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A Tale of Two Cities: Mark Cuban, David Einhorn, and the Ethics of Insider Trading Reform

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ARTICLE

A TALE OF TWO CITIES: MARK CUBAN, DAVID EINHORN, AND THE ETHICS OF INSIDER TRADING REFORM

John P. Anderson[*]

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I. Introduction

Mamma.com CEO Guy Faure emailed Mark Cuban on the evening of June 28, 2004, asking Cuban to contact him as soon as possible.[1] Cuban called Faure less than five minutes later.[2] Faure apparently opened the call by saying, "I've got confidential information."[3] Cuban appears to have responded by saying something like,

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[1] Complaint at 3, SEC v. Cuban, 634 F.Supp.2d 713 (N.D. Tex. Nov. 17, 2008) (No. 3-08CV2050-D).
[2] *Id.*
[3] SEC v. Cuban, 2013 WL 791405, at *4 (N.D. Tex. Mar. 5, 2013).

"Okay, uh huh, go ahead."[4] Faure then informed Cuban of Mamma.com's planned private investment in public equity ("PIPE") offering, which would dilute the value of Cuban's existing holdings in the company (6.3 percent of the firm's outstanding shares at the time).[5] As both Faure and the Mamma.com board members expected, Cuban "flew off the handle" when he heard the news.[6] Cuban is purported to have then said, "Well, now I'm screwed. I can't sell," apparently reflecting his view at that moment that insider trading laws would preclude his sale until after the public announcement of the PIPE.[7] Faure invited Cuban to contact Arnold Owen, the investment banker handling the PIPE, for more detailed information.[8] After speaking with Owen later that day, Cuban called his broker and instructed him to sell out of his entire 600,000 share position in Mamma.com.[9] Cuban's broker sold 10,000 shares after hours on June 28, and then sold the remaining 590,000 shares on June 29.[10]

The public announcement of the PIPE offering was made after the market close on June 29.[11] In the week following the PIPE announcement, Mamma.com shares declined almost 40 percent, and Cuban avoided a loss of more than $750,000 by selling in advance of the

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[4] *Id.*
[5] A PIPE offering is method of raising capital by issuing new shares to private investors at discounted price. Insofar as a PIPE will increase the number of outstanding shares by selling new shares at a price below current market value, the value of the existing shareholders' stock will be diluted. See, e.g., Complaint at 3–4, SEC v. Cuban, 634 F.Supp.2d 713 (N.D. Tex. 2008) (No. 3-08CV2050-D).
[6] *Id.* at 4.
[7] *Id.*
[8] SEC v. Cuban. 2013 WL 791405, at *5.
[9] Complaint at 5, SEC v. Cuban, 634 F.Supp.2d 713 (N.D. Tex. 2008) (No. 3-08CV2050-D).
[10] *Id.*
[11] *Id.*

announcement.[12] The SEC brought an insider trading enforcement action against Cuban.[13] After many years of costly litigation, a jury found Cuban not liable for insider trading in October of 2013.[14] *Business Insider* reported at the time that "Cuban spent more on the suit than he would have if he'd just paid the penalty, but he wanted to prove a point: The SEC never should have gone after him."[15] According to Cuban, "It's personal. You take all these years of my life, it's personal."[16]

Similar facts supported a British Financial Services Authority (FSA) action against American hedge fund manager, David Einhorn.[17] On March 8, 2009, a representative of Punch Taverns Plc., reached out to an analyst at Einhorn's fund, Greenlight Capital Inc., to raise the possibility of a new equity issuance and to inquire as to whether Greenlight would agree to be "wall crossed" (i.e., commit to confidentiality and not to trade) in order to receive more information.[18] Greenlight was then owner of 13.3 percent of Punch's outstanding shares.[19] The request was elevated to Einhorn, who immediately refused the invitation.[20] Despite this

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[12] SEC v. Cuban, 620 F.3d 551, 556 (5th Cir. 2010).
[13] *See* Complaint at 1, SEC v. Cuban, 634 F.Supp.2d (N.D. Tex. 2008) (No. 3-08CV2050-D).
[14] *See, e.g.*, Jana Pruet, *Billionaire Mark Cuban Cleared of Insider Trading; Blasts U.S. Government*, REUTERS (Oct. 16, 2013, 3:34 PM), https://www.reuters.com/article/us-usa-sec-cuban-verdict-idUSBRE99F0ZM20131016.
[15] Erin Fuchs, *Why The SEC Lost Its Big Case Against Mark Cuban*, BUSINESS INSIDER (Oct. 17, 2013, 3:54 PM), https://www.businessinsider.com/how-mark-cuban-defeated-the-sec 2013-10.
[16] Pruet, *supra* note 14.
[17] *See* Financial Services Authority "Final Notice" to David Einhorn (Feb. 15, 2012), https://www.fca.org.uk/publication/final-notices/david-einhorn.pdf.
[18] *Id.* para. 2.4, 3.8.
[19] *Id.* para. 2.2.
[20] *Id.* para. 2.4.

