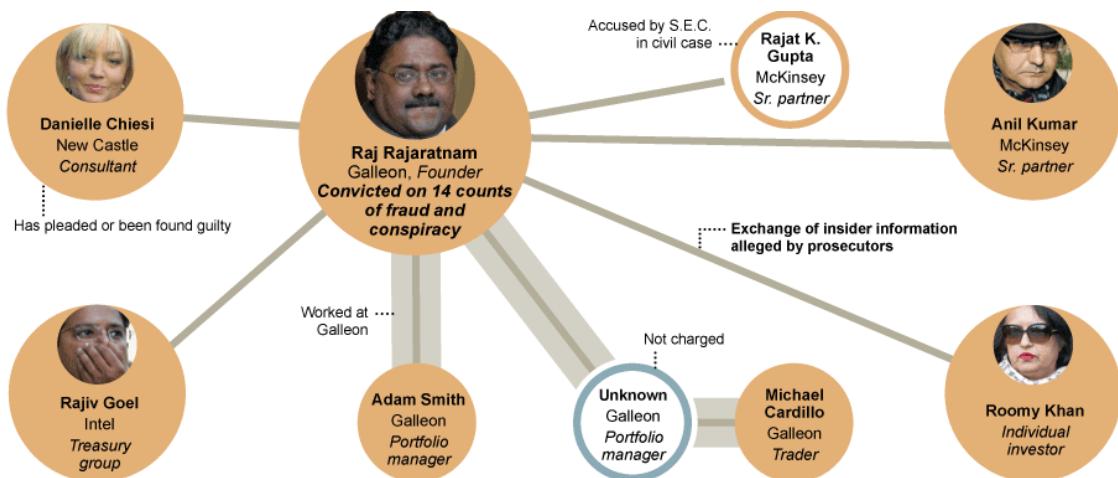


## INSIDER TRADING

In the past 5 years the Federal government has adopted a much more aggressive stance toward the prosecution of insider trading cases, winning convictions in more than 80 cases and sending many people to prison.

### Rajaratnam Network

<http://www.nytimes.com/interactive/2011/03/08/business/galleon-graphic.html?ref=insidertrading>



## TEST

A person violates the insider trading laws if the person:

- 1) **Has possesses material information** (information that would be significant to an investor in the stock; information that would move the market)
- 2) **That is non-public**
- 3) **And knowingly trades (or cause others to trade on) based upon this material information before the public is aware of it.**

(Trading may be buying, or shorting.)

Example:

You buy and sell stock in Todco, knowing that non-public information, once it is made public, will affect the price of Todco stock.

You can either buy low, and sell high, or buy and short the stock.

Example:

The U.S. Supreme Court has ruled that investors can be prosecuted for using inside information, even if they don't work for the company whose stock they are buying or selling.

Front running (3:30)

<http://www.npr.org/templates/story/story.php?storyId=7244110>

e.g. Bill Gates asked you to buy \$30M of Todco stock, when the money flooded into the market, the price would go up, so buying stocks before Bill Gates' purchase is front running.

SAC Capital to Pay \$616 Million in Insider Trading Cases

*By*

[Peter Lattman](#)

March 15, 2013 1:58 pm March 15, 2013 1:58 pm 374 Comments



Steve Marcus/Reuters Steven A. Cohen is the owner of SAC Capital Advisors.

10:58 p.m. | Updated

## ANTITRUST LAW

### WHAT ARE ANTI-TRUST LAWS

1. The rules of the game of capitalism, designed to preserve the competitive process.
2. The engine of free enterprise is competition. When it works, the market economy usually functions well – numerous sellers vie (by producing good products at reasonable prices) for numerous buyers, and those who produce the best products at the best prices win.
3. But competition sometimes fails because private participants in the market subvert competition.
4. Historical perspective: Anti-Trust (No Trusts). Trusts worked in a pernicious ways to stifle competition, allowing a small group of people to control entire industries (Standard Oil). The first Anti-Trust law was designed to combat this.

You may think that businesses don't really collude to fix prices, but it really happens.

### Apple, Google Poaching Settlement Appears Headed for Approval

By REUTERS MARCH 2, 2015, 7:07 A.M. E.S.T.

