevents this. There are several possible doctrines to consider.

United States federal courts invoke a presumption against extraterritorial application of U.S. law in part to avoid conflicts between U.S. and foreign laws.[65] The explicit language of Dodd-Frank rebuts the

O.J. (L 173) 349, Annex I, sec. C.

59 This includes so-called regulated, as well as multilateral and organized, exchanges in the E.U. MAR, *supra* note 28, at art. 2(1)(a)-(c).

60 *Id.*

61 *Id.* at art. 2(4).

62 *Id.* at 2(1)(d).

63 This depends on whether the prices and values of stocks and bonds issued by the same company impact each other.

64 *E.g.*, Marco Ventoruzzo, *Comparing Insider Trading in the United States and in the European Union: History and Recent Developments* 27 (Eur. Corp. Governance Inst., Working Paper No. 257, 2014).

65 *E.g.*, EEOC v. Arabian Am. Oil Co. (*ARAMCO*), 499 U.S. 244, 248 (1991).

presumption for the U.S. prohibition, while the explicit language of MAR would do the same, even if the European Court of Justice (the high court for interpreting E.U. law) were to follow the presumption.[66]

By triggering jurisdiction based upon either conduct or effects within the United States, Dodd-Frank employs two generally accepted grounds under international law for a nation to apply its law.[67] Insofar as MAR reaches trading outside Europe based upon its impact on the price or value of securities traded in Europe, MAR similarly can claim jurisdiction based upon effects. Ironically, European nations years ago argued that this sort of effects-based jurisdiction was inconsistent with international law.[68] MAR shows that the Europeans have moved past this view, and, since the U.S. has long used jurisdiction based upon economic effects within the nation,[69] the U.S. is hardly in a position to complain. Still, while effects-based jurisdiction allows MAR to reach trades outside Europe that impact securities prices in Europe, MAR also seeks to ban insider trading outside Europe in financial instruments whose prices depend on prices in Europe. This appears to go beyond the generally accepted grounds under international law for nations to apply their law.[70] Tut tut.

Finally, some U.S. courts have considered comity, among other concerns, in order to dismiss suits brought under U.S. laws in situations in which the challenged conduct was legal where it occurred.[71] Of course, prosecutors also might use their discretion not to prosecute in such situations. Even if the European Court of Justice recognizes comity, however, it is difficult to invoke the doctrine in the face of MAR's explicit language regarding the prohibition's scope.

---

66 *See, e.g.*, RJR Nabisco, Inc. v. European Community, 136 S. Ct. 2090, 2101–02 (2016) (presumption against extraterritoriality can be rebutted by language or context that shows Congress intended the statute to apply outside the United States).

67 *E.g.*, RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 402 cmt. c (AM. LAW INST. 1986).

68 *E.g.*, Gary B. Born, *A Reappraisal of the Extraterritorial Reach of U.S. Law*, 24 L. & POL'Y INT'L BUS. 1, 32-33 (1993) (discussing European objections to the application of U.S. antitrust law based upon the economic effects in the United States of conduct outside the United States).

69 *E.g.*, United States v. Aluminum Co. of Am., 148 F.2d 416, 443 (2d Cir. 1945) (applying the Sherman Act to a cartel limiting production outside the United States based upon the impact of increasing prices inside the United States).

70 *See, e.g.*, RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 402 (listing accepted bases under international law for claiming jurisdiction to apply a nation's law).

71 *See, e.g.*, Timberlane Lumber Co. v. Bank of Am., 549 F.2d 597, 614 n.31 (9th Cir. 1976).

IV. NORMATIVE LESSONS FROM THE EXPERIMENT

While much of the normative debate over the insider trading prohibition asks whether there should be any prohibition at all,[72] the clash between the U.S. and E.U. approaches takes the prohibition as a given and asks where to draw the line regarding whom the prohibition reaches. Even resolving this narrower issue, however, still depends upon one's view of the purpose for the prohibition.

A. Market Effects

Normative arguments about insider trading often focus on market effects. Proponents of a ban argue that insider trading deters investors and raises the cost of capital for companies.[73] Opponents of a ban, or of a broad ban, commonly argue that preventing persons from acting upon information relevant to the value of securities leads to less accurate securities prices.[74] Indeed, a primary argument made by critics of the broad reach of the E.U. prohibition is that it will deter parties from investigating companies by depriving researchers of rewards for their efforts.[75] This mirrors the Supreme Court's express concern in *Dirks* that an equal access rule deters legitimate efforts of stock analysts to ferret out important information.[76]

The E.U.'s adoption of a broad prohibition seemingly provides a testing ground for this concern. Any negative impacts on the efficient pricing of securities on European markets have not been sufficiently visible in the years since MAD to provide support for the concerns of

72 *E.g.*, HENRY MANNE, INSIDER TRADING AND THE STOCK MARKET (1966).

73 *E.g.*, Joel Seligman, *The Reformation of Federal Securities Law Concerning Nonpublic Information*, 73 GEO. L.J. 1083, 1115–18 (1985).