refusal, Punch arranged a call with Einhorn on June 9 to discuss the equity issuance on a "non-wall crossed" basis.[21] During that call, Einhorn was advised of the purpose, timing, and size of the proposed issuance.[22] The call convinced Einhorn that Greenlight should begin selling its holdings in Punch, and he gave his analysts instructions to do just that.[23] Starting the day of the call, Greenlight began a massive selloff of Punch shares, reducing its holdings from 13.3 percent of outstanding shares on June 9 to 8.9 percent on June 12.[24]

Greenlight's selloff allowed the hedge fund to avoid £5.8 million in losses when the June 15 announcement of the issuance was followed by a 29.9 percent drop in the value of Punch shares.[25] These events were soon followed by an FSA action against Einhorn for "market abuse" by insider dealing pursuant to §118 of the British Financial Services and Markets Act of 2000.[26] Despite claiming that his conduct resembled "insider dealing as much as soccer resembles football," Einhorn and his hedge fund settled and paid, collectively, a fine of $11.2 million.[27] Though Einhorn claimed that he only settled because he doubted his "chances of having a fair hearing,"[28] a review of the UK's market abuse statute,

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[21] *Id.*

[22] Financial Services Authority "Final Notice" to David Einhorn at para. 2.6 (Feb. 15, 2012), https://www.fca.org.uk/publication/final-notices/david-einhorn.pdf.

[23] *Id.* para. 2.7.

[24] *Id.*

[25] *Id.* para. 2.8.

[26] Financial Services and Markets Act 2000, c. 3, § 118; Financial Services Authority "Final Notice" to David Einhorn, *supra* note 17, at para. 1.

[27] Julia La Roche, *David Einhorn Tells His Side of the Story on the FSA's Insider Trading Fine*, BUSINESS INSIDER (Jan 26, 2012, 8:05 AM), https://www.businessinsider.com/david-einhorn-tells-his-side-of-the-story-on-the-fsas-insider-trading-fine-2012-1.

[28] *Id.*

which embraces a broad "parity of information" model, leaves little doubt that he was liable.[29]

The similarities between the insider trading stories of Mark Cuban and David Einhorn suggest that their circumstances are not uncommon, and the contrasting results also help to illustrate some significant differences between the common law fraud-based insider trading regime in the U.S. and the statutory parity-of-information regime in Europe.[30] And, as Congress and the SEC continue to weigh the merits of reform in the U.S.,[31] the examples of Cuban and Einhorn are particularly instructive for the reasons to be developed in the remaining sections of this Article. First, as will be explained in Part II of this Article, contrasting the enforcement actions against Cuban and Einhorn throw into stark relief the lack of ex ante guidance under the U.S. regime for good-faith traders who must make real-time decisions for themselves and for those who are relying upon them to invest their money. The examples help to illustrate why the ethics of legal certainty, due process, and the principle of legality weigh in favor of

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[29] *See infra,* Section II.

[30] *See infra,* Section II.

[31] For example, on December 5, 2019, a proposed statutory overhaul of the current insider trading enforcement regime the United States, the Insider Trading Prohibition Act (H.R. 2534) was passed by the U.S. House of Representatives on a 410-13 vote. See Andrew Ramonas, *House Passes Bill to Codify Insider Trading Ban*, BLOOMBERG (Dec. 5, 2019, 3:03 PM), https:// news.bloomberglaw.com/securities-law/house-passes-bill-to-codify-insider-trading-ban. The SEC has also demonstrated an interest in reform. In October of 2018, SEC Commissioner Robert J. Jackson and former U.S. attorney for Manhattan, Preet Bharara, announced the creation of the "Bharara Task Force on Insider Trading" to propose new reforms to the law. See Preet Bharara and Robert J. Jackson, Jr., *Insider Trading Laws Haven't Kept Up with the Crooks*, N.Y. TIMES (Oct. 9, 2018),https://www.nytimes.com/2018/10/09/opinionn/sec-insider-trading-united-states.html.

following Europe in adopting a relatively clear statutory insider trading enforcement regime. Second, however, it will be argued in Part II of this Article that if statutory reform is needed in the U.S., the liability imposed upon Einhorn despite the fact that his conduct (as I will argue) was neither deceptive nor unfair, shows why adopting the Europe's broad parity-of-information model would be a mistake.

