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## Toward the Unification of European Capital Markets: The EEC's Proposed Directive on Insider Trading

Christine A. McGuinness\*

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# Toward the Unification of European Capital Markets: The EEC's Proposed Directive on Insider Trading

Christine A. McGuinness

## **Abstract**

Part I of this Note examines the EEC's plan to establish a unified European capital market by 1992 and introduces the proposed directive. Part II discusses the current status of insider trading regulations in the Member States and focuses primarily on legislation in France and the United Kingdom. Part III analyzes the proposed directive and provides a brief comparison to the current U.S. regulatory framework. This Note concludes that the Commission's proposed directive provides a workable framework for formulating uniform regulations. However, if the ban on insider trading in the Community is to be effective, the proposal will have to mandate stronger mechanisms for enforcement.

## NOTE

### TOWARD THE UNIFICATION OF EUROPEAN CAPITAL MARKETS: THE EEC'S PROPOSED DIRECTIVE ON INSIDER TRADING

#### INTRODUCTION

The growing internationalization of the world's capital markets has made market surveillance and the enforcement of securities regulations more difficult.<sup>1</sup> Recent insider trading scandals have emphasized the urgent need to safeguard the integrity of globalized securities trading.<sup>2</sup> In an international market, nations and securities markets must cooperate to ensure equivalent regulatory treatment and to expedite the enforcement of fraudulent and illegal transactions.

In April 1987 the Commission of the European Community<sup>3</sup> ("EEC" or "Community") adopted a proposal aimed at establishing uniform legislation coordinating insider trading regulations among the EEC Member States. The proposal, which is subject to Council approval, is patterned on existing legislation in France and the United Kingdom and is part of a master plan designed to create a unified financial market in the

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1. Internationalization of the Securities Market, Exchange Act Release No. 21,958, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,759, at 87,393 (Apr. 18, 1985).

2. In 1986 American arbitrageur Ivan Boesky was linked to the British Guinness Company scandal, which centered on that company's illegal payments to investors in return for the purchase of large blocks of stock so as to increase its bid in a takeover offer. *U.K. Launches an Investigation into Guinness*, Wall St. J., Dec. 2, 1986, at 37, col. 1. In 1986 Guinness Company reported taking a US\$200,000,000 charge related partly to its involvement with Boesky. *Guinness Takes \$200M Charge Due to Boesky*, *Newsday*, Apr. 24, 1987, at 45, col. 1.

Perhaps more significant is the recent decision of Israeli businessman David Sofer to cooperate in an international insider trading scheme involving high-ranking former Merrill Lynch official Nahum Vaskevitch. Allegedly, Vaskevitch leaked "confidential information about numerous transactions involving Merrill Lynch clients" to the Israeli. Hertzberg, *Israeli Will Aid Trading Inquiry, Sources Assert*, Wall St. J., July 2, 1987, at 3, col. 4.

3. The EEC currently comprises twelve Member States: Belgium, Denmark, Federal Republic of Germany, France, Great Britain, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain. See Treaty Between the Member States of the European Communities and the Kingdom of Spain and the Portuguese Republic to the European Economic Community and to the European Atomic Energy Community, O.J. L 302/9 (1985), 1 Common Mkt. Rep. (CCH) ¶ 101, at 114-15.

Community by 1992.<sup>4</sup>

This Note argues that uniform insider trading laws in the EEC are essential to ensure maximum investor protection in its unified financial market. Part I of this Note examines the EEC's plan to establish a unified European capital market by 1992 and introduces the proposed directive. Part II discusses the current status of insider trading regulations in the Member States and focuses primarily on legislation in France and the United Kingdom. Part III analyzes the proposed directive and provides a brief comparison to the current U.S. regulatory framework. This Note concludes that the Commission's proposed directive provides a workable framework for formulating uniform regulations. However, if the ban on insider trading in the Community is to be effective, the proposal will have to mandate stronger mechanisms for enforcement.

### I. EEC PLAN TO CREATE A UNIFIED FINANCIAL MARKET

The Commission's proposal on insider trading is part of a larger program being implemented with a view toward establishing a Community-wide financial market.<sup>5</sup> The Treaty of Rome<sup>6</sup> calls for the removal of all restrictions on the movement of capital in the Community. This so-called liberalization of capital is designed to establish a free internal capital market.<sup>7</sup> The European Single Act has since targeted completion

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4. *Unified Financial Market: The European Commission Proposes EEC Standards Against Insider Trading Operations on the Stock Exchanges*, E.C. BULL. No. 4539 (new Series), at 9 (Apr. 29, 1987). The proposed directive will now have to be reviewed by the European Parliament and by the Social and Economic Committee and it is expected to be issued officially sometime in 1988. If such is the case, Member States will have until 1992 to implement the legislation. De Bandt, Van Hecke & Lagae, *Recent Belgian and European Community Law*, Vol. I, No. 4, at 1 (May 1987) (newsletter).

5. Proposal for a Council Directive Coordinating Regulations on Insider Trading, COM(87) 111 final, at 3, *Common Mkt. Rep.* ¶ 10,880, at 12,126 (May 21, 1987) [hereinafter COM(87) 111 final].

6. Treaty Establishing the European Economic Community, Mar. 25, 1957, 1973 Gr. Brit. T.S. No. 1 (Cmd. 5179-II) (official English trans.), 298 U.N.T.S. 11 (1958) (unofficial English trans.) [hereinafter EEC Treaty].