SAN FRANCISCO — A U.S. judge on Monday seemed satisfied with a proposed \$415 million settlement that would end a lawsuit in which tech workers accused Apple Inc, Google Inc and two other Silicon Valley companies of conspiring to hold down salaries.

ANTI-TRUST LAWS APPLY TO ALL BUSINESSES...

...Unless there is a specific statutory exception.

Congress has shielded the following from anti-trust enforcement:

Baseball (Go figure...)

Labor Unions (Why? Collective bargaining)

Agricultural co-ops (Why? Producers pool products)

Insurance businesses regulated by States (why? B/C states limit pricing)

**Anti-Trust laws can be enforced in four different ways:**

1. The Justice Department can file a civil case (to prohibit conduct) or a criminal case (that can result in fines for the company, and fines/jail for individuals). ([only way to file a criminal case](#))

Because the Executive Branch is “political”, whether anti-trust laws are vigorously enforced, or ignored, is often a function of the particular view of the President. Democrats tend to more vigorously enforce these laws than Republicans, who view mergers, in particular, and benefiting companies through economies of scale.

Settlements often result when the Government files civil/criminal cases.

2. The Federal Trade Commission has the right to enforce, on behalf of the government, the Anti-Trust Laws (through investigation); but can only file civil suits (no criminal penalties). Settlements – often result when the Government files civil/criminal cases.
3. State attorney generals, provided their states have anti-trust laws, can file cases (think of Elliot Spitzer, former Attorney General of New York – who has been the most active).
4. Private parties can sue in Federal Court for injunctive relief and treble damages.

In the case of individuals (or, more likely, competing corporations), the courts have held that the party wishing to sue must establish **STANDING**, e.g. –

- 1) That the antitrust action caused, or was a substantial factor in causing, the injury that was suffered;
- 2) That the unlawful actions of the accused affected business activities of the plaintiff that were protected by the antitrust laws. (**only for businesses, not individuals**)

ANTI-TRUST: HISTORY 1, 2, 3

FROM PBS / THE ROOSEVELTS

<http://www.pbs.org/kenburns/the-roosevelts/classroom/lesson-plans/>

The policy reason for antitrust legislation is the desire to maintain (and foster) competition.

Anti-trust laws are a set of rules designed to preserve the competitive process, and enable markets to direct resources to the uses that will best satisfy consumers.

Thesis: Adam Smith's (and Milton Friedman's) ideal of unfettered competition among businesses, as the recipe for best serving the consumer, is undermined to the extent that competition is diminished.

But competition sometimes fails because private participants in the market subvert competition. If the competitors get together, and rig the game, consumers lose.

The Standard Oil trust of the 1890s, and the so-called Robber Barons, were the catalyst for reform.

## THE SHERMAN ACT (1890) / SECTION I

1. Section I: “every contract, combination in the form of trust otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is...declared to be illegal.”

The restraint on trade must be unreasonable (See Rule of Reason, below)

The trigger is “**contract**”, “**combination**” or “**conspiracy**”.

Without one of these, there can be no violation.

The key here is that at least two actors must be acting in conscious concert (ex: ever notice how airfares always seem the same among multiple airlines...not illegal if one is simply the “price leader” and others follow. Only illegal if they get together and “set” prices.)

### The Rule of Reason

The Court had to develop a workable test, lest any communications between competing firms might have been deemed illegal under the anti-trust laws.

The Rule of Reason holds that only **unreasonable restraints of trade** violate Section 1.

Courts examine the following factors in applying the **rule of reason**:

1. The pro- and anticompetitive effects of the restraint;
2. The competitive structure of the industry
3. The firm’s market share or power;
4. The history and duration of the restraint;
5. Any other relevant factors.

### **The Per Se Rules**

These actions are **inherently illegal** under the antitrust laws; the court won't apply the rule of reason because the **violations are so obvious**.

Think of restraints of trade as being either:

**Horizontal** ---

Agreements between competing firms.

OR

**Vertical** ---

One firm controls all aspects of the product, from design and production, to retail sales;

OR

multiple firms, each involved in some aspect of design and production, to wholesale and retail distribution, involved in a conspiracy.