II. Ethics of Legal Certainty

Insider trading law has never been expressly defined by statute or rule in the United States.[32] Hence, to date, Congress and the SEC have been content to allow the scope of insider trading liability to develop through the common law. The principal statutory authority for the prohibition is found in section 10(b) of the Securities Exchange Act of 1934, which is a general "catchall"[33] anti-fraud provision proscribing the employment of "any manipulative or deceptive device or contrivance" in "connection with the purchase or sale of any security."[34] Though adopted In 1934, section 10(b) was not used as an insider trading enforcement tool until the early 1960s.[35] For the first two decades of insider trading enforcement,

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[32] *See, e.g.*, Andrew Verstein, *Insider Tainting: Strategic Tipping of Material Nonpublic Information*, 112 NW. U. L. REV. 725, 739 (2018) (noting that "no statute or rule defines 'insider trading.'").

[33] See Chiarella v. United States, 445 U.S. 222, 235 (1980) (recognizing Section 10(b) as a "catchall" provision).

[34] 15 U.S.C. § 78j(a), (b) (2012). Section 10(b) is implemented by the SEC in Exchange Act Rule 10b-5, which proscribes "any act, practice, or course of business which operated or would operate as a fraud or deceit upon any person, In connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5(c) (2016).

[35] The SEC concluded its first insider trading enforcement action in 1961. *See In re* Cady, Roberts & Co., 40 S.E.C. 907 (1961).

the SEC read a broad "parity-of-information" or "equal access" rule into section 10(b), whereby "virtually anyone who possessed material nonpublic information was required either to disclose it before trading or abstain from trading in the affected company's securities,"[36] and the federal courts gave their imprimatur.[37] The Supreme Court did not, however, visit the issue of insider trading until 1980, when, in *Chiarella v. United States*,[38] the Court explicitly rejected the parity-of-information enforcement model as ultra vires.[39]

The *Chiarella* Court made it clear that while section 10(b) is indeed a general "catchall" provision, "what it catches must be fraud."[40] But the insider trader's silence while buying or selling a security over an anonymous exchange is only deceptive (and therefore fraudulent) if the insider has a duty to disclose.[41] The Supreme Court has recognized two theories whereby a trader owes such a duty to disclose. Under the "classical" theory, insider trading liability is triggered where a corporate insider (actual or constructive) seeks to benefit from trading (or tipping others who trade) their firm's material nonpublic information.[42] Here, the insider's failure to disclose her information advantage violates a "fiduciary or other similar relation of trust and confidence" to the *counterparty* to the transaction, the firm's current or prospective shareholders.[43] Insider trading liability arises under the "misappropriation"

[36] STEPHEN M. BAINBRIDGE, INSIDER TRADING LAW AND POLICY 3–4 (2014).
[37] *See, e.g.*, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968).
[38] Chiarella, 445 U.S. 222 (1980).
[39] *Id.* at 233 ("neither Congress nor the Commission ever has adopted a parity-of-information rule.").
[40] *Id.* at 235.
[41] *Id.*
[42] *See* United States v. O'Hagan, 521 U.S. 642, 651–652 (1997).
[43] Chiarella, 445 U.S. at 228.

theory where *anyone* (insider or outsider) misappropriates material nonpublic information and then seeks to benefit by trading on the basis of it (or by tipping others who trade on it) without first disclosing the intent to trade to the source of the information.[44] The misappropriation trader's failure to disclose breaches a fiduciary duty of trust and confidence to the *source* of the information by "dup[ing]" the source out of their "right of exclusive use" of that information.[45]

Although these two theories of section 10(b) insider trading liability are well-established, the common-law development of their elements has yielded a great deal of uncertainty. As former U.S. Attorney Preet Bharara and SEC Commissioner Robert Jackson recently explained, the current "insider trading laws do not clearly define what the standard" for liability is, and the "result is a legal haziness that leaves both investors and defendants unclear about what sorts of information-sharing or other activities by investors would be considered insider trading."[46] This author has written extensively on numerous problems of vagueness resulting from the common-law development of the U.S. insider trading law,[47] but there is one ambiguity that warrants particular attention in the context of the *Cuban* case.

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[44] JOHN P. ANDERSON, INSIDER TRADING: LAW, ETHICS, AND REFORM 59 (2018).

[45] O'Hagan, 521 U.S. at 643.

[46] *See, e.g.*, Bharara & Jackson, *supra* note 31.

[47] *See, e.g.*, ANDERSON, *supra* note 43.1, at 59–117 (arguing that the common law articulations of crucial terms such as when information is "material" or "nonpublic," or when trading is "on the basis" of information, or the parameters of the relevant "relation of trust and confidence," or what constitutes the relevant mental state requirement for insider trading liability, etc., are so vague as to leave market participants with insufficient advance notice of when their trading will incur liability).