7. The EEC has invoked this "right of establishment" to develop its Company Law Harmonization Program, which is designed to protect employees, shareholders, and the general public against corporate misconduct. The Commission has formulated a number of directives dealing with this subject and the Council has adopted several directives aimed at coordinating the Member State's laws. Correlator, *Free Movement of Persons—Business—Capital*, *Common Mkt. Rep.* (CCH) ¶ 1000, at 1008.

of this unified market for 1992.<sup>8</sup>

### A. *Globalization*

The economic growth of advanced industrial nations, the expanding needs of multinational corporations, and the severe indebtedness of third world nations have all contributed to an overwhelming demand for capital throughout the world.<sup>9</sup> Securities are now being traded simultaneously on a variety of national exchanges.<sup>10</sup> Spurred by high-tech computers and old-fashioned greed, trading volumes have soared and financial deregulation and experimentation have extended into worldwide capital markets.<sup>11</sup> The development of the Eurobond market has provided new sources of capital to both U.S. and non-U.S. companies.<sup>12</sup> Eurobonds totalled 135.4 billion issues during 1985, nearly nine times the 1983 total, with the first three months of 1986 setting a record of 146.7 billion.<sup>13</sup> The annual trading volume has increased sevenfold over the last five years to an estimated 1.5 trillion.<sup>14</sup> The world's financial markets have also witnessed several multinational equity offerings. The US\$7.96 billion British Gas multinational offering of December 8, 1986, was the largest equity underwriting in history.<sup>15</sup> As a result of this growth, investors are increasingly purchasing foreign securities and national exchanges are taking steps to accommodate this new era of

8. Single European Act art. 13, O.J. L 169/1, at 7 (1987).

9. See Gill, *The Emerging Global Equity Market: Dimensions and Issues*, 4 B.U. INT'L L.J. 1, 39-53 (1986).

10. Internationalization of the Securities Markets, *supra* note 1, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,759, at 87,393.

11. Bianco, *Must the Panic Get Worse to Spark Reform?*, BUS. WEEK, Nov. 9, 1987, at 46.

12. Ketchum, *Internationalization of the Securities Markets*, in INTERNATIONAL SECURITIES ACTIVITIES OF BANKS, FINANCIAL INSTITUTIONS AND COMPANIES 4 (E. Greene, R. Ketchum & L. Quinn chairmen 1987).

13. *Id.*

14. *Id.* The success of the Eurobond market has since led to the development of a Euroequity market, which provides the international financial community with an equity-raising vehicle. In the first five months of 1986, there were 23 euroequity offerings in the U.S. totaling US\$1.7 billion. *Id.* at 6. Canadian and European issuers were the front-runners in this market. *Id.* The U.S., has recently begun participating on a regular basis, issuing US\$122.4 million in 1985 and over US\$605 million in the first half of 1986. *Id.*

15. *Id.* at 5.

globalized trading.<sup>16</sup>

The international investor is afforded varying degrees of protection throughout the world. Insider trading regulations range from strict legislation to complete absence of formal restrictions. This lack of uniformity has led to serious enforcement problems.<sup>17</sup> For instance, nonpublic sensitive information concerning a U.S. issuer may not be deemed inside information in another nation. If a non-U.S. resident in possession of such information effects a transaction in a U.S. security through his or her national market, U.S. regulatory officials may be hindered by the other country's application of its own securities laws.<sup>18</sup>

The United States and the United Kingdom have recently addressed this issue. The British Department of Trade and Industry ("DTI"), the U.S. Securities and Exchange Commission ("SEC"), and the U.S. Commodities Futures Trading Commission have agreed to cooperate in monitoring insider trading and other securities fraud on their exchanges.<sup>19</sup> In 1977, the EEC also established a Code of Conduct that recommended similar cooperation in investigating suspected cases of insider trading in the Member States.<sup>20</sup> If the EEC can effectively coordinate the insider trading regulations of its Member States through this proposed directive, the world's financial markets will be that much closer to global cooperation.

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16. *Id.*

17. See Grass, *Internationalization of Securities Markets*, 9 HOUSTON INT'L L.J. 17, 18 (1986).

18. *Id.* at 49.

19. Memorandum of Understanding on Exchange of Information Between the SEC, CFTC, and the United Kingdom Department of Trade and Industry in Matters Relating to Securities and Futures, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,027 (Sept. 23, 1986). Recently, a British High Court ruled that a London journalist was not obligated to divulge to government inspectors the sources of his two accurate predictions as to the government's disposition of reviewed takeover bids. *Lindsay v. Warner*, slip op. (C.A. May 6, 1987) (LEXIS, Enggen library, Cases file). It has been argued that this decision has impaired British investigatory efforts in security fraud cases and, in turn, has hampered future American requests for information under this accord. See Note, *The British-U.S. Memorandum of Understanding of 1986: Implications After Warner*, 11 FORDHAM INT'L L.J. 110 (1987).

20. O.J. L 212/37 (1977). The Code was recommended to the Community in 1977. *Id.* Rule 9 of the Code prohibits transactions conducted on the basis of inside information. *Id.*

B. *The Commission's Proposed Directive Coordinating Insider Trading Regulations In The EEC*

The EEC's proposed directive on insider trading is based on the premise that the proper functioning of the securities markets depends on the degree of confidence that they inspire in investors.<sup>21</sup> Because the prices quoted should reflect the true factors of supply and demand, all possible measures must be taken to ensure equal access to any relevant information regarding a company or its stock.<sup>22</sup> Consistent with this policy, the proposal is designed to provide an essential supplement to directives in the securities area that have already been adopted or are under consideration by the Council.<sup>23</sup>

The proposed directive on insider trading is designed to cover a broad category of "insiders." It applies to "primary insiders," namely, those who obtain privileged information in the context of their function or profession, as well as to "secondary insiders," or "tippees," who knowingly receive privi-

21. COM(87) 111 final, *supra* note 5, at 2, Common Mkt. Rep. (CCH) ¶ 10,880, at 12,126.

22. *Id.* at 1, Common Mkt. Rep. (CCH) ¶ 10,880, at 12,126.