Horizontal Restraints of Trade that are per se violations include:

**Bid Rigging**

(companies would cooperate together, set a winner a time, then help the other in the next time)

**Market Divisions**

(geographic/product division: one only sells in north SEA, one in south SEA)  
e.g. Sotheby/Christie

**Group boycotts**

Any agreement by two or more sellers to refuse to deal with, or boycott, a particular person or firm, is prohibited.

**Price Fixing**

**Covenants Not to Compete**

Generally illegal, as restraints on trade.

Example:

Taco Bell promises Taco Time \$100,000 if Taco Time doesn't locate any Restaurants within 10 miles of any Taco Bell in WA.

BUT – Two **major exceptions**:

Sale of business. Owner may agree not to compete in geographic area for several years; this is via the “goodwill” part of sale

Employees may sign “non-compete” clauses (discussed in Employment Law)

### **Tying Arrangements**

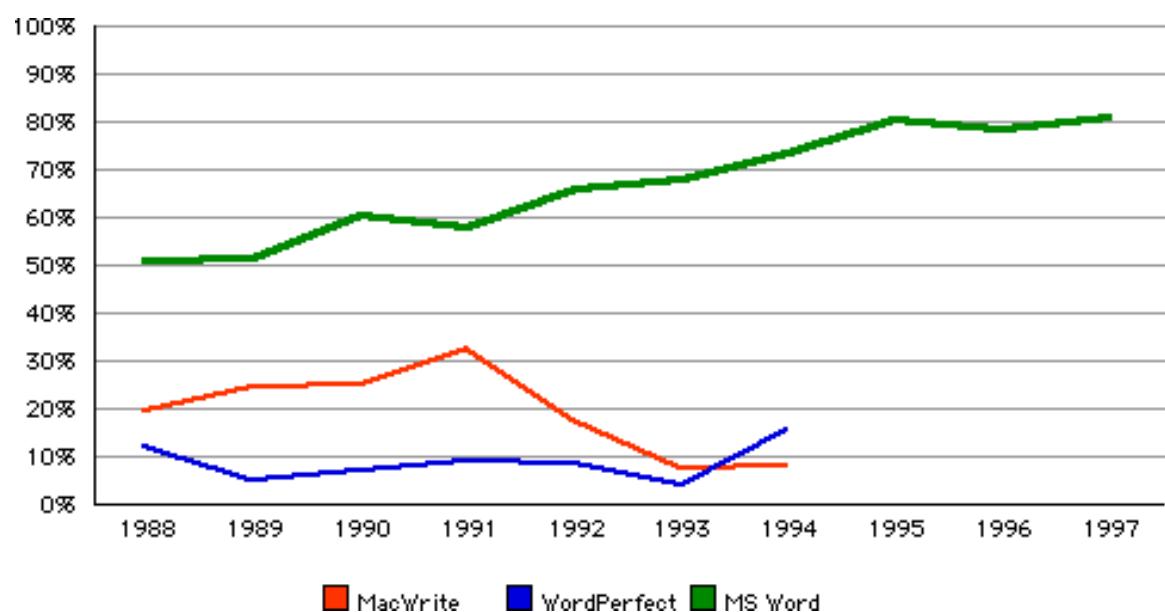
A tying arrangement is defined as the conditioning of the sale of one product on the buyer's purchase of another product.

(e.g. if you want to buy a fancy product, you should buy some inferior ones at the same time)

Tying arrangements can be challenged under S/1 of the Sherman Act, S/5 of the Clayton Act.

1. Most common form – occurs where a seller has market power with respect to the **tying product** and can use this to leverage increased sales of the **tied product**. (This results in economies of scale for the tied product, and cost savings to the manufacturer.)
2. There is a three-part test for unlawful tying (if met, the conduct is ordinarily a per se unlawful). But note: even if a tying arrangement is not per se unlawful, the court may apply the “rule of reason” test and still find it unlawful.
  - i. **Two separate products must be involved**  
(think of Xerox copiers, spare parts, and the technicians who services are required to fix them: these are different products... which might be illegally tied.)  
  
Note: Integrated products may be examined under the “rule of reason” rather than per se test. What is an integrated product? (Consider “clock-radios”?)
  - ii. **The seller must have sufficient market power in the tying product to force the sale of the tied product.** If the seller has a monopoly in the tying product...the test is usually met.
  - iii. **There must be an impact on commerce.**

Microsoft: Internet Explorer illegally tied to Window operating system.