The *Cuban* case brought to the fore one of the more pertinent unsettled questions in U.S. insider trading law, that is, whether a mere contractual or other commitment to confidentiality (without more) is sufficient to create a duty not to trade.[48] It appears that Supreme Court precedent interpreting Section 10(b) offers one answer, and an SEC rule, 10b5-2, adopted in 2000, appears to offer another.[49] As noted above, the Supreme Court has consistently held that the SEC's statutory authority in Section 10(b) requires that there must be a breach of a conjunctive fiduciary duty of "trust *and* confidence" to incur insider trading liability.[50] SEC Rule 10b5-2(b)(1), however, provides that liability may be incurred by the breach of a disjunctive duty of "trust *or* confidence."[51] The district court sided with Cuban against the SEC in holding that liability requires an express or implied commitment not to trade (duty of trust or loyalty) in *addition* to any commitment not to disclose (or keep the information in confidence),[52] but the Second Circuit refused to settle the question on appeal, noting only that:

> Given the paucity of jurisprudence on the question of what constitutes a relationship of 'trust and confidence' and the inherently fact-bound nature of determining whether such a duty exists,

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[48] *See, e.g.*, BAINBRIDGE, *supra* note 36, at 168–170.
[49] *See* 17 C.F.R. § 240.10b5-2 (2001).
[50] *See, e.g.*, Chiarella, 445 U.S at 228, Dirks v. S.E.C., 463 U.S. 646, 654 (1983), *O'Hagan*, 521 U.S. at 652; Salman v. United States, 137 S. Ct. 420, 423 (2016).
[51] 17 C.F.R. §240.10b5-2 (2001).
[52] SEC v. Cuban, 643 F.Supp.2d 713, 725 (2009) ("The agreement . . . must consist of more than an express or implied promise merely to keep information confidential. It must also impose on the party who receives the information the legal duty to refrain from trading on or otherwise using the information for personal gain.").

> we decline to first determine or place our thumb on the scale in the district court's determination of its presence or to now draw the contours of any liability that it might bring, including the force of Rule 10b5-2(b)(1).[53]

The appellate court's punt on this important issue offers little comfort or guidance to the next shareholder who finds herself in Cuban's shoes—especially for those who lack Cuban's resources to defend against an insider trading investigation.[54] And with civil penalties of disgorgement and up to "three times the profit gained or loss avoided" by the trading,[55] and criminal fines of up to $5 million and twenty years of imprisonment[56] (setting aside entirely the harm to reputation and the high costs of representation in even a successful insider trading defense), the stakes are high indeed.[57]

Professor Jeanne Schroeder has noted the fact that insider trading law in the U.S. is almost exclusively judge-made is a "scandal" in itself.[58] This is because, as

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[53] SEC v. Cuban, 620 F.3d 551, 558 (5th Cir. 2010).

[54] *See* Jana J. Pruet, *Billionaire Mark Cuban cleared of insider trading; blasts U.S. government*, REUTERS: BUSINESS NEWS (Oct. 16, 2013, 3:44 PM) (noting that "Cuban refused to settle the case and went to trial, even though he said on Wednesday that he had spent more on fees for lawyers than the possible fines for admitting insider trading"), https://www.reuters.com/article/us-usa-sec-cuban-verdict-idUSBRE99F0ZM20131016.

[55] *See* 15 U.S.C. § 78u-1(a)(2) (2018).

[56] See 15 U.S.C. § 78ff(a) (2018).

[57] Civil and criminal penalties have sometimes been described as "draconian." *See, e.g.*, Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition*, 52 WASH. & LEE L. REV. 1189, 1191 (1995) (noting that insider trading "carries penalties that can only be described as draconian.").

[58] Jeanne L. Schroeder, *Taking Stock: Insider and Outsider Trading by Congress*, 5 WM. & MARY BUS. L. REV. 159, 163

Professor Miriam Baer and others have explained, insider trading, as a common-law crime, flirts with violating the Western liberal jurisprudential principal of legality.[59] The principle of legality "is the basic premise of criminal law that 'conduct is not criminal unless forbidden by law which gives advance warning that such conduct is criminal.'"[60] The principle of legality is regarded as "a more or less self-evident maxim of justice at least since the French Revolution,"[61] and is based in at least four related principles:

> (1) the ancient rule of *nullem crimin sine lege* ("no crime without a law"); (2) the prohibition of retroactively criminalizing conduct (e.g., *ex post facto* laws); (3) the ancient rule of *nullem poena sine lege* ("no punishment without law") . . . ; and (4) the prohibition against the retroactive imposition of more severe penalties than previously authorized.[62]

As I've noted elsewhere, the principle of legality "gives expression to our shared intuition that justice requires that persons be given reasonable notice of when criminal sanctions will be imposed. Otherwise persons

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(2014) (noting the "jurisprudential scandal that insider trading is largely a federal common law offense").

