Chapter-4

Selected Foreign Case Studies on Insider Trading

4.1 Introduction

Present study focuses on problems of insider trading in securities market in India. In chapter-3, some selected cases have been studied to understand the magnitude of the problems in the Indian context. However, in order to understand the problem of insider trading in its right perspective it is desirable to have an international perspective. A selection of cases from leading countries of the world has been studied in this chapter. We have selected four cases from the USA, one from the UK and one from Australia for in-depth study.

The purpose of this chapter is to study the texture of the insider trading cases as well as regulatory practices by the securities market regulators in those countries mentioned above. This chapter has been organised into four sections. Section- 4.2 deals with some important insider trading cases in the USA. Section - 4.3 analyses insider trading case in the UK. Australian insider trading case is studied in section- 4.4. Section- 4.5 concludes the chapter.

4.2 Selected case studies on insider trading in the USA

During 1980s a number of Wall Street takeover players viz., Dennis Levine, Ivan F Boesky and Michael R Milken allegedly gained millions of dollars from illegal insider trading. Exhibit 4.1 displays the list of traders who were convicted for insider trading crimes.
Exhibit -4.1: Insider trading charges and convictions in the USA¹

<table>
<thead>
<tr>
<th>Trader</th>
<th>Occupation</th>
<th>Fine and Repayment of illicit profit</th>
<th>Probation²</th>
</tr>
</thead>
<tbody>
<tr>
<td>Michael R. Milken</td>
<td>Banker, Drexel Burnham Lambert</td>
<td>$600 million</td>
<td>Pending</td>
</tr>
<tr>
<td>Ivan F. Boesky</td>
<td>Arbitrage</td>
<td>$100 million</td>
<td>3 years</td>
</tr>
<tr>
<td>Dennis Levine</td>
<td>Banker, Drexel and other firms</td>
<td>$11.6 million</td>
<td>2 years</td>
</tr>
<tr>
<td>Martin Siegel</td>
<td>Banker, Kidder Peabody, Drexel</td>
<td>$9 million</td>
<td>2 months</td>
</tr>
<tr>
<td>James T. Sherwin</td>
<td>Vice-Chairman, GAP Corp.</td>
<td>$2 million</td>
<td>6 months</td>
</tr>
<tr>
<td>Salem Lewis</td>
<td>Arbitrage</td>
<td>$400,000</td>
<td>Probation</td>
</tr>
<tr>
<td>Charles Zarzecki</td>
<td>Partner, Princeton/Newport</td>
<td>$275,000</td>
<td>6 months</td>
</tr>
<tr>
<td>Boyd Jefferies</td>
<td>CEO, Jefferies &amp;Co</td>
<td>$250,000</td>
<td>Probation</td>
</tr>
<tr>
<td>Bruce Newberg</td>
<td>Trader, Drexel</td>
<td>$365,000</td>
<td>3 months</td>
</tr>
<tr>
<td>Paul Berkman</td>
<td>Partner, Princeton/Newport</td>
<td>$100,000</td>
<td>3 months</td>
</tr>
<tr>
<td>Jack Rabinowitz</td>
<td>Partner, Princeton/Newport</td>
<td>$50,000</td>
<td>3 months</td>
</tr>
<tr>
<td>Steven Smotrich</td>
<td>Comptroller</td>
<td>None</td>
<td>3 months</td>
</tr>
</tbody>
</table>

It was found that huge amount of monetary penalties and convictions were imposed by the regulators who had committed such violations. Even the profits earned by the insiders were required to be refunded.

We have analysed (i) SEC vs. Texas Gulf Sulphur Company (1964); (ii) Chiarella vs. United States (1978); (iii) Dirks vs. SEC (1983); and (iv) United States vs. Carpenter (1986) in the present study.

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4.2.1 SEC vs. Texas Gulf Sulphur Company (1964)³

The Gulf Sulphur Company was formed in Matagorda County in December 23, 1909. In 1918 its name had been changed to Texas Gulf Sulphur (TGS) Company. A plant was built at the Big Hill Dome and sulphur was first produced in 1919. The company created a town named Gulf, Texas. When the Texas Gulf Sulphur Company began operations on the Boling Dome in 1928, a new company town was established named New Gulf. The town contained businesses, more than 350 homes, a school, library, hospital, movie house, golf course and county club.

