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H.R. 2534 Insider Trading Prohibition Act Passes House

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On December 5, 2019, the House passed the Insider Trading Prohibition Act (the Act). If the Act becomes law, it would codify prohibitions on insider trading and would result in important changes in substantive insider trading law. It thus could replace the current regime where insider trading is enforced through the application of complex, and at times inconsistent, case law applying the broad anti-fraud rules.

Tipper-Tippee Liability

A major focus of the Act is clarifying when "tippers" and "tippees" can be liable—an issue that has plagued the courts in recent years. The Act includes two changes or clarifications to existing law, which were suggested in an amicus brief submitted by Jenner & Block to the Supreme Court in its most recent insider trading case, *Salman v. United States*.[1]

First, the Act requires the government to prove that it was "reasonably foreseeable" to the tipper that the tippee would trade on the inside information.[2] This requirement, which is suggested in the amicus brief filed on behalf of the NYU Center on the Administration of Criminal Law,[3] would protect persons who disclose inside information for purposes unrelated to securities trading. This would give a greater degree of protection than exists under current law to such parties as a journalist who is looking to unearth corporate wrongdoing. This requirement would also protect innocent or inadvertent disclosures in situations where the alleged tipper had no reason to expect the person they were speaking with would trade on the information.

Second, the Act would eliminate uncertainty under current law concerning the circumstances under which remote tippees—traders who are not in direct communication with the insider—are liable. The Act provides that it will *not* be necessary for the government to prove that the tippee knows either that a "personal benefit was paid or promised by or to any person in the chain of communication," or "the specific means by which the information was obtained or communicated."[4] Instead, the Act focuses the inquiry more broadly on whether the tippee "was aware, consciously avoided being aware, or recklessly disregarded that such information was wrongfully obtained, improperly used, or wrongfully communicated."[5] This change addresses the government's concern that inside information could be "laundered" through multiple tippees, who would trade on the information, but have plausible deniability as to how the information was originally obtained or whether it was obtained in exchange for a personal benefit. Consistent with the position in the amicus brief, this change puts the focus of tipper-tippee liability on the circumstances in which information was obtained and communicated, rather than the remote tippee's knowledge of whether the original tipper received a personal benefit.[6]

Broader Grounds for Insider Trading Liability

The Act also seeks to clarify when inside information has been used or disclosed "wrongfully." The Act specifically defines "wrongful" means of obtaining inside information to include four forms of conduct: (a) "theft, bribery, misrepresentation, or espionage (through electronic or other means);" (b) "a violation of any Federal law protecting computer data or the intellectual property or privacy of computer users;" (c)

"conversion, misappropriation, or other unauthorized and deceptive taking of such information;" or (d) "a breach of any fiduciary duty, a breach of a confidentiality agreement, a breach of contract, a breach of any code of conduct or ethics policy, or a breach of any other personal or other relationship of trust and confidence for a direct or indirect personal benefit (including pecuniary gain, reputational benefit, or a gift of confidential information to a trading relative or friend)."[7]

Although these four types of wrongful conduct largely overlap with current law, they are slightly broader in two respects. First, they give the government a clearer path in cases involving hacking. Although the government has brought a series of cases where the insiders obtained information through intrusions, such cases do not fit neatly within traditional insider trading law. For example, in 2009, in *SEC v. Dorozhko*, the Second Circuit found that not all forms of computer hacking violated the anti-fraud statute and remanded for further proceedings to determine if the hacking at issue involved deception.[8] Second, the Act's provision that a "breach of contract" could support an insider trading prosecution is arguably broader than under existing law.

Next Steps in Congress

The House approved the Insider Trading Prohibition Act on a 410-13 vote. Now, the Act will be considered by the Senate, where it has been referred to the Committee on Banking, Housing, and Urban Affairs and will likely be considered by the Securities, Insurance, and Investment Subcommittee. Although it is difficult to predict whether the Act will be passed, let alone in its current form, the strong bipartisan support for the Act in the House suggests the possibility of enactment.

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[1] 137 S. Ct. 420 (2016).

[2] Insider Trading Prohibition Act, H.R. 2534, 116th Cong. § 2 at 16A(b)(2) (2019).

[3] Brief of the NYU Center on the Administration of Criminal Law as *Amicus Curiae* in Support of Neither Party at 4-5, 14-15, *Salman v. United States*, 137 S. Ct. 420 (2016) (No. 15-628).

[4] H.R. 2534 at 16A(c)(2).

[5] *Id.*

[6] Brief of the NYU Center on the Administration of Criminal Law, *supra* note 3, at 4, 15-20.

[7] H.R. 2534 at 16A(c)(1).

[8] 574 F.3d 42 (2d Cir. 2009).

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