## **The Big Picture -- 1998**

Worldwide, over 90% of all personal computers run Windows. As Windows has grown its market share, Microsoft has also grown its market share in the word processing and spreadsheet markets – unfairly, according to Novell and many observers.



---

## **Judge rules Microsoft violated antitrust laws**

A federal judge issues a stinging rebuke of Microsoft, saying the software giant violated antitrust laws.

Tech Industry

January 2, 2002

4:43 PM PST

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tw

in

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ex

com

link

**WASHINGTON--A federal judge has concluded that Microsoft violated antitrust laws by leveraging its monopoly position in operating systems to capture the market for Web browsers.**

"The court concludes that Microsoft maintained its monopoly power by

## **CLAYTON ACT**

The Clayton Act looks to potential problems in the future, and tries to curb them now.

1. Section 3 makes “tying” or “exclusive dealing” illegal

- (e.g., A manufacturer will only sell products to a retailer if the retailer refuses to carry one of the manufacturer's competitor's products.
2. Section 7 prohibits certain acquisitions (for example, one company purchasing a rival company) if the result will be a significant decrease in competition.  
(Consider the likely result if Exxon were allowed to purchase all the BP, Arco, and Chevron gas stations within a 30 mile radius.)

The objective of antitrust law is to maintain competition. If a merger threatens competition, the government can block the merger, or order the two companies to take steps (usually divestiture) before the merger is allowed to go through.

Pursuant to this provision, the Government may bring an action to stop a proposed merger.

Section 7 was last amended in 1980, and now prohibits any merger "where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

NPR 4 Min

How anti-trust regulators decide whether to block a merger

<http://www.npr.org/blogs/money/2013/02/15/171955074/mavericks-hot-documents-and-beer>

#### US ANTITRUST LAWS REACH FOREIGN COUNTRIES.

A combination to fix prices, even if hatched on foreign soil, may be prosecuted in the United States, per the Sherman Act, if the effect of the combination is to raise prices in the United States.

United States v. Nippon Paper Industries. The touchstone is whether the conduct that takes place abroad significantly affects either consumers in the United States or American export opportunities to foreign countries. The Antitrust Division of the Justice Department expends considerable resources each year dealing with foreign matters.

Archer-Daniels-Midland and foreign competitors...

Nine Japanese Auto Parts Makers Plead Guilty To Price Fixing NPR 3 Min

<http://www.npr.org/templates/story/story.php?storyId=226552996>

## INTERNATIONAL ANTITRUST ENFORCEMENT

Three factors have changed antitrust enforcement into a global, rather than a strictly national matter:

1. Companies have become international, either selling goods around the globe, or buying raw materials or labor around the world; international mergers also contribute to this;
2. Foreign countries have realized that competition rather than state monopolies adds wealth to countries;
3. The deregulation of former natural monopolies (telecommunications, power, etc) have caused regulators to become concerned about anticompetitive practices, especially when mergers occur.

EU Fines Microsoft 700 Million NPR

<http://www.npr.org/2013/03/06/173605317/e-u-hits-microsoft-with-a-732-million-fine>

## **FOREIGN CORRUPT PRACTICES ACT**

As a result of **U.S. Securities and Exchange Commission** investigations in the mid-1970s, over 400 U.S. companies admitted making questionable or illegal payments in excess of \$300 million to foreign government officials, politicians, and political parties.

The abuses ran the gamut from **bribery** of high foreign officials to secure some type of favorable action by a foreign government to so-called **facilitating payments** that were made to ensure that government functionaries discharged certain ministerial or clerical duties.

One major example was the **Lockheed** (a major commercial airplane manufacturer) **bribery scandals**, in which officials of **aerospace** company **Lockheed** paid foreign officials to favor their company's products.

**Congress** enacted the FCPA to bring a halt to the bribery of foreign officials and to restore public confidence in the integrity of the American business system.

The FCPA prohibits

- (1) US business and their agents (important: you are responsible for the actions of those who you hire to represent you!)
- (2) from bribing (what's a bribe? [Something of value](#))
- (3) foreign **OFFICIALS** (e.g., the person bribed must work for the government)  
ADD ON: WHICH COUNTRIES, THAT COMBINE GOVT AND INDUSTRY, MIGHT BE PROBLEMATIC?
- (4) to influence an official act (e.g., to do something on behalf of the government)
- (5) to gain or retain business.