23. *Id.* at 3, Common Mkt. Rep. (CCH) ¶ 10,880, at 12,126. In March 1979, the Council passed Directive No. 79/279 to coordinate the conditions for the admission of securities to official stock exchange listings. Council Directive No. 79/279, O.J. L 66/21 (1979), 1 Common Mkt. Rep. ¶ 1721. The Council Directive is the most common type of EEC legislation. The Commission is responsible for introducing a proposal for consideration as a directive. The Treaty of Rome mandates that the Council consult the Assembly and the Economic and Social Committee before considering the Commission's proposal. EEC Treaty, *supra* note 3, art. 193,298 U.N.T.S. at 79. Once a proposal is adopted as a directive, the Member States usually have a period of two years to comply. If a Member State fails to comply, the Court of Justice will order compliance. Cruickshank, *Insider Trading and the EEC*, 10 INT'L BUS. L. 345 (1982).

Other directives include Directive No. 80/390 to coordinate the requirements for the drafting, scrutiny, and distribution of the listing particulars that must be published in order for a security to be admitted to an official exchange. O.J. L 100/1 (1980), 1 Common Mkt. Rep. (CCH) ¶ 1731. In 1982, the Council issued Directive No. 82/121, which requires companies that have shares listed on an official stock exchange to publish information on a regular basis. O.J. 48/26 (1982); 1 Common Mkt. Rep. (CCH) ¶ 1741. Finally, in 1985 the Commission submitted a proposal for a directive requiring companies to publish major changes in the ownership of their capital. The Council has to formally address this proposal. Proposal for a Council Directive on Information to be Published when Major Holdings in the Capital of a Listed Company are Acquired or Disposed of, COM(85) 795 final, O.J. C 351/35 (1985).

leged information from a primary insider.<sup>24</sup>

The term "privileged information" is defined by the proposed directive as information that is confidential or nonpublic, specific in nature, and is likely to have a material effect on the quotation of a security once it is publicly disclosed.<sup>25</sup> This information must also "relate to one or more issuers of securities or to one or more securities."<sup>26</sup>

Insiders are prohibited from taking advantage of such information by directly buying or selling a listed security, and are also forbidden from engaging in off-market transactions that are carried out through a professional intermediary, such as a bank, stockholder, or dealer.<sup>27</sup> Insiders may disclose privileged information only if it is necessary to do so in the course of their profession or duties.<sup>28</sup> Finally, a ban is imposed on the practice of "tipping," which prohibits an insider from recommending a listed security to a third party on the basis of inside information.<sup>29</sup>

To detect violations of insider trading and to identify those responsible for such violations, the proposed directive stipulates that each Member State must designate authorities to monitor the application of the proposal's provisions.<sup>30</sup> In addition, the directive provides for the establishment of a Contact Committee at the Community level, which would organize an institutionalized exchange of information between the Member States to suggest additional measures to combat insider trading.<sup>31</sup> The EEC first adopted Contact Committees in the directives containing rules for admission to the stock exchanges.<sup>32</sup> These committees are composed of persons appointed by the Member States and representatives of the Com-

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24. COM(87) 111 final, *supra* note 5, at 4, Common Mkt. Rep. (CCH) ¶ 10,880, at 12,126.

25. *Id.* at 5, Common Mkt. Rep. (CCH) ¶ 10,880, at 12,126.

26. *Id.*

27. *Id.* at 5-6, Common Mkt. Rep. (CCH) ¶ 10,880, at 12,126.

28. *Id.*

29. *Id.* at 6, Common Mkt. Rep. (CCH) ¶ 10,880, at 12,126.

30. *Id.*

31. *Id.* at 9, Common Mkt. Rep. (CCH) ¶ 10,880, at 12,126-27.

32. See Council Directive No. 79/279, art. 20, O.J. L 66/21, at 24-25 (1979), 1 Common Mkt. Rep. ¶ 1752A (designated art. 25). Article 20 of this directive describes the function of the Contact Committee as facilitating the harmonized implementation of the directive through regular consultations on any practical problems arising from its application and on which exchanges of view are deemed useful. *Id.*



mission who serve as chairpersons.<sup>33</sup>

The EEC's proposed directive establishes basic standards. Member States may establish stricter national rules provided that these rules do not favor one state over another.<sup>34</sup> However, since the proposal does not include sanctions, each Member State is to mandate its own form of punishment.<sup>35</sup>

## II. *INSIDER REGULATIONS IN THE MEMBER STATES TODAY*

A review of the current status of insider trading regulations in the Community reveals marked differences among the Member States. At present, only the United Kingdom, France, and Denmark have enacted official insider trading statutes. The Federal Republic of Germany, however, has introduced a comprehensive set of voluntary rules prohibiting the exploitation of inside information. Belgium, the Netherlands, and Ireland have formulated proposed legislation. The remaining Member States have left insider trading virtually unregulated.

### A. *Existing Laws: The United Kingdom, France, Denmark, and the Federal Republic of Germany*

#### 1. The United Kingdom

Insider trading was not a crime in the U.K. until 1980.<sup>36</sup> In 1985 the Company Securities (Insider Dealing) Act<sup>37</sup> (the "1985 Act") was passed to strengthen prosecutorial powers by imposing criminal sanctions on those convicted of insider trading in listed and advertised securities. This legislation was amended by the Financial Services Act in 1986<sup>38</sup> and may in-

33. *Id.*

34. E.C. BULL. No. 4539 (new series), at 9 (Apr. 29, 1987). As a matter of principle, the Commission considers the penal law an exclusive prerogative of each Member State. De Bandt, Van Hecke & Lague, *supra* note 4, at 2. Thus, a Member State may only decide to provide for civil sanctions in its legislation. *Id.*

35. *Id.*

36. See Read, *How To Avoid Going Inside*, Bus., Dec. 1986, at 32. Insider trading in the United Kingdom is commonly referred to as insider dealing. *Id.*

37. Company Securities (Insider Dealing) Act 1985, ch. 8.

38. Financial Services Act 1986, ch. 60. The 1985 Act, ch. 8, supplanted the Companies Act 1981, ch. 62, regarding securities fraud, and the 1986 Financial Services Act, ch. 60, elaborated on these violations.

clude civil sanctions.<sup>39</sup>

The 1985 Act addresses dealings on the National Stock Exchange. However, certain off-market deals are also scrutinized. These include "advertised securities" through a professional dealer on the over-the-counter market, and dealings on recognized investment exchanges established under the Financial Services Act.<sup>40</sup>

