

Congress Reacts to Insider Trading Case with Two Proposed Bills

By Renzo Lima, LL.M. Candidate 2015 | March 19, 2015

As [previously discussed on this blog](#), in U.S. v. Newman the U.S. Court of Appeals for the Second Circuit made it more difficult to prosecute future cases of insider trading involving tippees. To establish a tippee's liability, prosecutors are now required to prove not only the tippee's knowledge of the tipper's breach of the duty of confidentiality, but also the tippee's [knowledge of a personal benefit to the tipper](#). The court also held that the benefit should be of "some consequence," and that mere friendship or a familial relationship alone are [insufficient](#) to establish a benefit to the tipper.

Now Congress is trying to [solve the problem](#) with two bills dubbed the "Ban Insider Trading Act" and the "Stop Illegal Insider Trading Act." Both would make it illegal to buy and sell securities based on information the person knew or should have known was confidential. In other words, prosecutors would no longer be required to prove the tippee's actual knowledge of a breach of the tipper's duty of confidentiality.

Introduced in the House by Representative Stephen F. Lynch, the Ban Insider Trading Act [removes the personal benefit requirement to establish the tipper's liability](#) and makes it illegal to trade on inside information, which it defines as "nonpublic and obtained illegally, directly or indirectly from an issuer with an expectation of confidentiality or that such information will only be used for a legitimate business purpose, or in violation of a fiduciary duty."

The Senate proposition is broader, making it [illegal to trade with information not publicly available](#). However, the bill provides two exceptions: it's legal to trade with information developed independently from public sources and the S.E.C. may exempt certain persons, transactions or communications which serve the public interest. [Critics](#) argue that the bill changes the focus from the breach of the duty of confidentiality to simply whether the information was available to the public. Without providing a definition for "publicly available sources," the bill could hamper trades based on restricted but reasonable sources of information, such as investment banks' reports.

Before these propositions surfaced, it was [expected](#) that Congress would react to U.S. v. Newman against Wall Street and hedge funds and in favor of small investors. However, it remains in question whether Democrats will actually be able to get these bills passed through a sharply divided legislature.