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NOTES

NEW CAPITAL MARKETS AND SECURITIES REGULATIONS IN HUNGARY: A COMPARATIVE ANALYSIS OF THE INSIDER TRADING REGULATIONS IN HUNGARY AND THE UNITED STATES

I. INTRODUCTION

The explosion in insider trading regulation abroad during the last decade has sparked renewed interest in the economic, ethical, and legal bases and consequences of prohibiting securities trading on the basis of inside information. There is an "evolving consensus among the countries with important capital markets that trading on the basis of inside information should be regulated." The prevailing policy is that insider trading undermines the confidence of investors and the integrity of the market and that such inefficient and unfair practices should be prohibited. However, the worldwide outcry against


2. 10 SECURITIES LAW SERIES, INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION § 1.08[5][a], at 1-116.19 (Harold Bloomenthal & Samuel Wolff eds., 1993) [hereinafter Bloomenthal].

insider trading is also relatively new⁴ and has spawned diverse legislative and regulatory reactions.⁵

An ambitious effort to codify insider trading law has recently been effected in Hungary. On January 25, 1990, the Hungarian Parliament enacted Act VI of 1990 on Issuing and Public Broking of Certain Securities and on Stock Exchange (1990 Securities Act), which includes a “Restriction of Insider Dealing.”⁶ Additionally, as part of a comprehensive economic


4. Until 1980 the United States and France were the only countries which had comprehensively addressed the insider trading problem. However, during the last decade, new laws have emerged in Europe, Canada, Latin America, and the Pacific Rim countries. Langevoort, supra note 1, at 7.

5. While most countries now agree that trading or tipping on the basis of inside information should be regulated, international approaches differ as to the scope of persons prohibited and the range of prohibited activity. For example, the definitions of primary insiders, those persons with direct and personal access to inside information, vary considerably. The European Community's Insider Trading Directive broadly defines primary insiders as members of the issuer, shareholders of the issuer, and persons possessing inside information by virtue of the exercise of their employment, profession, or duties, thereby including persons unrelated to the issuer. EC Insider Dealing Directive, supra note 3, art. 2. The United Kingdom's Company Securities Act defines primary insiders more restrictively, as persons who are “knowingly connected” with an issuer, such as directors, officers, employees, or other persons in positions involving a professional relationship in which it would be reasonable to expect the person not to disclose the information, thereby requiring an indirect link between the trader and the issuer. UK Insider Dealing Act, supra note 3. The most conservative definition of primary insiders is found in Japan's Securities Exchange Law, which defines them as corporate-related parties associated with the issuer by employment, contract, or government supervision, thereby requiring a direct link between the trader and the issuer. Japan Securities Exchange Law, supra note 3. See infra text accompanying notes 121-30, 143 for the scope of primary insiders in Hungary and the United States. Additionally, while most countries extend the insider trading prohibition to recipients of inside information, known as secondary insiders or tippees, they differ in their scope of tippee liability. The European Community and Great Britain limit tippee liability by requiring actual or constructive knowledge of the inside nature of the information received on the part of the tippee. Japan further restricts the scope of tippees by imposing liability only on tippees who receive inside information directly from the corporate-related party. See infra text accompanying notes 152-55, 163-64 and note 123 respectively for the American and Hungarian definitions. Finally, most countries prohibit the disclosing of inside information, but differ on the scope of tippers. Great Britain broadly prohibits both primary and secondary insiders from the act of tipping. The European Community less broadly bars primary, but not secondary, insiders from tipping, except for disclosures made in the normal course of the exercise of their employment, profession, or duties. Japanese law contains no express anti-tipping ban. See infra part IV.C. and text accompanying notes 156-58 for the United States and Hungarian renditions.