The 1985 Act defines an insider as any individual who has been knowingly connected with a company during the prior six months and who holds information: (a) by virtue of his relationship with the company; (b) that it would be reasonable to expect him not to disclose; and (c) that he knows is nonpublic and price-sensitive.<sup>41</sup> The definition is also extended to secondary insiders or tippees who receive information from primary insiders in connection with a business or professional relationship that they suspect should not be disclosed.<sup>42</sup>

The definition of "price-sensitive information" is made up of three components. First, the information must relate to specific matters concerning the company.<sup>43</sup> Second, the information must be likely to affect the price of a company's security if disclosed.<sup>44</sup> Finally, the information must not be generally known to those who are likely to deal in the company's securities.<sup>45</sup>

Generally, an exchange or takeover panel will first conduct an investigation when insider trading is suspected and then turn over the results to the Department of Trade and Industry.<sup>46</sup> If there is enough evidence to warrant a public prosecution, the DTI will forward the matter to the Director of Public Prosecutions for official consent.<sup>47</sup>

An individual who violates the 1985 Act faces imprison-

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39. Financial Services Act 1986, ch. 60, § 62; see Read, *supra* note 36, at 32 (explaining section 62).

40. Financial Services Act 1986, ch. 60, § 174(3).

41. Company Securities (Insider Dealing) Act 1985, ch. 8, § 1. See generally J. ROBINSON, INTERNATIONAL SECURITIES LAW AND PRACTICE (1985).

42. J. ROBINSON, *supra* note 41, at 264-65.

43. Company Securities (Insider Dealing) Act 1985, ch. 8, § 10(a).

44. *Id.* § 10(b).

45. *Id.* § 10(b).

46. *Id.* § 10(b).

47. *Id.* § 8(2).

ment for a term not exceeding two years and/or a fine.<sup>48</sup> The opportunity to seize all of the insider's profits is not excluded because the English courts have general power to award compensation in criminal proceedings.<sup>49</sup> In addition, the Financial Services Act of 1986 creates new opportunities for investors wishing to bring an action for damages. The Act permits civil actions by any party that has suffered a loss as a result of a contravention of the rules made by regulatory authorities and any of the self-regulating organizations.<sup>50</sup>

Britain's new laws were tested for the first time in July 1987, when Geoffrey Collier, a director of London's Morgan Grenfell PLC securities unit, was convicted of insider trading.<sup>51</sup> Collier had traded stock in AE PLC and Cadbury Schweppes PLC with the nonpublic knowledge that each of these companies was a possible target of Morgan Grenfell clients.<sup>52</sup> Much to the public's surprise, Collier drew the lenient penalty of a one-year suspended sentence and a fine of US\$40,450.<sup>53</sup>

## 2. France

In France, two types of individuals are prohibited from insider trading: "direct" and "indirect" insiders.<sup>54</sup> Direct insiders include the chairman/president, the general managers, members of the executive committee, the board of directors and their representatives, and the spouses of such officials.<sup>55</sup> Indirect insiders include all individuals who, as a result of their

48. *Id.* § 8(1)(a); see *Civil Liability Under the Financial Services Act*, INT'L FIN. L. REV., July 1987, at 6. According to Kate Mortimor, the Head of Policy at the Securities and Investments Board, the British investment firms are verging on a state of paranoia, fearing all kinds of "malicious civil actions." *Civil Liability Under the Financial Services Act*, *supra*, at 6. They appear to be particularly worried about rules that may be too subjective, such as those requiring firms to use best efforts. *Id.*

49. *Civil Liability Under the Financial Services Act*, *supra* note 48, at 6.

50. Financial Services Act 1986, ch. 60, § 174(3).

51. Forman, *Lenient Penalty in Insider Trading Case Threatens U.K. Crackdown's Credibility*, Wall St. J., July 6, 1987, at 8, col. d. In delivering the sentence, Judge Farquharson said that Collier was a "first time offender" and should not be made a scapegoat for all of London's financial misconduct. *Id.*

52. *Id.*

53. *Id.*

54. Law No. 70-1208, Dec. 23, 1970, art. 4, 1970 Journal Officiel de la Republique Francaise [J.O.] 11,981; see J. ROBINSON, *supra* note 41, at 127.

55. 1967 Dalloz-Sirey, *Legislation* [D.S.L.] 42 (adding Art. 162-1 to Law No. 66-537, July 24, 1966, 1966 J.O. 6402).

profession, have access to privileged information about a company or its securities.<sup>56</sup> Unlike the EEC's proposed directive and British law, the French regulations do not include tippees outside the insider's immediate family.<sup>57</sup> However, those insiders who knowingly allow someone else to take advantage of price-sensitive information are also guilty of a penal violation.<sup>58</sup>

Information that has not been made sufficiently public and that refers to the technical, commercial, or financial state of a company is considered "price-sensitive privileged information."<sup>59</sup> In addition, the Paris Cour d'appel has ruled that trading is prohibited only when the information is "precise, special and certain."<sup>60</sup>

The Commission des Operations de Bourse ("COB"), an authoritative body that supervises the French securities exchanges, is not permitted by law to introduce proceedings or appear as plaintiff in actions regarding securities violations.<sup>61</sup> Thus, when the COB suspects that insider trading has occurred, it turns the investigation over to the public prosecutor.<sup>62</sup>

Anyone convicted of insider trading in France faces a maximum prison term of two years and/or a fine ranging from Ffr. 6,000 to Ffr. 5,000,000.<sup>63</sup> The fine may be increased to four times the amount of profit when that profit exceeds the statutory fine.<sup>64</sup>

In 1967 the COB was created to oversee Paris's capital markets. The COB was relatively inactive until the Socialist government gave it new muscle.<sup>65</sup> In April 1984, the COB in-

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56. 1971 D.S.L. 17 (adding Art. 10-1 to Ordinance No. 67-833, Sept. 28, 1967, 1967 J.O. 9589) [hereinafter Art. 10-1].