In March 1959, agents of TGS found evidence of an ore deposit near Timmins, Ontario. In October 1963, TGS began ground surveys of the area. In early November a drilling rig took core samples from depths of several hundred feet. Visual examination of the samples suggested commercially significant deposits of copper and zinc. TGS’s president ordered the exploration group to maintain strict confidence, even at the level of TGS directors and employees. In early December, a chemical assay confirmed the presence of copper, zinc and silver at Ontario. At the subsequent trial several expert testified that they had never heard of any other initial exploratory drill hole showing comparable results. Over the next several months, TGS acquired the rights to the land under which this remarkable ore deposit lay. In March and early April 1964, further drilling confirmed that TGS had made a significant ore discovery. After denying several rumours about the discovery, TGS finally announced its discovery in a press conference on April 16, 1964⁶.

Throughout the fall of 1963 and spring of 1964, a number of TGS insiders bought stock and or options on company stock. Others passed inside information to the outsiders. Still others accepted stock options authorised by the company’s board of directors without informing the director about the discovery.
Between November 1963 and March 1964, the insiders were able to buy shares at prices that were slowly rising with fluctuations from just under $18 per share to $25 per share. As rumours began circulating in the late March and early April 1964, the price jumped to about $30 per share. On 16th April, 1964 the stock opened at $31, but quickly jumped to $37 per share. Again shares were trading over $58 per share on 15th May, 1964 which was 222% increase over price of November 1963. Charles F. Fogarty was an executive vice-president of the company. He knew that the company had discovered a rich mineral lode in Ontario. He purchased and sold shares during 1963 and 1964 on the basis of such information and earned US $1, 25,000. The SEC sued him and other insiders who were allegedly involved in that trading for violating insider trading regulations.

Texas Gulf Sulphur is the first of the truly seminal insider trading cases in the USA. This case involved corporate insiders who purchased stock in the open market on the basis of non-public information of a valuable mineral ore. The US Second Circuit Court of Appeals held that an insider possessing material non-public information must disclose such information before trading or should be abstained from trading until the information is disclosed. But Mr. Fogarty had violated Rule 10b-5 of the Securities Exchange Act, 1934. He had exclusive access to non-public information but he failed to disclose it while trading and the information would have been material to a reasonable person’s investment decision.

Anyone who possesses inside information is required either to disclose such information publicly or to abstain from trading in the affected company’s securities. The Court expressed the view that no one should be allowed to trade with the benefit of inside information because the same is nothing but a fraudulent transaction to all other buyers and sellers (non-insiders) in the market. The Court stated that the insider trading prohibition applies to anyone in possession of material inside information because Section 10 (b) of Securities Exchange Act, 1934 was intended to assure that all investors trading on impersonal exchanges
have relatively equal access to material information. This disclose or abstain rule was the broadest formulation of insider trading prohibition rule in the USA.

4.2.2 Chiarella vs. United States (1978)

Vincent Chiarella was an employee of Pandick Press in New York, a financial printer that prepared tender offer disclosure materials among other documents. During 1975 to 1976 he worked as a linkman of composing room. He handled huge documents of five announcements of corporate takeover bids. When these documents were delivered to the printer the identities of the acquiring and target corporations were concealed by blank spaces or false names. The true names were sent to the printer on the night of the final printing. In preparing those materials Pandick used codes to conceal the names of the companies involved but Chiarella broke the codes. He was able to deduce the names of the target companies before the final printing from other information contained in the documents. He purchased shares in the target companies and sold the shares immediately after the takeover attempts were made public. By this method, he realised a profit of slightly more than $30,000 in the course of 14 months.

Subsequently, the Securities and Exchange Commission (SEC) began an investigation of his trading activities. In May 1977 he entered into a consent decree with the SEC in which he agreed to return his profits to the sellers of the shares. On the same day he was discharged by Pandick Press. Thereafter, he was indicted and convicted for violating section 10 (b) of the Securities Exchange Act and Rule 10b-5 of SEC. The District Court's charge permitted the jury to convict Chiarella. It was found that he wilfully suppressed information to sellers of the target company securities that he knew of a forthcoming takeover bid that would make their shares more valuable. His conviction was affirmed by the Court of Appeals.
Although Chiarella was not a corporate insider, he used to receive confidential information from the target companies. No duty had arisen from his relationship with the sellers of the target companies' securities, because he had no prior dealings with them. He was neither their agent nor a fiduciary. He was a person in whom the sellers had placed their trust and confidence. A duty to disclose under section 10(b) of the Securities and Exchange Act, 1934 did not arise from the mere possession of non-public securities market information.