6. Act VI 1990 on Issuing and Public Broking of Certain Securities and on
program to transform its Soviet-style command economy into a Western-style market economy, Hungary formally reopened the Budapest Stock Exchange on June 12, 1990, after a forty-two-year hiatus. In light of the tremendous political and economic changes in Central and Eastern Europe in recent years and Hungary's singular position as the most economically advanced country in the region, the Hungarian market represents a unique opportunity for theorists to examine new securities regulations in the context of a fresh market. The economic success of the Budapest Stock Exchange and the legal consequences of the Hungarian securities regulations are of practi-
This Note explores the meaning and effect of the insider trading provisions in the Hungarian Securities Act by contrasting them with comparable American legislation. Many of the differences which will emerge reflect fundamental differences in the economic and legal conditions in Hungary and the United States. Specifically, lawmaking under Hungary's civil code system differs significantly from the United States' mix of statutory and judicial lawmaking. Additionally, the former socialist economy of Hungary is radically different from the prosperous market economy of the United States. In order to delineate the economic differences, Part II traces the economic development of Hungary from the New Economic Mechanism of 1968 to the reopening of the Budapest Stock Exchange in 1990.

Part III briefly discusses the basic elements of the insider trading prohibitions in the United States and Hungary. Part IV determines that the primary motivation behind the Hungarian statute is a desire to conform with a growing international consensus rather than a true concern with the economic inefficiency and ethical unfairness of insider trading. Part IV also notes that the clarity and predictability of a statutory definition of insider trading is preferable to the vagueness and arbitrariness of a case-by-case definition. Part IV concludes that because the scope of liability under Hungarian law is not limited by the American requirement of a fiduciary duty, Hungary's statutory scheme is broader and more rationally consistent with traditional market efficiency and fairness rationales underlying a policy against insider trading. Part V observes that lenient criminal sanctions, exceptions to short-swing liability, and nonaggressive institutional action will provide only weak deterrence and ineffective enforcement of the statutory regula-

10. See Emerging Stock Markets, supra note 6 (noting that Eastern European governments are adopting regulatory frameworks for securities markets and that it is a "particularly appropriate time to review the emerging regulatory framework, the present stages of development and the short-term future of the emerging capital markets in Eastern Europe"). But see Zsuzsa Ban, Taking Stock, HUNGARIAN OBSERVER, Sept. 1990 (emphasizing that "[f]or the time being, the new institution [the Budapest Stock Exchange] has more theoretical significance than practical utility").
tions. Part VI concludes that regardless of the true intentions behind the Hungarian reforms, Hungary must critically re-examine the bases and merits of its statutory approach. Part VII concludes by praising the Hungarians for an admirable effort, but warning that the true effectiveness of Hungary's enactment depends on its cohesive implementation, and that the real success of its emerging capital markets depends on their global adaptability.

II. AN OVERVIEW OF THE HUNGARIAN ECONOMY

A. Hungarian Economic Development

The economic transformation of Hungary from a command to a market economy has been implemented in sporadic reforms by the Hungarian government. The economic history of Hungary can be divided into three distinct phases: (1) the period after the 1968 reforms; (2) the period after the 1978 reforms; and (3) the period after the recent reforms during the late 1980s and early 1990s. Through economic deregulation

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11. See Denise Hamilton, Hungary's Stock Market Has Same Woes as Capitalist Counterparts, L.A. TIMES, Sept. 5, 1989, at 1 (noting that financial leaders in Hungary realize that implementing laws is much more difficult than passing them); OTTO HIERONYMI, ECONOMIC POLICIES FOR THE NEW HUNGARY: PROPOSALS FOR A COHERENT APPROACH 65 (1990) (arguing that the reform attempts in Hungary have been piecemeal and erratic); Danube Blues, ECONOMIST, May 28, 1988, at 48 (concluding that reform in Hungary has suffered from a chasm between rhetoric and reform).