[\(the FCPA does not apply to bribing private persons\)](#)

So, is this law actually used?

#### Largest Settlements Under the Foreign Corrupt Practices Act

The law designed to prohibit the payment of bribes to foreign officials by United States businesses has produced more than \$3 billion in settlements from a list of companies that is notable for its lack of American names. As of 2012, this list shows the highest fines.

COMPANY	NATIONALITY	YEAR	AMOUNT, IN MILLIONS
Siemens	GERMANY	2008	\$800
KBR/Halliburton	U.S.	2009	579
BAE Systems	BRITAIN	2010	400
Snamprogetti/ENI	HOLLAND/ITALY	2010	365
Technip	FRANCE	2010	338
JGC	JAPAN	2011	219
Daimler	GERMANY	2010	185
Alcatel-Lucent	FRANCE	2010	137
Magyar Telekom/Deutsche Telekom	HUNGARY/GERMANY	2011	95
Panalpina	SWITZERLAND	2010	82

[Send Feedback](#)

The firm at the top of the list if Siemens:

According to the New York Times:

WASHINGTON — Shell companies, Swiss bank accounts, double-crossing middlemen and cash being smuggled across borders were all part of a decade-long bribery scheme aimed at helping Siemens, the German industrial giant, secure a \$1 billion contract to produce national identity cards for Argentina, the Justice Department said Tuesday.

As a matter of public policy (the reasons for laws), what are the Pros?

Cons?

Wal-Mart in Mexico

The New York Times (The series of reports by the New York Times won journalism's highest award, the Pulitzer Prize).

(length – 1:30)

<http://www.nytimes.com/2012/12/18/business/walmart-bribes-teotihuacan.html>

All US companies, and their employees, and agents, are forbidden from paying bribes to obtain business.

So, it's clear American businesses cannot bribe ***FOREIGN OFFICIAL***...

New Question:  
Who is this man?

WHAT ABOUT THIS COMPANY.....



JPMorgan Chase & Company

JPMorgan Chase & Co. is an American **multinational** banking and financial services **holding company**. It is the **largest bank in the United States**, with total assets of US\$2.515 trillion.

To promote its standing in China, **JPMorgan Chase** turned to a consulting firm run by a 32-year-old executive named Lily Chang.

Ms. Chang's firm, which received a \$75,000-a-month contract from JPMorgan, appeared to have only two employees.

And on the surface, Ms. Chang lacked the influence and public name recognition needed to unlock business for the bank.

## THE REST OF THE STORY / FOREIGN CORRUPT PRACTICES ACT

### Graph of Family Dynamics

Is it illegal?

Or, as Fortune Magazine asked:  
FORTUNE — Does it pass the smell test?

So you can see, this presents some difficulties for American Businesses.

In a country like China, where so much of the government is tied to businesses, it's problematic.

### SOX (SARBANES-OXLEY)

Why the need?

## LIST OF MAJOR ACCOUNTING SCANDALS

## LEHMAN BROTHERS SCANDAL (2008)

### COMPANY

LEHMAN BROTHERS

Global financial services firm

### WHAT HAPPENED

Hid over **\$50 billion** in loans disguised as sales.



### MAIN PLAYERS

Lehman executives



the company's auditors,  
Ernst & Young



### HOW THEY DID IT

Allegedly sold toxic assets to Cayman Island banks with the understanding that they would be bought back eventually. Created the impression Lehman had \$50 billion more cash and \$50 billion less in toxic assets than it really did.

### HOW THEY GOT CAUGHT

Went bankrupt.



### PENALTIES

Forced into the largest bankruptcy in U.S. history. SEC didn't prosecute due to lack of evidence.



### FUN FACT

In 2007 Lehman Brothers was ranked the #1 "Most Admired Securities Firm" by Fortune Magazine.



## TYCO SCANDAL (2002)

### COMPANY



New Jersey-based blue-chip Swiss security systems company

### WHAT HAPPENED

CEO & CFO stole \$150 million and inflated company income by \$500 million.



