

# Insider Trading

## Pre-Reading

### A. Warm-Up Questions

1. What do you know about these people or organizations? Charles Fogarty, Martha Stewart, ImClone, Texas Gulf Sulphur, US Security and Exchange Commission.
2. Do you want to own stock in any companies? Why or why not?
3. What kind of companies do you think are good investments? Can you name any companies that you think have stock prices that will go up?
4. What kind of companies do you think are poor investments? Can you name any companies that you would not invest in because the stock prices will go down?
5. If you were a business owner, would you want to be publicly owned? In other words, would you want stock in your company to be bought and sold? Or would you remain privately owned? Discuss the pros and cons to both types of companies.



### B. Vocabulary Preview

Match the words on the left with the correct meanings on the right.

- |                         |   |
|-------------------------|---|
| _____ 1. stock          | a) to use in the wrong way                            |
| _____ 2. securities     | b) those who work at a company                        |
| _____ 3. employees      | c) to put money into a company                        |
| _____ 4. officers       | d) those owning stock in a company                    |
| _____ 5. directors      | e) those holding positions of authority at a company  |
| _____ 6. stockholders   | f) those holding power to give direction to a company |
| _____ 7. shares         | g) stocks or bonds proving ownership in a company     |
| _____ 8. fiduciary      | h) held in trust at a company                         |
| _____ 9. misappropriate | i) a portion of a company                             |
| _____ 10. invest        | j) equal portions in a company                        |

# Reading

## INSIDER TRADING

### *A Definition and Discussion*

1. Insider trading has a negative connotation even though it isn't always done illegally. Insider trading occurs when corporate "insiders" trade the company's **stock** or **securities**. An "insider" is someone who plays an important role in the corporation—certain **employees, officers, directors, or stockholders** who already hold a certain percentage of the company's **shares**. Most of the time, their trades are legal. When they trade in their own securities, they must report their trades to the US Securities and Exchange Commission (SEC). However, when an insider trades based on information that has not been made public and is obtained from the insider's everyday role at the company, it becomes illegal. Insiders are prohibited by their **fiduciary** duties to buy or sell a security based on the insider information. It is also illegal for an insider to share this information with someone else, and "tipping" or acting on a tip is illegal.
2. The SEC has brought several insider trading cases. Those cases are against insiders and others who traded after they gained knowledge of certain business developments that might affect the stock prices. The SEC has also brought cases against friends and relatives of the insiders who traded based on receipt of the information from an insider; legal, banking, and printing company employees who received information to perform services to the corporation whose stocks they traded; government employees who gained information based on their employers, or other people who **misappropriated** and profited from confidential information.
3. Insider trading is a serious offense because it is not fair. People cannot believe in the integrity of **investing** and they start to worry that investing

is not safe. Although many countries have laws forbidding insider trading, it is the United States, the United Kingdom, and Canada that have the strictest laws and punishments. The SEC has made enforcing insider trading a priority. Stiff criminal penalties or less strict civil penalties can be decided in the event that an insider trading case is proved. It can be difficult to prove because there often isn't evidence such that is found in other criminal cases. While cases such as murder might have some sort of physical evidence that directly links the accused to the crime, most of the evidence in insider trading cases is circumstantial. Hence, civil insider trading cases can be easier to prove since they only require guilt be shown by most of the evidence and not beyond a reasonable doubt as in a criminal case. Therefore, in the US, insider trading can be punished with monetary fines that must be paid, or by imprisonment that must be served depending on the type of case.