The Jury instructions demonstrated that he was convicted merely because of his failure to disclose material non-public information to sellers from whom he bought the shares of target companies. One who fails to disclose material information prior to the dealing of shares and committed fraud only when he is under a duty to do so and the duty to disclose arises when one party has information that the other party is entitled to know because of a fiduciary or similar relationship of trust and confidence between them.

In this case, Chiarella was convicted of violating section 10(b) of the Securities and Exchange Act, 1934 although he was not a corporate insider and he received no confidential information from the target company. Moreover, the 'market information' upon which he relied did not concern the earning power or operations of the target company but only the plans of the acquiring company. The Court squarely rejected the notion that section 10(b) was intended to assure all investors equal reliance on the existence of a fiduciary duty which would create itself a duty to disclose, the breach of which would give rise to a violation of law.

In response to the Chiarella decision, the SEC promulgated Rule 14e-3\textsuperscript{13} under Section 14(e) of the Securities Exchange Act and made it illegal for anyone to trade on the basis of material non-public information regarding tender offers if they knew the information emanated from an insider. This case had made it clear that 'Disclose or Abstain rule' is not triggered merely because the trader possesses material non-public information.
4.2.3 Dirks vs. SEC (1983)\textsuperscript{14}

Raymond Dirks was an officer of a New York broker-dealer firm who specialised in providing investment analysis of insurance company securities to institutional investors. On March 6, 1973, Dirks received information from Ronald Secrist, a former officer of Equity Funding of USA. Secrist alleged that the assets of Equity Funding, a diversified corporation primarily engaged in selling life insurance and mutual funds were vastly overstated. Secrist also stated that various regulatory agencies had failed to act on similar charges made by Equity Funding employees. He urged Dirks to verify the fraud and disclose it publicly.

Dirks decided to investigate the allegations. He visited Equity Funding's headquarters in Los Angeles and interviewed several officers and employees of the company. The senior management denied any wrongdoing but certain company employees corroborated the charges of fraud. Neither Dirks nor his firm owned or traded any Equity Funding stock but throughout his investigation he openly discussed the information he had obtained with a number of clients and investors. Some of those persons sold their holdings of Equity Funding securities including five investment advisers who liquidated holdings of more than $16 million.

Dirks received from his firm a salary plus a commission for securities transactions above a certain amount that his clients directed through his firm. The Boston Company Institutional Investors Inc. promised Dirks about $25,000 in commissions but it was unclear whether Boston actually generated any brokerage business for his firm. While Dirks was in Los Angeles, he was in touch regularly with William Blundell the Wall Street Journal's Los Angeles Bureau Chief. Dirks urged Blundell to write a story on the fraud allegations. Blundell did not believe. However, such a massive fraud could go undetected and he declined to write the story. During the two week period in which Dirks persuaded his investigation and spread word of Secrist's charges, the price of Equity Funding stock fell from $26 per share to less than $15 per share\textsuperscript{15}. This led the New York Stock Exchange to
halt trading on March 27, 1973. Shortly thereafter California insurance authorities impounded Equity Funding's records and uncovered evidence of the fraud. Only then the SEC did file a complaint against Equity Funding on April 2, 1973. The Wall Street Journal published a front-page story based largely on information assembled by Dirks. Equity Funding immediately went into the hand of receiver.

The SEC began to investigate into Dirks' role in the exposure of the fraud. After a hearing by an Administrative Law Judge, the SEC found that Dirks had aided and abetted violations of Section 17(a) of the Securities Act of 1933 and Securities Exchange Act of 1934 by repeating the allegations of fraud to members of the investment community who later sold their Equity Funding stock.

Dirks sought review in the Court of Appeals for the District of Columbia Circuit. The Court entered judgment against Dirks for the reasons stated by the Commission in its opinion. Judge Wright, a member of the panel, subsequently issued his opinion. Judge Robb concurred in the result and Judge Tamm dissented. Neither of them expressed any opinion. Judge Wright believed that the obligations of corporate fiduciaries passed to all those to whom they disclosed their information before it was disseminated to the public at large. Alternatively, Judge Wright concluded that as an employee of a broker-dealer, Dirks had violated obligations to the SEC and to the public completely independent of any obligations he acquired as a result of receiving the information.