### MAIN PLAYERS

CEO Dennis Kozlowski and former CFO Mark Swartz



### HOW THEY DID IT

Siphoned money through unapproved loans and fraudulent stock sales. Money was smuggled out of the company disguised as executive bonuses or benefits.



### HOW THEY GOT CAUGHT

SEC and Manhattan D.A. investigations uncovered questionable accounting practices, including large loans made to Kozlowski that were then forgiven.

### PENALTIES

Kozlowski and Swartz were sentenced to **8-25 years in prison**. A class-action lawsuit forced Tyco to pay **\$2.92 billion** to investors.



### FUN FACT

At the height of the scandal Kozlowski threw a **\$2 million birthday party** for his wife on an island, complete with a Jimmy Buffett performance.



## AMERICAN INSURANCE GROUP SCANDAL (2005)

### COMPANY

Multinational insurance corporation



### WHAT HAPPENED

Massive accounting fraud to the tune of \$3.9 billion was alleged, along with bid-rigging and stock price manipulation.



### MAIN PLAYERS

CEO Hank Greenberg

### HOW HE DID IT

Allegedly booked loans as revenue, steered clients to insurers with whom AIG had payoff agreements, and told traders to inflate stock prices.

### HOW HE GOT CAUGHT

SEC regulator investigations, possibly tipped off by a whistle-blower.



### PENALTIES

Settled with the SEC for \$10 million in 2003 and \$1.64 billion in 2006, with a Louisiana pension fund for \$115 million, and with 3 Ohio pension funds for \$725 million. Greenberg was fired, but has faced no criminal charges.



### FUN FACT

After posting the largest quarterly corporate loss in history in 2008 (\$61.7 billion) and getting bailed out with taxpayer dollars, AIG execs rewarded themselves with over \$165 million in bonuses.



## ENRON SCANDAL (2001)

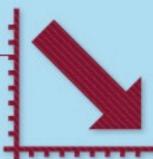
### COMPANY

Houston-based commodities, energy and service corporation



### WHAT HAPPENED

**Shareholders lost \$74 billion**, thousands of employees and investors lost their retirement accounts, and many employees lost their jobs.



### MAIN PLAYERS

CEO Jeff Skilling and former CEO Ken Lay



### PENALTIES

Lay died before serving time; Skilling got **24 years in prison**. The company filed for bankruptcy. Arthur Andersen was found guilty of fudging Enron's accounts.

### HOW THEY DID IT

Kept huge debts off the balance sheets.



### HOW THEY GOT CAUGHT

Turned in by internal whistle-blower Sherron Watkins; high stock prices fueled suspicions.



### FUN FACT

Fortune Magazine named Enron "America's Most Innovative Company" for six years in a row prior to the scandal.



Major Elements: **Sarbanes Oxley (SOX)**

### **Public Company Accounting Oversight Board (PCAOB)**

Title I Establishes the Public Company Accounting Oversight Board, to provide independent oversight of public accounting firms providing audit services ("auditors").

### **Auditor Independence**

Establishes standards for external auditor independence, to limit conflicts of interest. It also addresses audit partner rotation, and It restricts auditing companies from providing non-audit services (e.g., consulting) for the same clients.

### **Corporate Responsibility**

Title III consists of eight sections and mandates that senior executives take individual responsibility for the accuracy and completeness of corporate financial reports.

### **Corporate and Criminal Fraud Accountability**

Title VIII consists of seven sections and is also referred to as the "Corporate and Criminal Fraud Accountability Act of 2002". It describes specific criminal penalties for manipulation, destruction or alteration of financial records or other interference with investigations, while providing certain protections for whistle-blowers.

### **White Collar Crime Penalty Enhancement**

Increases the criminal penalties associated with [white-collar crimes](#) and conspiracies. It recommends stronger sentencing guidelines and specifically adds failure to certify corporate financial reports as a criminal offense.

### **Corporate Tax Returns**

Title X consists of one section. Section 1001 states that the **Chief Executive Officer** should sign the company tax return.

### **Corporate Fraud Accountability**

It revises sentencing guidelines and strengthens their penalties. This enables the SEC to resort to temporarily freezing transactions or payments that have been deemed "large" or "unusual".

How Sarbanes-Oxley Has Affected Corporate Culture NPR

<http://www.npr.org/templates/story/story.php?storyId=4673074>