[59] *See* Miriam H. Baer, *Insider Trading's Legality Problem*, 127 YALE L.J.F. 129, 134–138 (2017); *see also* John P. Anderson, *Anticipating a Sea Change for Insider Trading Law: From Trading Plan Crisis to Rational Reform*, 2015 UTAH L. REV. 339, 369–371 (2015).

[60] State v. Robbins, 986 So.32d 828, 835 (La. App. 2 Cir 2008) (citing Heyward D. Armstrong, *Rogers v. Tennessee: An Assault on Legality and Due Process*, 81 N.C.L.REV. 317, 321–22 (2002)).

[61] DAVID A.J. RICHARDS, THE MORAL CRITICISM OF LAW 193 (1977).

[62] *Id.* at 835.

would be left helpless in planning their lives to avoid such sanctions."[63] These ethical commitments are also reflected in the *ex post facto* law and due process clauses of the U.S. Constitution.[64]

The vagueness doctrine is an "outgrowth" of the Due Process Clause, and it provides that a criminal conviction "fails to comport with due process if the statute under which it is obtained fails to provide a person of ordinary intelligence fair notice of what is prohibited, or is so standardless that it authorizes or encourages seriously discriminatory enforcement."[65] It has been explained that there is *no* express statutory guidance as what conduct incurs criminal liability for insider trading, and it has been argued that even the common law and administrative guidance is unclear, and sometimes even conflicting.[66] The *Cuban* case offers only one (but a nevertheless very compelling) example of how this confusion and ambiguity in the law unjustly places well-meaning traders in the awkward position of being totally clueless as to whether their trading will expose them to massive fines and significant jail time.[67] Neither experienced Wall Street traders, nor large-firm attorneys, nor law professors, nor even judges can say with certainty whether misappropriation trading liability will be triggered by one who trades while under mere duty of confidentiality (as suggested by SEC Rule 10b5-2's imposition of liability for trading while under a duty of "trust *or* confidence"), or whether liability is only triggered where there is also an express or implied duty

[63] ANDERSON, *supra* note 44, at 89.
[64] *See* U.S. CONST. art. I §§ 9–10 (neither Congress nor the states may pass ex post facto laws); U.S. CONST. amend. V, XIV (no one shall be "deprived of life, liberty, or property without due process of law" by either the federal government or the several states).
[65] United States v. Williams, 553 U.S. 285, 304 (2008).
[66] ANDERSON, *supra* note 44, at 89–91.
[67] SEC v. Cuban, 620 F.3d 551 (5th Cir. 2010).

of loyalty not to trade (as suggested by the Supreme Court's requirement of a duty of "trust *and* confidence").[68] If such experts cannot advise a trader ex ante on whether their trading will trigger insider trading liability, it seems a significant stretch to suggest that a person of ordinary intelligence has fair notice of when their trading crosses the line.[69] But regardless of whether the insider trading regime in the United States is unconstitutionally vague (as some have argued),[70] my goal in the preceding has simply been to point out the serious moral concerns that are raised by imposing harsh civil and criminal penalties for conduct covered by such constantly-changing, common-law rules that are riddled with uncertainty.

Vagueness under U.S. law is starkly contrasted by the relatively clear statutory guidance offered by Europe's insider trading enforcement regime. The enforcement action against Einhorn came pursuant to a detailed statutory scheme that implements a broad parity-of-information regime.[71] Though the U.K.'s statutory regime (implemented in compliance with the European Market Abuse Regulation)[72] employs some inherently imprecise elements like that of materiality, it

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[68] ANDERSON, *supra* note 44, at 77–78.
[69] ANDERSON, *supra* note 44, at 89.
[70] *See, e.g.*, Homer Kripke, *Manne's Insider Trading Thesis and Other Failures of Conservative Economics*, 4 CATO J. 945, 949 (1985).
[71] *See* Edward Greene & Olivia Schmid, *Duty-Free Insider Trading*, 2013 COLUM. BUS. L. REV. 369, 386 (2013) (noting that the United Kingdom embraces "the parity-of-information" approach to insider trading enforcement).
[72] MAR went into effect on July 3, 2016, though its prohibitions do not vary significantly from the Market Abuse Directive of 1989 that preceded it. The principal difference is that MAR binds each European Union member state directly. *See New EU rules to fight insider dealing and market manipulation in Europe's financial markets take effect*, EUROPEAN COMMISSION: PRESS CORNER (Jul. 1, 2016), http://europa.eu/rapid/press-release_IP-16-2352_en.htm?locale=EN.