The Supreme Court decided that the insider breaches the fiduciary duty if he acts not in the corporate interest. As to the recipient of the information he has an obligation to refrain from trading only if he knows the guilty circumstances under which the information was passed along with him. Neither Dirks nor any of his customers were agents, officers or directors of Equity Funding. Nor did they have any special relationship of trust and confidence with those with whom they traded. Dirks endeavoured to bring the fraud to the attention of the government. As per SEC, Dirks who had been considered as a tippee, collected inside
information. As he knew that it was confidential, he might disclose the information publicly or could remain abstained.

4.2.4 Carpenter vs. United States (1987)\textsuperscript{16}

R. Foster Winans, who was employed by The Wall Street Journal to write its influential “Heard on the Street” column which was a daily gossip column that focused on stock price movements and prospects. He collected his information by regularly interviewing company officials and obtained information which was presumably available to any other market researcher. In October 1983, Winans struck a deal with Peter Brant, a Kidder Peabody stockbroker to supply him with the subject matter for the column. Knowing that Winans would write a story that included the information he supplied. Brant traded on the basis of what he expected would happen to the stocks once the column hit the streets. Brant and Winans made a scheme of splitting the profits. Over a period of four month, trading on the basis of the contents of twenty-seven “Heard on the Street” columns produced a profit of $69,000 for the group. Winans claimed that his part in this scheme brought him only $31,000.

The journal had a policy by which the contents of the column were confidential to it prior to publication. But, Winans passed confidential information regarding the timing and contents of future editions of the column. Once the scheme was exposed, Brant earned profit. He was convicted of committing of securities fraud and became the government’s star witness against Winans and two other conspirators: Kenneth Felis, another Kidder Peabody stock broker-David Carpenter who was Winans room-mate. The men were convicted of mail and wire fraud and securities fraud. Of his confederates, Carpenter and Felis, the former was sentenced to three years probation and the latter; a former stockbroker was sentenced to six months imprisonment to be served on weekends.

From a detailed review of the case it was found that Winans was neither a corporate insider nor he was dealing in the securities of his employer. He was not
even the buyer or seller of the journal. But the Supreme Court broadly interpreted
the phrase requiring a 'connection with a sale or purchase of a security and
unanimously found fraud against Winans. The court also held that a financial
journalist misappropriated using information from his employer for his financial
benefit and to the financial detriment to those who used to trade with him was in
connection with the purchase or sale of securities within the terms of Rule 10b-5

This case was again appealed to the US Supreme Court which was asked
among other things to rule on whether the securities laws applied in this case. The
government argued that since the column in the journal was a central feature of the
market, the actors were operating a fraud in connection with the purchase or sale
of securities and thus Rule 10b-5 was applied. The defendant argued that the
Journal was not a direct market participant and therefore the deception was not
material to an investor. The Supreme Court unanimously agreed that the columnist
engaged in fraud. The Court quoted an earlier New York decision that ruled “it is
well established as a general proposition that a person who acquired special
knowledge or information by virtue of a confidential or fiduciary relationship with
another is not free to exploit that knowledge or information for his own personal
benefit but must account to his principle for any profit derived there from”.

Winan’s and other associate persons involved in this issue misappropriated
information belonging to the Wall Street Journal. The Journal was neither a
purchaser nor seller of the affected securities, nor did it have any financial stake in
any of the affected transactions.

4.2.5 Role of Securities and Exchange Commission (SEC) in the
context of insider trading

Both Self Regulatory Organisations (SROs) and SEC play an important role
for investigating the insider trading cases in the USA. The SEC has its
investigation department with highly technical professionals. In the course of insider trading investigations the following steps are taken by the SEC:

(a) Establishing the materiality of the case (generally a price movement of 10% or more) with obtaining price/volume trade data, contacting issuer and reviewing news releases;

(b) To identify suspicious trades, the SEC and SROs routinely analyse trading records among others in computerised format via the automated blue sheet system, namely monthly account statements, account opening documents, order tickets, price volume runs etc.,

(c) Identification of insiders and traders by the SROs and SEC. To determine material non-public information the SEC staff routinely requests chronologies from issuers, law firms, investment bankers and tender offers when information had began to create and when various persons started accusing to it. These chronologies show the locations, dates, times, participants and subject matter of relevant meeting and documents from the inception of the discussion of the material event through its public disclosure. Investing authority creates a master chronology using information from trading records, travel records, day timers, calendars, telephonic conversation and other records;

(d) Establishing connection between insiders and traders. Documents like day timers, address books, calendars, telephone records, banks records and other personnel files are extremely useful in establishing connections between insiders and outsiders;

(e) Establishing the fiduciary duty; and

(f) Setting stage for disgorgement.