## Reading cont.

4. With many mergers taking place, the risk of insider trading increases. Several cases in the US in the 1980s were important to the legal history of insider trading. In one case, a printer was brought to trial accused of learning of information that was not known to the public. He learned the information because he had been hired to print materials for a company who was buying another company. He bought stock in the company that was buying the other. The case went through several decisions, reversals, and courts. Another case in the late 1980s involved a writer for the Wall Street Journal. His stories were considered influential and his column could affect the stock prices about his subjects. He was accused of tipping information and then sharing in the profits that others made from his tips. This case too was appealed and later involved the Supreme Court who agreed that the writer engaged in fraud.
5. Since insider trading is not just a US issue and companies are publicly traded in other countries around the world, more nations are involved in prosecuting cases. The US has entered into several treaties with countries such as Switzerland, Turkey, Canada, and Italy, among others. These treaties are called Mutual Legal Assistance Treaties and allow countries to help each other locate witnesses, obtain statements, and find business records. Perhaps if everyone works together, the world of investing will remain fair and safe, and keep its integrity intact.

## Vocabulary Review 1

### A. Penalties

What two types of penalties are there for insider trading in the US?  
 Define each based on the information in the reading.

- |                            |                            |
|----------------------------|----------------------------|
| 1. _____<br>_____<br>_____ | 2. _____<br>_____<br>_____ |
|----------------------------|----------------------------|

### B. Questions

Answer these questions in your notebook based on what you read in the main reading.

1. If you are punished monetarily, how are you punished?
2. If you are imprisoned, how are you punished?
3. How do insiders get their name?
4. If you receive a tip, what do you get?

## Pair Work (Partner A)

### A. Reading

Read the short article to the right, but do not show it to your partner. Your partner will ask you questions about your article.

#### **CHARLES FOGARTY**

The history of insider trading extends for years. In 1963 and 1964, a man named Charles Fogarty purchased Texas Gulf Sulphur shares. Fogarty was an insider. He was an executive VP (vice president) of Texas Gulf and he had the inside knowledge that his company was about to become even more lucrative. He learned of some confidential information that could not be made public until after the company completed the legal rights necessary. While the legalities were in process, Fogarty purchased over 3000 shares of Texas Gulf and made a lot of extra money. This transaction was considered unfair because other people did not have the same privy information. Did Fogarty win while other traders who didn't have the information lose? The case did eventually go to court in 1966: the SEC vs. Texas Gulf Sulphur Company. Did Fogarty have an unfair advantage since he had prior knowledge? In this case, the federal court said that a person who obtains information has two choices. That person can disclose the information or can refrain from handling any trading transactions. Since that time, many cases have traveled through the American court system and the laws have evolved. Other cases include the US vs. Carpenter and the US vs. O'Hagan.

### B. Sharing Information

Work with your partner. Ask the questions to the right about your partner's reading. Write the answers in your notebook.

1. Who was the alleged inside trader?
2. What did she do?
3. Where did she work?
4. When did she receive a tip?
5. Why did she sell her stock?

## Pair Work (Partner B)

### A. Reading

Read the short article to the right, but do not show it to your partner. Your partner will ask you questions about your article.

#### MARTHA STEWART

Martha Stewart is an American businesswoman who is famous for homemaking. She has written books on cooking and wedding planning. She is also the editor of the magazine *Martha Stewart Living* that at one time had a circulation of millions of copies per issue. Her empire grew and Martha Stewart Living Omnimedia eventually went public so people could buy shares. Those who follow the stock market could track the company on the New York Stock Exchange. Its ticker symbol was MSO. Stewart maintained a majority of the shares. This fame isn't Stewart's only association with the stock market. Stewart also owned stock in a company called ImClone which develops medicines for oncology. In 2001, she had received notice from her broker's company that the CEO of ImClone was going to sell his shares before what was likely to be a negative Food and Drug Administration (FDA) ruling. Stewart sold her shares, and was subsequently accused of insider trading when she avoided losing a lot of money by selling her stock of ImClone just one day before the value fell. Stewart went to trial and was found guilty. She was sentenced to serve five months in a federal prison and a two-year supervised release program that included five months of being confined to her home. In addition to the imprisonment, Stewart was ordered to pay a large fine. Today, she is back and is very involved in her business.

### B. Sharing Information

Work with your partner. Ask the questions to the right about your partner's reading. Write the answers in your notebook.

1. Who was the alleged inside trader?
2. What did he do?
3. Where did he work?
4. When did the case go to court?
5. Why did the court determine that any person with prior knowledge has two choices?