74 *E.g.*, Bruce H. Kobayashi & Larry E. Ribstein, *Outsider Trading as an Incentive Device*, 40 U.C. DAVIS L. REV. 21, 35 (2006).

75 *E.g.*, Sergio Gilotta, *The Regulation of Outsider Trading in EU and the US*, 13 EUR. COMPANY & FIN. L. REV. 631, 664 (2016); Richard A. Booth, *Insider Trading: There Oughta be a Law — Or Not*, 38 REG. 18, 21 (2015).

76 463 U.S. 646, 658–59 (1983).

critics.[77] Searching for less readily visible impacts would be an interesting project for empirical research employing statistical methods. About all one can conclude at this point is that the European experience does not support overly dire predictions regarding the consequences of an equal access rule.

B. Fairness

Unfashionable as such fuzzy thinking might be, the prohibition on insider trading may rest more upon a sense of what is unfair than upon market effects. Fairness, however, is often in the eye of the beholder. Hence, the reason for presenting the cases in Part II of this essay is not simply to demonstrate the difference between the results under U.S. versus E.U. law through real examples, but also to provide a real world context for asking what is fair.

Perhaps I have been reading too much recently about income inequality and the growing class division in the United States.[78] What strikes me, however, as the common thread running through the cases in Part II is the division between in-group haves and out-group have-nots. Large shareholders, and individuals working in finance who are members of professional and social networks, obtained information as a result of contacts not available to ordinary traders. The result is a systematic transfer of wealth from the unconnected in the ordinary middle class to the rich and to those in the financial industry.[79] In short, the trading in these cases presents a microcosm seemingly validating complaints that a rigged system has produced growing income inequality in the United States, the consequences of which we saw in the 2016 election.

---

77 *See* Gilotta, *supra* note 75 (not citing any empirical evidence of a negative impact of MAD or MAR on the efficiency of pricing on securities markets in Europe); Booth, *supra* note 75 (same). To be honest, there is no readily visible evidence of positive impacts on European securities markets either.

78 *See, e.g.*, RICHARD V. REEVES, DREAM HOARDERS: HOW THE AMERICAN UPPER MIDDLE CLASS IS LEAVING EVERYONE ELSE IN THE DUST, WHY THAT IS A PROBLEM, AND WHAT TO DO ABOUT IT (2017); THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY (Arthur Goldhammer trans., Belknap Press: An Imprint of Harvard University Press 2014).

79 *See, e.g.*,ROBERT B. REICH, SAVING CAPITALISM: FOR THE MANY, NOT THE FEW 52–53 (2016).

Of course, one may object that of all the advantages possessed by those with greater wealth or working in finance,[80] insider trading may have the least impact in producing income inequality. Still, there is a difference between insider trading and the sorts of networking advantages that often open doors to interviews, education, jobs and business opportunities. Trading on inside information simply produces a zero sum wealth transfer from those without the information to those who have it. By contrast, access to educational, employment or business opportunities presumably still requires the recipient of the opportunity to perform.[81]

Viewed in this light, the difference between the U.S. and E.U. insider trading prohibitions is simply one manifestation of a broader difference between current U.S. and European laws and cultural attitudes concerning income inequality. For example, levels of executive compensation in the United States versus Europe, as well as the application of corporate law to challenges to executive compensation, also illustrate this difference.[82] The irony is that when I was growing up, the stereotype of Europe was of economically divided societies and the image of the United States was of a middle class nation.

C. Line Drawing

Not even the Europeans outlaw every trade in which one party knows more than the other. Article 9 of MAR excludes a person's knowledge of the person's own intention to purchase or sell securities from the definition of inside information.[83] Also, Paragraph 28 of MAR's preamble excludes research and estimates based upon publicly available data from being considered inside information. Essentially, MAD and MAR, like the Second Circuit's pre-*Chiarella* rule, embody an equal access, not an equal information, rule.

---

80 *See, e.g.*, REEVES, *supra* note 78.

81 One might question whether such broad societal fairness concerns justify harsh criminal penalties (prison). This essay simply addresses the scope of the prohibition, not the question of sanctions.

82 *E.g.*, Franklin A. Gevurtz, *Disney in a Comparative Light*, 55 AM. J. COMP. L. 453, 478-83 (2007).

83 *See supra* note 28, at art. 9.

Critics have argued that the particular line MAD and MAR draw between inside and not inside information—or at least ambiguity about this line[84]—might deter desirable use of information.[85] No doubt any line can be over- or under-inclusive and can raise issues in its application. Still, it helps to start with the right questions. The question of whether information consists of research and estimates based upon publicly available data gets at the heart of fairness and efficiency concerns insofar as it seeks to reward legitimate efforts. Fiduciary duty—the ostensible linchpin of the U.S. approach—is simply the product of the historical need to fit the prohibition of insider trading into a rubric built around the word "fraud."

CONCLUSION

In *Chiarella*, the U.S. Supreme Court took one fork in the road; in MAD and MAR the European Union took the other. One fork leads in a small way toward a more just and fair society.

---

84 Specifically, there can be room for dispute over what is publicly available data.

85 Gilotta, *supra* note 75 at 22. Also see author's text accompanying notes 54–92 in his article.