defines the scope of insider dealing liability with admirable clarity.[73] In the U.K. (as in all European countries under MAR), essentially *anyone* who "knows, or could reasonably be expected to know" that they are trading on material nonpublic information is subject to insider trading liability.[74] No subtle analysis of common-law precedent concerning the nature of fiduciary duties (and whether they impose a duty of "trust and confidence" or "trust or confidence") is required to determine the boundary of liability under the European model.[75] The trader need only ask herself if the information is "likely to have significant effects on price" and is "not generally available" (analogs to the elements of "material" and "nonpublic" under U.S. law).[76] If so, she may not trade on the information.

So, in Einhorn's case, it seems fair to say that any person of ordinary intelligence, having read the governing FSA and E.U. statutes, could have told him in

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[73] *See, e.g.*, ANDERSON, pp. 246–47 (noting that materiality is a relative concept that eludes precise definition).
[74] *See* Council Regulation 596/2014, art. 8, 2014 O.J. (L 173) (EU) (providing that insider trading liability arises any time "a person possesses inside information and uses that information" to trade or tip); *Id.* art. 10; Financial Services and Markets Act 2000, c.8, §118(B), (UK.); *see also* Franklin A. Gevurtz, *The Road not Taken: A Comparison of the E.U. and U.S. Insider Trading Prohibitions*, 56 WASH. U. J.L. POL'Y 31, 35 (2018) (noting that mere possession of material nonpublic information while trading, regardless of how it was acquired, is sufficient to incur liability under the European insider dealing regime); Peter Henning, *Einhorn Case Highlights Britain's Broader Definition of Insider Trading*, N.Y. TIMES, (Jan. 31, 2012), https://dealbook.nytimes.com/2012/01/31/einhorn-case-highlights-britains-broader-definition-of-insider-trading/?searchResultPosition=1 (noting the broad scope of the European insider dealing regime).
[75] See Greene & Schmid, *supra* note 66, at 386.
[76] *See* Financial Services and Markets Act 2000, c.8, § 118(C), (UK).

advance that it didn't matter whether he obtained the material nonpublic information on a "wall-crossed" or "open" basis. Once he possessed the material nonpublic information concerning the equity issuance, he would incur liability by trading in Punch shares prior to the announcement.[77]

In sum, contrasting Cuban's and Einhorn's cases helps to illustrate the moral superiority of the European statutory model over the U.S. common-law model from the standpoint of notice and due process.[78] But even if justice requires clear statutory notice for traders, nothing said so far suggests that justice or fairness requires that the scope of insider trading liability under any new U.S. statutory regime should extend so far as the European equal-access model. The next section contrasts the examples of Cuban and Einhorn to address this equally important question.

III. Ethics of Trading

If Einhorn had said that his conduct resembles insider trading under U.S. law as much as soccer resembles football, then he would have been correct. As a general anti-fraud statute, §10(b) insider trading liability requires some element of deception.[79] Indeed, it was, among other things, the SEC's inability to prove deception that allowed Cuban to avoid liability.[80] Under the European parity-of-information model, however, the absence of deception on the part of Einhorn or Greenlight

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[77] *See* sources cited *supra* note 69.
[78] *See supra* notes 64–71 and accompanying text.
[79] *See* 15 U.S.C. § 78j(a), (b) (2012).
[80] *See* Bradley J. Bondi, *How Cuban Scored a Home Court Win Against the SEC*, LAW 360 2 (Nov. 14, 2013), https://www.law360.com/articles/488308/how-cuban-scored-a-home-court-win-against-the-sec (noting that the SEC failed to prove "that Cuban deceived Mamma.com with respect to his intent to sell his shares.").

was irrelevant.[81] Einhorn expressly refused to commit to not trade prior to the disclosure, and the disclosure was made by Punch with this understanding.[82] Both the Cuban and Einhorn actions were civil, but this was simply a result of the exercise of prosecutorial discretion. The elements for criminal liability under both regimes track the elements for civil liability.[83] If we begin with the basic presumption that criminal sanctions should only be imposed to punish or prevent conduct that is morally wrongful, or that "unjustifiably and inexcusably inflicts or threatens substantial harm to individual or public interests,"[84] then there is something very troubling about any regime that permits criminal liability for someone like Einhorn.

First, Einhorn's conduct was not deceptive. He made it perfectly clear to Punch prior to disclosure that he may trade on the information disclosed.[85] Punch was aware of this and presumably concluded that disclosure on these terms was in the best interest of the firm and its

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[81] *See* Council Regulation 596/2014, art. 8, 2014 O.J. (L 173) (EU) (providing that insider trading liability arises any time "a person possesses inside information and uses that information" to trade—without any requirement of deception).