57. *Id.*

58. *Id.*

59. Note, *Insider Trading and the EEC: Harmonization of the Insider Trading Laws of the Member States*, 8 B.C. INT'L & COMP. L. REV. 151, 172 (1985) (citing Art. 10-1, *supra* note 56).

60. *Id.* at 173 (citing Judgment of May 26, 1977, Cour d'appel, Paris, 1978 Juris-Classeur Periodique No. 18,789 (2d case)).

61. J. ROBINSON, *supra* note 41, at 128.

62. *Id.*

63. Art. 10-1, *supra* note 56; see J. ROBINSON, *supra* note 41, at 128.

64. Art. 10-1, *supra* note 56; see J. ROBINSON, *supra* note 41, at 128.

65. Karel & Sygma, *France's Securities Watchdog Grows at Insiders*, BUS. WEEK, Nov. 19, 1984, at 142. In an effort to develop the French economy, the French govern-

investigated a run-up in the share price of French arms manufacturer Thomson-CSF.<sup>66</sup> The surge occurred ten days before the government-controlled company won a US\$4.2 billion contract from Saudi Arabia.<sup>67</sup> The investigation led to the criminal indictment of a top French Defense Ministry official.<sup>68</sup> The French officials have since recognized the need to police the Bourse in an effort to attract more foreign investors.<sup>69</sup>

### 3. Denmark

Insider trading legislation was introduced in Denmark in June 1986 as part of the country's new stock exchange rules. The legislation does not distinguish between insiders and outsiders and is designed to reach "anyone who trades on information about a company or its stock that has not yet been made public."<sup>70</sup>

Violators face criminal penalties of a fine of an unlimited amount.<sup>71</sup> The legislation will be enforced by the Stock Exchange in Copenhagen, which will further all suspected cases to the Bank Inspectorate.<sup>72</sup>

### 4. The Federal Republic of Germany

In 1970 the Federal Republic of Germany devised a voluntary set of Insider Trading Guidelines, which were amended in 1976.<sup>73</sup> Semi-Official Commentaries and a Code of Procedure were adopted along with the Guidelines and were subsequently revised in 1976.<sup>74</sup>

Insiders and third parties "on an equal footing" may not

ment has begun a privatization program in which it is offering equity securities of 65 state-owned companies over the next five years to provide French companies freer rein to compete internationally. Greenhouse, *France Embraces Popular Capitalism*, N.Y. Times, June 8, 1987, at D10, col. 1.

66. Karel & Sygma, *supra* note 65.

67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.*

71. Telephone interview with Klaus Struwe, Secretary General of the Stockbrokers Association of Copenhagen (Nov. 13, 1987) (author's notes on file at the *Fordham International Law Journal* office).

72. *Id.*

73. Hopt, *The German Insider Trading Guidelines—Spring Gun or Scarecrow?* 8 J. COMP. BUS. & CAPITAL MARKETS L. 381, 382 (1986).

74. Hopt, *supra* note 73, at 391.

engage in insider trading or cause transactions to be effected in securities while exploiting privileged information that they have obtained via their positions.<sup>75</sup>

Insiders include: (a) legal representatives and members of the supervisory board of the company; (b) any such representatives of connected domestic companies; (c) domestic shareholders, including their legal representatives and supervisory board members, where they have more than a twenty-five percent interest in the company; and (d) employees of the company and of domestic companies connected with it and twenty-five percent shareholders in connected domestic companies.<sup>76</sup>

Third parties "on an equal footing" with insiders include "banks, their supervisory board members, managing directors and employees, who . . . are brought in and thereby obtain knowledge of inside information."<sup>77</sup> There is no mention of tippers in these rules because of the contractual nature of compliance.<sup>78</sup>

The Insider Trading Guidelines are currently enforced by review boards established at the various German stock exchanges.<sup>79</sup> Once the board holds a hearing, an outside panel appointed by the committee begins the investigations.<sup>80</sup> These investigators include accountants, auditors, or members of management.<sup>81</sup> At the principal hearing all the facts are evaluated and a formal decision is rendered.<sup>82</sup> The review panels, however, do not have the authority to determine the type of legal sanctions that should be imposed.<sup>83</sup>

A company wishing to bring an action for damages must be able to produce the contract that recognizes the insider's submission to the Insider Trading Guidelines.<sup>84</sup>

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75. Insider Trading Guidelines § 2 (G. Wegen trans. 1985), *reprinted in* J. ROBINSON, *supra* note 41, at 108 [hereinafter Insider Trading Guidelines].

76. *Id.* § 2, *reprinted in* J. ROBINSON, *supra* note 41, at 108.

77. *Id.* § 2, *reprinted in* J. ROBINSON, *supra* note 41, at 109.

78. Hopt, *supra* note 73, at 384.

79. Insider Trading Guidelines, *supra* note 75, § 3, *reprinted in* J. ROBINSON, *supra* note 41, at 109.

80. Hopt, *supra* note 73, at 390-91.

81. *Id.*

82. *Id.*

83. *Id.*

84. Hopt, *supra* note 73, at 388.

The principal sanction requires the wrongdoer to return all pecuniary profits to the company that has been damaged by the insider's transactions.<sup>85</sup> This includes all asset advantages obtained from the violation, including avoided losses to the company.<sup>86</sup>

In February 1987, West Germany's largest shareholders association called for a tightening of the country's rules on insider trading.<sup>87</sup> Nearly 100 out of the 480 companies quoted on the eight German bourses still have not accepted the voluntary rules on insider trading.<sup>88</sup> The insider trading case involving AEG, a German electrical engineering group, illustrates the need for mandatory legislation.<sup>89</sup> In 1985, AEG's former supervisory board chairman purchased shares of AEG during takeover talks with Daimler.<sup>90</sup> After Daimler's bid for AEG he sold the stock for a profit.<sup>91</sup> Once the Frankfurt Stock Exchange discovered his actions, he was forced to pay US\$16,000 and resigned from his position at AEG.<sup>92</sup>

## B. Proposed Legislation: The Netherlands, Belgium, and Ireland

### 1. The Netherlands

Since January 1, 1987, a model code of the Amsterdam Stock Exchange has been in place to regulate insider trading in the Netherlands.<sup>93</sup> While the Code is strictly limited to company personnel, an important Dutch investment fund, Nederlandse Participatie Maatschappij ("NPM"), has recently imposed insider trading restrictions on all its employees.<sup>94</sup> In addition, the Dutch Committee on Corporate Law has proposed

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85. Insider Trading Guidelines, *supra* note 75, § 4, reprinted in J. ROBINSON, *supra* note 41, at 109.