Look at the business section of a newspaper. Study the ticker symbols and the values of the stocks. Write an analysis of the top three stocks you'd like to own and discuss why. Then list three stocks you would not want to own and your reasons.

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.

## Vocabulary Review 2

### A. Acronyms

What do the following acronyms stand for?

1. NYSE: \_\_\_\_\_
2. MSO: \_\_\_\_\_
3. CEO: \_\_\_\_\_
4. SEC: \_\_\_\_\_
5. FDA: \_\_\_\_\_
6. VP: \_\_\_\_\_

### B. Choose the Correct Word

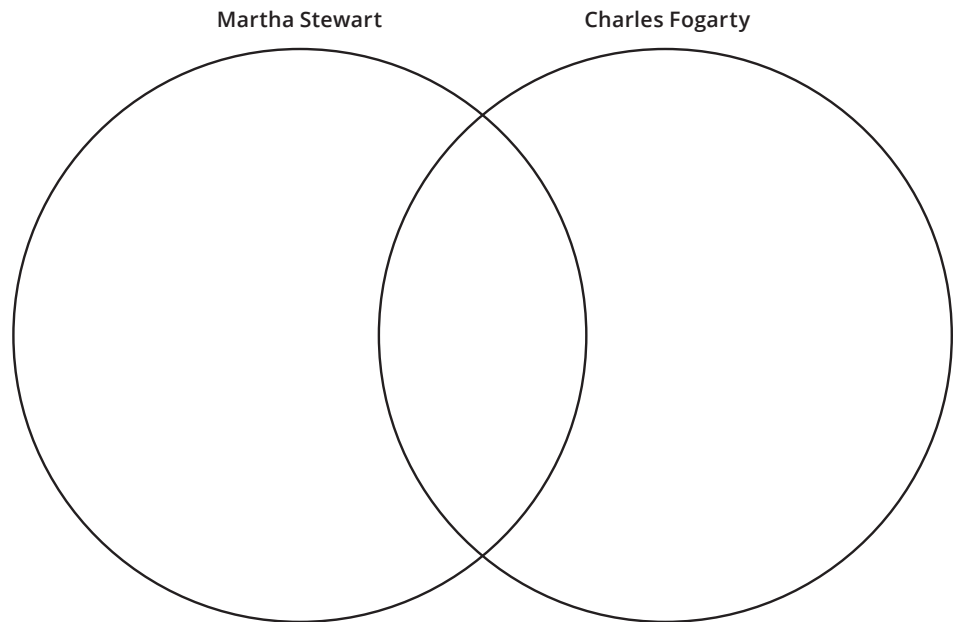
Choose the word closest in meaning to the vocabulary used in the jigsaw readings.

- |                |                           |  |
|----------------|---------------------------|--|
| 1. lucrative   | 4. refrain from           | 7. empire                                    |
| a) bankrupt    | a) give away              | a) a country with a lot of people            |
| b) profitable  | b) hold onto              | b) a home with a lot of rooms                |
| c) poor        | c) go away                | c) a company with a lot of holdings          |
| d) midrange    | d) keep from              | d) a university with a lot of teachers       |
| 2. privy       | 5. trading                | 8. go public                                 |
| a) public      | a) buy, sell, or exchange | a) a company remains private                 |
| b) well-known  | b) give away              | b) a company doesn't sell shares             |
| c) private     | c) hold onto              | c) a company has only directors and officers |
| d) unknown     | d) do away with           | d) a company allows people to buy shares     |
| 3. disclose    | 6. transactions           |  |
| a) tell        | a) bargains               |  |
| b) keep secret | b) dealings               |  |
| c) lock up     | c) negotiations           |  |
| d) hold        | d) talks                  |  |

## Group Work

### A. Compare and Contrast

Work with a partner. Compare and contrast the insider trading cases of Charles Fogarty and Martha Stewart. Fill in the Venn diagram.



### B. Research

Can you think of other cases of insider trading? Do some research and add a circle to the Venn diagram with a case you find.