Insider trading often crosses borders. A foreign national may be engaged in insider trading in the domestic market through foreign accounts or important evidence of domestic insider trading that lies outside domestic borders. Therefore successful investigations and prosecutions of these cases require international
cooperation. SEC has made 32 arrangements with foreign countries for information sharing and cooperation in the investigation and prosecution of securities law. The United States has entered into Mutual Legal Assistance Treaties (MLAT) and Memorandum of Understanding (MOU) with a number of countries including Switzerland, the United Kingdom, the Northern Ireland, the Cayman Islands, the Netherlands, Turkey, Canada, the Bahamas and Italy. The treaties generally provide for assistance of locating witness, obtaining statements and testimony of witness, production and authentication of business records and service of judicial and administrative documents.

Informants, market surveillance and spin-offs yielded the most SEC enforcement cases. Half of the insiders trading cases were detected through these three methods. Computerised surveillance systems have been adopted by the SEC, the NYSE and the National Association of Securities Dealers (NASD). These systems use statistical methods to detect unusual patterns of activity that might reflect unlawful trading.

Section 21A (e) of the Securities Exchange Act of 1934 authorises the SEC toward a bounty to a person who provides information leading to the recovery of a civil penalty from an insider trader, from a person who "tipped" information to an insider trader, or from a person who directly or indirectly controlled an insider trader. This pamphlet is designed to provide interested persons with information on bounties and the SEC rules for making a bounty application. Section 21A (e) of the Exchange Act and the SEC's bounty rules are set out at the end of this pamphlet.

Insider trading may result in enforcement action by the SEC or criminal prosecution by the Department of Justice (DOJ). The Exchange Act permits the Commission to bring suit against insider traders to seek injunctions, which are court orders that prohibit violations of the law under threat of fines and imprisonment. The Commission may also seek other relief against insider traders, including recovery of any illegal gains (or losses avoided) and payment of a civil
penalty. The amount of a civil penalty could be up to three times the profit gained (or loss avoided) as a result of insider trading.

The SEC has been permitted to make bounty awards from the civil penalties that are actually recovered from violators. With minor exceptions, any person who provides information leading to the imposition of a civil penalty may be paid as an award. However, the total amount of bounties that may be paid from a civil penalty may not exceed ten percent of that penalty.

US securities regulations have been changed for several times on the basis of verdicts by their courts. In various areas, securities market players were convicted and punished. Insider trading is one of the areas where US securities laws had been amended several times.

4.3 Selected Case Studies on Insider Trading in United Kingdom

United Kingdom (UK) is one of the first countries to enact laws against insider trading. Insider trading regulation in the UK is primarily based on the British Common Laws and various companies’ legislation in force in England and Wales. The general principles of corporate securities law apply throughout the UK and there is a little divergence in the various statutory provisions. Insider trading became a criminal offence in the UK under the Company Securities (Insider Dealing) Act, 1985. This legislation was strengthened by the passage of Part VII of the Financial Services Act, 1986. We have studied Warner’s case.

4.3.1 Warner Case (1988)²⁰

A large ring of people had dealt at the stock exchanges in the UK using price sensitive information which had been derived from more than one Crown-servant. These servants were involved in disseminating this unpublished price sensitive information. The volume of dealings in that trading is such that the value
of the shares bought and sold by its members exceeded £10 million. Warner, was a financial journalist who collected this alleged insider information. This information was leaked from government agencies. Warner was refused to disclose this information to the investigating authority. An inspector was appointed by the Secretary of the State for Trade and Industry who investigated this case as per Section 177 and 178 of the Financial Services Act, 1986. Warner placed reasonable arguments of not disclosing inside information to the inspector as a journalist.

According to the Company Securities (Insider Dealing) Act, 1985 and Part VII of the Financial Services Act Act 1986, a person fails to comply with any request made by an investigating authority any matter relevant for establishing whether or not any suspected contravention has occurred would be punishable offence. Although Warner had incurred legal cost of £100,000 and he was penalised with a fine of £20,000.