86. *Id.*

87. Fisher, *West German Shareholders' Body Calls for Insider Trading Curbs*, FIN. TIMES, Feb. 12, 1987, at 48. The shareholders association has recommended that companies first coming to the market be required to accept the insider trading rules in full. *Id.* In addition, the group has requested that the definition of insider be expanded to include consultants, journalists, banks, and 25% shareholders. *Id.*

88. *Id.*

89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.*

93. Huizing, *Netherlands: Some Developments on Insider Trading*, INT'L FIN. L. REV., July 1987, at 45.

94. *Id.*

adding a new section to the country's Penal Law that would prohibit insider trading.<sup>95</sup> Offenders would face imprisonment for a maximum term of two years or a fine of up to D.fls. 100,000.<sup>96</sup> If the profit made actually exceeds the statutory fine, an amount equal to four times the amount of profit may be assessed against the wrongdoer.<sup>97</sup>

## 2. Belgium

The Belgium Banking Commission has severely condemned insider trading as an infringement on the rule of professional ethics.<sup>98</sup> Some larger Belgian companies have introduced self-imposed codes of conduct in this area.<sup>99</sup> At present, there is a bill before Parliament that would define insiders as persons employed by a company and persons who have access to inside information by virtue of their relationship to the company.<sup>100</sup> Tippees would be liable if they acted as aiders and abettors.<sup>101</sup> Criminal sanctions would include a maximum prison term of one year and a fine of up to 40,000B.fr.<sup>102</sup> An insider could also be liable in a civil action for profits realized or losses avoided as a result of the misconduct.<sup>103</sup>

## 3. Ireland

Legislation is being formulated in Ireland that would prohibit insider trading in the Republic.<sup>104</sup> The key provisions of the proposal are not yet publicized. The opportunities for insider trading in Ireland are likely to increase because of the Republic's widespread campaign to encourage foreign investment.<sup>105</sup> The country's tremendous industrial growth has al-

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95. *Id.*

96. 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION § 8.11[2], at 8-28 (H. Bloomenthal ed. 1987) [hereinafter INTERNATIONAL CAPITAL MARKETS].

97. *Id.*

98. 10A INTERNATIONAL CAPITAL MARKETS, *supra* note 96, § 8A.13[1], at 8A-47.

99. *Id.* at 8A-48.

100. *Id.* § 8A.13[2][b], at 8A-48.

101. *Id.* at 8A-48 to 8A-49.

102. *Id.* § 8A[2][e], at 8A-49.

103. *Id.*

104. COM(87) 111 final, *supra* note 5, at 2, Common Mkt. Rep. (CCH) ¶ 10,880, at 12,126.

105. Griffith, *The Republic of Ireland's Foreign Investment, Licensing, and Intellectual Property Law: A Guide for the Practitioner*, 12 N.C. J. INT'L. & COM. REG. 1, 2 (1987).



ready been stimulated by governmentally created aids and incentives, which include: tax breaks, training grants, loan guarantees, interest subsidies, research and development grants, and cash grants.<sup>106</sup>

### C. *Insider Trading in the Remaining Member States*

Despite the increased opportunities for insider trading in Europe's newly globalized markets,<sup>107</sup> several European nations have yet to impose insider restrictions. Luxembourg, for instance, is quickly becoming one of the largest money havens in the world.<sup>108</sup> Foreign deposits have jumped forty percent from 1986 to an estimated US\$160 billion.<sup>109</sup> The European Code of Ethics serves as the nation's sole control of insider trading.<sup>110</sup> The Code of Ethics has been published in the Luxembourg Official Gazette, and is acknowledged by Luxembourg's stock exchange.<sup>111</sup>

The Lisbon Stock Exchange, or Bolsa, has undergone a resurgence under the management of the new chairman, Carlos Rosa.<sup>112</sup> With eighteen new companies listed on the official exchange in 1986 and forty on the unlisted securities exchange, Portugal's capital market appears to be reborn.<sup>113</sup> However, despite these very positive signs, skepticism still exists in Portugal, where there are no insider trading prohibitions and where "everyone in business has a useful friend somewhere."<sup>114</sup>

The Italian Stock Exchange has been characterized as a

106. *Id.*

107. See Internationalization of the Securities Market, *supra* note 1.

108. Finn & Pouschine, *Luxembourg: Color It Green*, *FORBES*, Apr. 20, 1987, at 42. For decades, West German banks have kept about five percent of their money in Luxembourg to capitalize on the Duchy's low reserve requirements and relaxed regulations on commercial banking. *Id.* The recent influx of money, however, appears to be coming from tax avoiders like shipping magnates and rock stars. *Id.* The country is now neck and neck with Switzerland in this area and both are in reach of the Cayman Islands, the largest money haven in the world, with deposits of roughly US\$200 billion. *Id.*

109. *Id.*

110. 10A INTERNATIONAL CAPITAL MARKETS, *supra* note 96, § 8B.13, at 8B-46.