[82] FINANCIAL SERVICES AUTHORITY, *supra* note 17, para. 2.4.

[83] *See* 15 U.S.C. § 78ff(a) (2018) (providing that a willful violation of Rule 10b-5 is a felony that can be punished by a $5 million fine and up to 20 years imprisonment); *see also* Directive 2014/57/EU, of the European Parliament and of the Council of 16 Apr. 2014 on Criminal Sanctions for Market Abuse (Market Abuse Directive), art. 3, 2014 O.J. (L 173) 185 (EU) (requiring that "[m]ember States shall take the necessary measures to ensure that insider dealing . . . constitute criminal offences at least in serious cases and when committed intentionally.").

[84] MODEL PENAL CODE § 1.02(1)(a) (AM. LAW INST. 1962).

[85] FINANCIAL SERVICES AUTHORITY, *supra* note 17, para. 2.4.

shareholders.[86] There is no deception in this.[87]

Second, Einhorn's conduct was not unfair. Admittedly, Greenlight had an information advantage over the counterparties to its transactions, but trading on information asymmetries is not typically regarded as unfair unless the advantage was wrongfully acquired.[88] In this case, however, the information was offered willingly by the owner of the information for a legitimate business purpose, and on an expressly "non-wall-crossed" or "open" basis.[89] It seems trading on such information would only be unfair if *all* trading on information asymmetries is unfair, but few would go so far. Indeed, market participants typically expect that there are information asymmetries when they trade, and they usually presume that they possess the advantage.[90] As one Wall Street journalist put it, "The only reason to invest in the market is because you think you know something others don't."[91] In a recent U.S. criminal insider trading action, Judge Jed Rakoff of the Southern

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[86] FINANCIAL SERVICES AUTHORITY, *supra* note 17, paras. 2.4–2.6.

[87] *See* ANDERSON, *supra* note 66, at 208–213 (arguing that such issuer-licensed insider trading is not deceptive).

[88] It is a well-settled jurisprudential principle, at least in the United States, that parties may profit from information advantages acquired by legitimate means. *See, e.g.*, Laidlaw v. Organ, 15 U.S. 178, 195 (1817) (in such cases, no rights are violated, and no legitimate expectations are disappointed); *See* ANDERSON, *supra*, note 66, at 208–215.

[89] FINANCIAL SERVICES AUTHORITY, *supra* note 17, para. 2.4.

[90] *See, e.g.*, Basic Inc. v. Levinson, 485 U.S. 224, 256 (1988) (White, J., concurring in part and dissenting in part) (explaining that many investors trade precisely because they are of the opinion that the stock price does not reflect the corporation's actual worth).

[91] Jeanne Schroeder, *supra* note 57, at 168 (citing *Thoughts on the Business of Life*, FORBES, http://thoughts.forbes.com/thoughts/r-foster-winans (last visited Jan. 12, 2014) (quoting R. Foster Winans)).

District of New York granted the defense's pretrial motion to prevent prosecutors from telling the jury that the stock market should be a "level playing field."[92] The defense argued that "the stock market is not supposed to be a . . . level playing field, as traders routinely seek out ways to gain an advantage over their competitors to increase profits."[93] Judge Rakoff agreed, noting that "[a]nyone who thinks that the stock market is a level playing field obviously has no contact with reality."[94]

As manager of Greenlight, Einhorn presumably made the determination that it was not in his investors' interests to restrict his ability to trade Punch shares by acquiring material nonpublic information on a "wall-crossed" basis.[95] Punch accepted this decision and nevertheless presumably decided it was in *its* investors' interests to share the information with Greenlight on an "open," "non-wall-crossed" basis.[96] They did so.[97] On these facts, there is nothing wrongful or unfair in Einhorn's trading on the information so acquired (other than that such trading happens to be illegal under the European model—and, absent extraordinary circumstances, persons have a moral obligation to obey the law).[98]

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[92] *See* Pete Brush, *Rakoff Tells Gov't to Dump 'Level Playing Field' Language*, LAW 360 (Apr. 16, 2019), https://www.law360.com/articles/1150320/rakoff-tells-gov-t-to-dump-level-playing-field-language.

[93] *Id.*

[94] *Id.*

[95] *See* FINANCIAL SERVICES AUTHORITY, *supra* note 17, para. 2.4.

[96] *See id.* para. 2.6.