The evidence which the inspectors relied on was never fully spelt out. Their statement to the Court was criticized for its lack of particularity. But it was sufficient to convince both the Court of Appeal and the House of Lords that Warner's cooperation with the inspectors was necessary. The case then went on appeal to the House of Lords where in unanimously finding against Warner. Their Lordships emphasised the importance of the insider dealing provisions. It was noted that Section 10 of the Contempt of Court Act had no direct application to a reference under Section 178 of the Financial Services Act. The policy goal of the prevention of crime was a limitation on the breadth of the privilege enjoyed by journalists.

Warner was not a corporate insider and apparently innocent of any fraudulent activity. He had no unpublished price-sensitive information belonging to a company. However, he was punished for not disclosing inside information.
4.3.2 Role of the Financial Services Authority (FSA) in the context of insider trading

The FSA regulates the financial services industry in the UK. It is an independent non-governmental body which has been given statutory powers by the Financial Services and Markets Act 2000. It is financed by the financial services industry. The Majesty’s Treasury appoints the Board, consisting of a Chairman, a Chief Executive Officer, three Managing Directors, and eleven non-executive directors (including a lead non-executive member, the Deputy Chairman). This Board sets the overall policy of FSA. FSA sets a code which is called the Code of Market Conduct. The Code sets out in more detail the standards that should be observed by everyone who uses the UK’s markets. The Code of Market Conduct, through the Misuse of Information Act, regulates the Insider trading legislation. Through its descriptions of what is and is not acceptable. The Code brings new levels of transparency to all market users. It helps to ensure that they know where they stand and what standards are expected of them. The main objective to tackle abuse of the UK’s financial markets is to maintain the UK’s hard-earned reputation for efficient, clean and fair markets. It not only covers the insider dealing scenarios through the Misuse of Information regulation, but also extends to other type of market abuse, namely creating a false or misleading repression and distorting market. The Code was welcomed by retail investors because it would make it more difficult for others to take unfair advantage of any information they had that had not yet been made available to all investors. It should also reduce the risk of investors having the price of their investments (whether held in their pensions, or elsewhere) manipulated to their disadvantage. Inside information and other privileged knowledge can be exploited for illegitimate profit. The requirements which they have recently proposed (in CP 07/9) covering dealers, brokers and institutional sales staff aim to address the market failure which arises where insider trading undermines market confidence. The aim is to increase the
probability of successful enforcement, thus reducing the profit incentive to exploit the information asymmetry which imposes costs on third parties. They considered the possibility of imposing similar requirements on other individuals working in firms\textsuperscript{21}.

4.4. Selected Case Studies on Insider Trading in Australia

Insider trading is no new phenomenon to Australia. The Rae Committee reported on large scale insider trading in 1974. The reputation of Australian corporate players and the bullish state of the stock market in the late 1980s presented an ideal opportunity to examine the extent to which insider trading occurs in Australia. Although insider trading has been an offence under various Securities Industry Acts since 1970\textsuperscript{22}, there has not been a successful prosecution and there has been any substantial body of judicial commentary on insider trading. The National Companies and Securities Commission (NCSC) reported that as on April 28, 1989 it had undertaken 50 inquiries into alleged insider trading activity. During the same period Corporate Affairs Commissions (CAC) undertook a total of 82 insiders trading inquires. In our study we have undertaken Rivkin’s case.

4.4.1 Rivkin Case (2004)\textsuperscript{23}

Mr. Rivkin wished to sell a house in the eastern suburbs of Sydney and instructed a real estate agent, Mr. Doff, to act on his behalf. Mr. Gerard McGowan, the executive chairperson of Impulse Airlines, was interested in purchasing the house and approached Mr. Doff and the group operations manager of the Rivkin group of Companies, Mr. Dassakis.

On April 24, 2001, Mr. Doff and Mr. Dassakis arranged a telephone call with Mr. Rivkin. Mr. McGowan informed Mr. Rivkin by telephone that he was interested in buying the house, but made a conditional offer that he was currently trying to sell his business. When pressed for further details, he informed Mr.
Rivkin (as well as Mr. Doff and Mr. Dassakis) that he was trying to ‘merge’ Impulse Airlines with Qantas and was awaiting approval from the Australian Competition and Consumer Commission (ACCC) for that deal. Mr. Rivkin told Mr. McGowan that he did not believe that the ACCC would approve such a transaction, but Mr. McGowan informed Mr. Rivkin that he believed that ACCC approval would be forthcoming. Mr. McGowan told Mr. Rivkin that he could not trade in Qantas shares, because of the knowledge Mr. Rivkin now possessed about the proposed deal between Impulse Airlines and Qantas. Mr. Rivkin agreed to give Mr. McGowan a seven-day conditional contract to buy the property, which ultimately did not proceed.