111. *Id.*

112. Smith, *Portugal, Banking and Finance 3; New Instruments Revitalize Sector*, *FIN. TIMES*, Mar. 12, 1987, at 111.

113. *Id.*

114. *Id.*

"scandal ridden bourse" in desperate need of reform.<sup>115</sup> In March 1981, however, Guido Rossi was appointed to head the Consob, Italy's securities enforcement body, and has since made considerable progress in reforming this country's stock exchanges.<sup>116</sup>

Insider trading in Spain and Greece is also unregulated.<sup>117</sup> However, both countries are actively seeking foreign investment.<sup>118</sup> As the number of investors begins to increase so too will the opportunities for insider abuse. The Socialist government in Greece offers a choice of investment grants, interest subsidies, loans, investment allowances, and accelerated depreciation.<sup>119</sup> In Spain, the government introduced the Royal Decree Liberalising Foreign Investments No. 1265 just five days after the general elections on June 27, 1986.<sup>120</sup> This Decree establishes a "regime of free investment," in line with the Community rules on the freedom of movement of capital.<sup>121</sup>

### III. THE EEC'S PROPOSED DIRECTIVE: A CRITICAL EVALUATION

Member States of the EEC clearly have different ideas as to the regulation of insiders. The Commission's proposed directive attempts to bring these ideas together by establishing some minimum standards. While these standards provide a starting point for creating uniformity, they will not be sufficient to control insider trading effectively in the Community. Current legislation in the United States offers a guide for comparison. However, it should be noted that the U.S. regulatory agencies have had difficulty addressing the problem of insider trading.<sup>122</sup>

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115. 10 INTERNATIONAL CAPITAL MARKETS, *supra* note 96, § 1.05[7], at 1-43.

116. *Id.*

117. Clark, *Direct Foreign Investment: Greece, Spain and Portugal*, 17 J. WORLD TRADE 614 (1983).

118. *Id.*

119. *Id.*

120. Blackshaw, *Liberalisation of Foreign Investments*, 7 BUS. L. REV. 276 (1986). See generally COM(87) 111 final, *supra* note 5, at 2, Common Mkt. Rep. (CCH) ¶ 10,880, at 12,126.

121. Blackshaw, *supra* note 120, at 276.

122. For instance, the Supreme Court recently reviewed the Second Circuit decision in *United States v. Carpenter*, 791 F.2d 1024 (2d Cir. 1986), where a *Wall Street Journal* reporter was found liable under a theory of misappropriation. See *Carpenter v. United States*, 108 S. Ct. 316 (1987). Reporter Winans authored the *Journal's*

A. *Some Strengths and Weaknesses*

Perhaps the strongest point in the EEC proposed directive is its broad definition of "insider."<sup>123</sup> A narrower approach would have excluded the tippee and focused primarily on those insiders who are fiduciaries of the company whose shares are in question. If investors are to be fully protected, anyone who knowingly trades on the basis of inside information should be sanctioned. To instill the European investor's confidence in the securities markets, the EEC must not let the conduct of tippees go unregulated. At present, the United Kingdom has also included secondary insiders in its legislation.<sup>124</sup> France, on the other hand, has taken a different approach. Only the insider who knowingly allows someone else to take advantage of inside information will be prosecuted.<sup>125</sup>

The Commission also provides a thorough definition of the term "inside information."<sup>126</sup> The definition appears to have incorporated the essential elements that are present in existing Member State laws.<sup>127</sup> The information must concern the issuer or its securities and be likely to have a material effect on the price of the security once it is publicly disclosed.<sup>128</sup> The French legislation provides a much more specific definition requiring the information to refer to the technical, commercial, or financial state of the company.<sup>129</sup> The EEC wisely excluded these elements from their definition. Although a simple change in the management of a company can affect a com-

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"Heard on the Street" column, which published weekly stock evaluations. Prior to publishing his column, Winans would leak this information, sometimes through his co-worker, David Carpenter, to Peter Brant, who would then invest for all three of them. *Id.* at 318. The misappropriation theory emphasizes the "fraud and deceit" language of rule 10b-5 of the Securities Exchange Act of 1934, 17 C.F.R. § 240.10b-5 (1987), as opposed to the fiduciary duty theory's emphasis on "in connection with the sale" language. The Supreme Court deadlocked, by 4 to 4, on this issue but ruled 8 to 0 upholding the conviction of Winans and two other men on federal mail and wire fraud charges. *See* *Carpenter v. United States*, 108 S. Ct. 316 (1987).

123. *See* COM(87) 111 final, *supra* note 5, at 4, Common Mkt. Rep. (CCH) ¶ 10,880, at 12,126.

124. *Civil Liability Under the Financial Services Act*, *supra* note 48, at 32, col. 4.

125. *See* J. ROBINSON, *supra* note 41, at 127.

126. *See* COM(87) 111 final, *supra* note 5, at 5, Common Mkt. Rep. (CCH) ¶ 10,880, at 12,126.

127. *See supra* notes 38-92 and accompanying text.

128. COM(87) 111 final, *supra* note 5, at 5, Common Mkt. Rep. (CCH) ¶ 10,880, at 12,126.

129. *See* Art. 10-1, *supra* note 56.

pany's stock price, French law would probably not categorize this type of information as privileged and price-sensitive.<sup>130</sup> The price of an exchange-listed security should reflect a consensus among investors as to the stock's fair value. It is therefore very important to supply investors with all relevant information as soon as it becomes available.

The major weakness of the EEC's proposed directive occurs in a very critical area: enforcement. One of the basic policy reasons behind the proposed directive is to encourage the interpenetration of the national securities markets by providing that investors will be equally protected in each of the Member States.<sup>131</sup> Yet the proposal fails to establish guidelines so that uniform sanctions will be imposed on those convicted of insider trading. As a result, investors will face varying levels of deterrence in each Member State. This disparity undermines one of the guiding principles of the Common Market: the elimination of discrimination on the basis of nationality.<sup>132</sup> The British Financial Services Act has added civil sanctions to the penal sanctions that already existed in the country's Insider Dealing Act.<sup>133</sup> If insider trading is to be uniformly controlled throughout the EEC both forms of punishment should be imposed.