[97] *Id.*

[98] Though the claim that citizens have an assumed moral obligation to obey just laws that apply to them is not uncontroversial, claims of a general political obligation have been defended from Plato's *Crito* to John Rawls's *A Theory of Justice*. *See* PLATO, FIVE DIALOGUES (G.M.A. Grube trans., John M. Cooper ed., 2d ed. 2002); JOHN RAWLS, A THEORY OF JUSTICE 350 (1971) ("There is quite clearly no difficulty in

Indeed, I would go so far as to argue that, absent the legal proscription, given Einhorn's fiduciary duty to his investors, it would be wrongful *not* to order the trading in accord with his best judgment on these facts. Finally, given Einhorn's position as controlling 13.3 percent of Punch's outstanding shares, and that any liquidation of those shares in advance of the PIPE offering might have upset the company's plans, it is possible that the Punch executives were anxious to disclose inside information to Einhorn precisely to prevent him from being able to trade.[99] If that was indeed part of the Punch executives' motivation for sharing material nonpublic information, then Einhorn may have been the victim of what Professor Andrew Verstein has termed "insider tainting," the "weaponizing" of broad insider trading prohibitions by issuers to paralyze large shareholders and prevent them from trading.[100] In light of the above considerations, perhaps it is the legal proscription, rather than the conduct in violation of it, that warrants the greater moral condemnation.

Of course, the fact that there is nothing morally impermissible in Einhorn's conduct does not force the conclusion that it should not be criminalized. Indeed, historically, a large number of so-called "white collar crimes" are categorized by the courts and jurists alike as *malum prohibitum* (wrong only because prohibited).[101] In

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explaining why we are to comply with just laws enacted under a just constitution. In this case the principles of natural duty and the principle of fairness establish the requisite duties and obligations."); A.J. SIMMONS, MORAL PRINCIPLES AND POLITICAL OBLIGATIONS 12 (1979).

[99] FINANCIAL SERVICES AUTHORITY, *supra* note 17, para. 2.2.

[100] *Verstein*, *supra* note 32, at 725.

[101] *See, e.g.*, State v. Horton, 51 S.E. 945, 946 (N.C. 1905) (explaining that "[a]n offense malum in se is properly defined as one which is naturally evil as adjudged by the sense of a civilized community, whereas an act malum prohibitum is wrong only because made so by statute."); *see also* Hentzner v. State, 613 P.2d 821, 826 (Alaska 1980) (noting, for example,

fact, in the context of "public welfare offenses," where the risk of public harm from otherwise morally blameless conduct is sufficiently great, the criminal law will sometimes impose sanctions as a prophylactic without the requirement of any evidence of a mens rea.[102] The criminal penalties for such public welfare offenses are, however, typically minimal.[103] Assuming *arguendo* such criminal sanctions are sometimes justified,[104] there is little reason to think that any social harm resulting from insider trading along the lines of that committed by Einhorn is sufficiently great to warrant the extreme measure. I have argued elsewhere (in agreement with a host of others) that it is unlikely issuer-licensed insider trading like Einhorn's will result in any net negative economic consequences for the owner of the information, for the counterparties to the transaction, or for the broader market.[105] If there are any net negative consequences for such trading, however, they are unlikely to rise to a level of magnitude that would warrant the imposition of criminal sanctions against moral innocents as a mere prophylactic. Indeed, Europe's historically anemic criminal enforcement of its insider trading laws suggests that many of its prosecutors may agree.[106]

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that "[t]he crime of offering to sell or selling unregistered securities is malum prohibitum, not malum in se." (emphasis omitted) (footnote omitted)).

[102] *See, e.g.*, Morissette v. U.S., 342 U.S. 246, 252–256 (1952) (describing the nature and origin of public welfare offenses).

[103] *Id.* at 256.

[104] *See id.* at 254 (noting that the "[c]onsequences of a general abolition of intent as an ingredient of serious crimes have aroused the concern of responsible and disinterested students of penology.").

[105] *See* ANDERSON, *supra* note 66, at 202–206.

[106] *See, e.g.*, James H. Thompson, *A Global Comparison of Insider Trading Regulations*, 3 INT'L J. OF ACCT. AND FIN. REPORTING 1, 6–7 (2013); *see also* Hugo Miller, *In Land of Discretion, no Jail for Swiss Insider Trading*, BLOOMBERG, (Dec. 3, 2018, 12:00 AM),

IV. Conclusion

In sum, the examples of Cuban and Einhorn help to illustrate some moral reasons why (1) the U.S. should follow Europe's lead in implementing a statutory insider trading enforcement regime, but unlike Europe, (2) any new U.S. insider trading regime should take care to only impose liability on trading that is morally wrongful.

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https://www.bloomberg.com/news/articles/2018-12-03/swiss-inside-traders-dodge-jail-in-land-where-discretion-rules (noting that "criminal convictions remain rare" in Germany).