Within a matter of hours of the telephone conversation, Mr. Rivkin gave instructions to a SEATS (Simulation Environment for the Analysis of the Tactical Situation) operator with Rivkin Discount Stock broking to purchase 50,000 Qantas in the name of Rivkin Investments. Mr. Rivkin was the sole director of Rivkin Investments and had a shareholding interest of 11%. On May 01, 2001, on Mr. Rivkin’s instructions, the Qantas shares were sold for a profit of $2,664.94. Later the same day, Qantas shares were subject to a temporary trading halt, and Impulse Airlines and Qantas then made a joint announcement that they had entered into a ‘virtual or contractual merger’ (although the actual transaction entered into was not a true merger of the two companies). Following the joint announcement there was a significant rise in the Qantas share price. As Rivkin Investments had already sold its Qantas shares prior to the joint announcement, it did not receive the benefit of that rise in the Qantas share price, although there had been a price-rise during the period in which Rivkin Investments had bought and sold Qantas shares.

Rivkin was charged and prosecuted for insider trading in relation to the purchase and sale of the Qantas shares by Rivkin Investments. Following a jury trial and conviction for insider trading in the South Wales Supreme Court on April 30, 2003, Mr. Rivkin was fined $30,000 and sentenced to 9 months’ periodic detention by Whealy J, on May 29, 2003. Incidentally, insider trading
proceedings were also brought against Mr. Rivkin's real estate agent, Mr. Doff, in relation to purchase of 20,000 Qantas shares by a company Mr. Doff controlled on 24 April 2001. Mr. Doff was convicted of insider trading charges in the Supreme Court of New South Wales on November 19, 2004 and on February 11, 2005 and was sentenced to 350 hours of community service and ordered to pay a pecuniary penalty of $37,255.25. The maximum penalty which could have been imposed in such case was a fine of $200,000 or imprisonment upto 5 years or both.

Mr. Rivkin appealed against the conviction and sentence to the New South Wales Court of Criminal Appeal, which delivered its judgement on February 2004. The conviction and sentence were both upheld. This case considers the role of the courts in interpreting difficult legislative provisions such as the laws regulating insider trading. This case has provided a rare opportunity for judicial review and consideration of the insider trading offence, which has long been considered an extremely difficult offence to prosecute.

The judgement of the New South Wales Court of Criminal Appeal examined several aspects of the insider trading offence. The most and consequential of which were:

(a) whether the source of information can form part of the information itself;
(b) whether information must be received under an obligation of confidence;
(c) whether the tests to determine what an alleged insider trader knew or ought to have known are subjective or objective in nature and whether the source of information is relevant to its level of materiality.
4.4.2 Role of National Companies and Securities Commission (NCSC) in the context of insider trading

The Australian Securities & Investments Commission (ASIC) is an independent government body that acts as Australia’s corporate regulator. ASIC’s role is to enforce and regulate company and financial services laws to protect Australian consumers, investors and creditors. ASIC was originally formed as the Australian Securities Commission (ASC), which came into being on January 1, 1991 in accordance with the ASIC Act 1989. The purpose of ASIC was to unify corporate regulators around Australia by replacing the National Companies and Securities Commission and the Corporate Affairs Offices of the states and territories.

Besides, National Companies and Securities Commission (NCSC) and Corporate Affairs Commission (CAS) are responsible for investigating insider trading cases in Australia. NCSC has its own surveillance mechanism to inquire insider trading cases. In Australia, (i) there is no requirement to demonstrate that the alleged insider trader used inside information (or a defence of non-use of inside information); (ii) information no longer needs to be specific and (iii) there remains no longer any distinction between ‘primary’ and ‘secondary’ insiders.