### B. *Insider Trading in the United States*

Much of the deterrent effect of U.S. regulation has evolved from judicial interpretation of the antifraud provisions of the Securities Exchange Act of 1934.<sup>134</sup> A person is prohibited

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130. *Id.*

131. COM(87) 111 final, *supra* note 5, at 2, Common Mkt. Rep. (CCH) ¶ 10,880, at 12,126.

132. Correlator, *supra* note 6, at 1007-08.

133. *Civil Liability Under the Financial Services Act*, *supra* note 48, at 6.

134. Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (1982), allows a suit by an issuer against any "beneficial owner, director, or officer" who realizes a profit on the sale or purchase of any equity security through the unfair use of information. This section applies only to public corporations and involves "short-term swing profits" made within a period of six months. *Id.* § 16(b), 15 U.S.C. § 78p(b).

Rule 10b-5 of the Securities Exchange Act makes it unlawful to "use any means or instrumentality of interstate commerce . . . to defraud or make an untrue statement of a material fact or to omit to state a material fact necessary to make the statements made not misleading [or] to engage in any act, practice, or course of business which operates . . . as a fraud or a deceit . . ." 17 C.F.R. § 240.10b-5 (1987).

from trading while in possession of material nonpublic information if he owes a fiduciary duty of disclosure to one or more contemporaneous traders in the marketplace.<sup>135</sup> The case law has traditionally described insiders as officers and directors, controlling shareholders, and employees of the issuer.<sup>136</sup> Also included are those persons who have entered into a special relationship with the issuer, such as accountants, bankers, lawyers, and underwriters.<sup>137</sup> Tippees are held liable only if a fiduciary relationship exists.<sup>138</sup> The Supreme Court of the United States has held that a tippee "assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached a fiduciary duty to the shareholders by disclosing the information to the tippee, and the tippee knows or should know that there has been a breach."<sup>139</sup> The Court added an additional factor: the tippee must also know or have reason to know that the information was given to him for the personal benefit of the insider.<sup>140</sup> Conversely, the EEC has chosen to downplay the fiduciary aspect as well as the scienter requirement in its proposed directive.<sup>141</sup> This approach will allow investors the greatest protection. The definitions of "inside information" in the U.S. and the EEC are essentially the same.<sup>142</sup> The U.S. has defined the concept as information that is nonpublic and

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135. See Langevoort, *Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement*, 70 CAL. L. REV. 1 (1982).

136. D. LANGEVOORT, *INSIDER TRADING HANDBOOK* 61-63 (1986).

137. *Id.* at 66-67. In the infamous footnote 14 of the Supreme Court decision in *Dirks v. SEC*, "temporary insiders" of an issuer, that is, "those who enter into a special relationship in the conduct of the business enterprise and are given access to information solely for corporate purposes," also included persons who did not have a formal relationship with the issuer. *Dirks v. SEC*, 463 U.S. 646, 655 n.14 (1983).

138. *Dirks*, 463 U.S. at 660. The facts of the case involved an investment analyst and a former employee of Equity Funding of America. The former employee told *Dirks* that Equity Funding was being fraudulently managed and that the stock was grossly overvalued. *Id.* *Dirks* subsequently investigated and publicized the fraud. *Id.* Prior to publication, however, he contacted numerous persons, including his clients, and told them to sell their Equity Funding shares. *Id.* at 648-50. The Supreme Court held that tippee liability arises only when the tipper and the tippee join together in a "co-venture" to exploit the information for personal gain. *Id.* The Court did not find *Dirks* liable. *Id.*

139. *Id.*

140. *Id.* at 662-64.

141. See COM(87) 111 final, *supra* note 5, Common Mkt. Rep. (CCH) ¶ 10,880 at 12,126.

142. *Id.*

material.<sup>143</sup> Material information is any information that would be likely to cause a substantial change in the price of a security.<sup>144</sup> This is similar to the EEC's definition of "price-sensitive." The U.S. appears to have a great advantage over the EEC in the field of enforcement. The regulatory framework in the U.S. is evidence that a bigger arsenal can lead to more effective enforcement. Under the Insider Trading Sanctions Act of 1984, persons found guilty of insider trading face penalties of up to three times the amount of profit made (or losses avoided) as a result of the trading.<sup>145</sup> This penalty is in addition to a possible injunction or the possible disgorgement of the actual profits made.<sup>146</sup> The U.S. Congress has established criminal penalties for securities violations. A violator can face a criminal sentence of up to five years in jail or a fine of up to US\$100,000.<sup>147</sup> The EEC should follow the United States' lead and impose similar sanctions so that insiders in the EEC will face severe civil and criminal penalties wherever they may illegally trade.

### CONCLUSION

The European Commission has taken some very promising steps toward creating a unified financial market. The proposed directive coordinating insider trading regulations will be an essential component in a common European capital market. The Council should move quickly in adopting this directive but only after steps have been taken to ensure uniform deterrence

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143. *TSC Indus. v. Northway*, 426 U.S. 438, 449 (1976). In rare cases materiality will be at issue if the information in question suggested only a possibility of price movement rather than substantial certainty. D. LANGEVOORT, *supra* note 136, at 126-33.

144. D. LANGEVOORT, *supra* note 136, at 126-33.

145. Pub. L. No. 98-376, § 2, 98 Stat. 1264, 1264 (1984) (codified at 15 U.S.C. § 78u(d)(2)(A) (Supp. IV 1986) (amending Securities Exchange Act § 21)).

146. 15 U.S.C. § 78u(d)(2)(A) (Supp. IV 1986). All damages recovered under the Act go directly to the U.S. Treasury and the Act does not punish those who, without scienter, aid or abet the purchase or sale of securities. *Id.* § 78u(d)(2)(B). Those insiders who do not benefit from employing other defrauders are also not punished. *Id.*

147. 15 U.S.C. § 78ff(a) (Supp. IV 1986).

throughout the Member States. Only then will investors be assured of maximum protection throughout the Community.

*Christine A. McGuinness\**

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\* J.D. candidate, 1988, Fordham University.