The Corporations and Markets Advisory Committee (CMAC) is constituted under Part 9 of the Australian Securities and Investments Commission Act 2001. CMAC has submitted a report on insider trading to the Australian Government which covers various issues. The Advisory Committee recommends that the legislation be strengthened by: (i) enhancing the provisions requiring directors to notify trading in securities of their companies or any related companies and extending that disclosure requirement to senior executives; (ii) restricting the on-selling exemption for underwriters; (iii) repealing the exemption for external
administrators; (iv) clarifying that the relevant time for determining liability when trading takes place through an intermediary is when the informed person instructs the intermediary to undertake the transactions; (v) permitting courts to extend the range of civil claimants beyond the insider’s immediate counterparty. The Committee also recommends legislative changes to overcome apparent anomalies in the current law by: (a) extending the Chinese Walls defence to procuring; (b) extending the equal information defence to civil proceedings (c) extending the ‘own intentions’ defence to anyone trading on behalf of a takeover bid consortium (d) protecting uninformed procured persons from civil liability where the procurer receives no direct or indirect benefit. A majority of the Advisory Committee also recommends: (i) replacing the test of generally available information and (ii) permitting the exercise of physical delivery option rights.

4.5 Conclusions

In TGS case, the corporate insiders earned profit through buy and sale of securities as well as options on the basis of unpublished price sensitive information. They violated provisions of the Section 10(b) and Rule 10b-5 of the Securities and Exchange Act, 1934. Chiarella was neither an employee nor an officer or director of any of the companies in whose stock he traded. But he was convicted of violating Rule 10b-5 by trading on the basis of material nonpublic information. The US Court applied the principle of equal access to information-based on disclosure or abstinence rule. In another case Dirks was convicted because he breached confidentiality of information. Class action suits were brought against Winans and associates including Carpenter.

The SEC enjoys a high level of credibility in the US and is highly regarded and respected both by the Government and the Courts there. On its part, the SEC makes full use of its powers to promulgate and enforce laws. The SEC went ahead
and used its law-making powers to introduce major amendments to the existing Rules 10b5-1 and 10b5-2 with effect from October 23, 2000 providing that mere possession of non-public information would suffice to charging a person with insider trading and that its ‘use’ in share market dealings need not be proved.

The US Supreme Court plays an important role for regulating insider trading practices. The Court supported the SEC’s decision that anyone in possession of insider information is required either to disclose the information publicly or to keep himself abstained from trading. Two theories have been developed in USA. One is traditional theory and the other one is misappropriation theory.

In UK the Financial Services Authority sets insider trading regulations and the UK securities market regulators are most proactive to combat this crime. In Australia there is no requirement to demonstrate that the alleged insider trader ‘used’ the inside information (or a defence of ‘non-use’ of inside information). In that country information is not required to be specific and there remains no distinction between primary and secondary insiders.
Notes and References


2 Keeping an official check on the behaviour of people found guilty of crime as an alternative to sending them to prison

3 SEC vs. Texas Gulf Sulphur Co. (1968), 401, F. 2d. 833 (2d Cir.) at 849

4 Equipment for special purpose

5 Quality checking of metals


7 The word ‘seminal’ is the adjective of the word semen. Semen is the root cause of a child’s birth. TGS is a path breaking or landmark case of insider trading in the securities market

8 Rule 10b-5 provides: it shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (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 to (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.

10 Section 10(b) provides that be it shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, to use or employ, in connection with purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive or contrivance in contravention of such rules and regulations as the SEC may prescribe as necessary or appropriate in the public interest or for the protection of the investors.

11 Disclosure or abstain rule: An insider in possession of material non-public information must disclose such information before trading or if disclosure is impossible or improper, abstain from trading.


13 Rule 14e-3 prohibits ‘transactions in securities on the basis of material, non-public information in the context of tender offers”. Once a tender offer has commenced (substantial steps toward the commencement of a tender offer are sufficient), this rule prohibits trading by any person on the basis of material information which he knows or has reason to know is non-public and which he knows or has reason to know was acquired directly or indirectly from the offering person, the issuer of the securities sought, any officer, director, partner, employee
or any other person acting on behalf of the offeror or the issuer. Trading is prohibited until a reasonable time after the public release of such information.

14 Dirks vs. SEC 463 U.S. 646, 77 L. Ed. 2d. 911, 103 Supreme Court, 3255(1983)

15 One might think that Dirks deserved a medal, one suspects Mr. Dirks definitely felt that way


18 Spin Off: A type of sell-off in which a parent company distributes shares on a pro rata basis to its shareholders. These new shares give shareholders ownership rights in a division or part of the parent company that the sold off entity


21 Investment managers without dealing authority, research analysts, corporate finance advisors, and retail financial advisors
22 For example, section 75A Securities Industry Act 1970 [New South Wales]


24 ibid


26 Corporations Act, 2001, Section -1311 and Schedule 3 (Cth)