12. The Hungarian securities market suffers from an inadequate supply of and demand for securities. The dearth of promising and profitable businesses and absence of confident and willing investors indicates that foreign expertise and investment is needed. Sources of this problem include difficult currency convertibility, intractable foreign debt, and unsophisticated technology. See, e.g., Gary Humphreys, Privatisers Get Back on Track, EUROMONEY, Mar. 1991, at 45; Thomas G. Donlan, Hungary for Stock—What's Up for Budapest's Bourse, BARRON'S, Feb. 5, 1990, at 46; Meat and Potatoes, J. COM., Mar. 6, 1989, at 8A; HIERONYMI, supra note 11, at 67-68.

and liberalization, Hungary has struggled to establish a new type of social economy combining centrally planned regulation with free market competition. While some commentators have praised Hungary for its “unparalleled ... efforts to transcend the basic structure of the traditional Soviet-type economic system,” others have criticized its “radically conceived but modestly implemented liberalism” and its “piecemeal and often erratic reform attempts.”

The New Economic Mechanism of 1968 was the first important milestone in Hungary’s economic transformation. The 1968 reforms rejected the former system of central, mandatory planning and introduced a more competitive environment of profit-driven state enterprises centrally regulated on only a macroeconomic level. As a result of the 1968 reforms, Hungary’s economy grew between 1972 and 1978. However, the country also suffered from unsophisticated trade exports, decreased terms of trade, increased inflation, and increased foreign debts.

The Hungarian government resorted to a more centralistic approach to respond to these problems. The shift in econom-

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14. BEREND, supra note 13, at 190, 294.
15. Brada & Dobozi, supra note 13, at 3.
17. HIERONYMI, supra note 11, at 65.
18. During the 1940s and 1950s, the Hungarian economy was a traditional Soviet-style command economy characterized by nationalized banks and industries, state and cooperative ownership, and compulsory plan indices. BEREND, supra note 13, at 2-6. The period between 1953 and 1968 was marked by a more indirect form of economic regulation, which introduced a limited number of reforms to increase company autonomy and provide profit incentives for market growth. BEREND, supra note 13, at 168-90. See generally BEREND & RANKI, supra note 13.
19. Specifically, between 1968 and 1972, the reforms pushed for increased company autonomy under a profit regulation system, changes in the pricing system to better reflect domestic value relations and international market prices, and partial decentralization of investment decisions whereby companies would compete for investment credits and capital allotments from the state budget. REVESZ, supra note 13, at 61-79.
20. RICHET, supra note 13, at 4; See also REVESZ, supra note 13, at 88-100. Arguably, these problems were the result of a host of external factors such as the explosion of oil prices in 1979, which led to increased energy import prices and decreased terms of trade, and the inflation of interest rates, which led to increased debt burdens. Clarke, supra note 13, at 46.
21. Specifically, some of the measures taken were attempts to correlate domestic prices to international market prices, to connect producer prices with consumer prices, to dismantle the branch ministries and unify bureaucratic institutions, to break up monopolistic state companies and encourage smaller private and coopera-
ic policy during the period between 1979 and 1984 emphasized the priorities of external trade balance over growth, and standard of living over investment.\textsuperscript{22} Although this short-term recentralization\textsuperscript{23} appeared to be a temporary step back from the 1968 efforts to minimize bureaucratic influence in microeconomic decisions, the centralist reforms of the 1970s did partially manage to accomplish some economic goals, such as debt stabilization and external balance.\textsuperscript{24} Despite the good intentions behind these reforms, economic stagnation pervaded the country in the years between 1978 and 1986,\textsuperscript{25} and a deep economic crisis hit during the late 1980s. The economy continued to suffer from severe inflationary pressures, excessive reliance on foreign credit, an intractable debt problem, declining export market shares, and decreased real wages and living standards.\textsuperscript{26} While drastic changes were obviously necessary, the reasons for Hungary's economic failures in the 1970s and 1980s are still unclear. Most of the criticism centers on the inadequacies of the regulatory mechanisms rather than external political and economic factors.\textsuperscript{27}

The late 1980s and early 1990s ushered in one of the biggest waves of economic reforms in Hungarian history. New economic regulations have focused on promoting privatization of businesses, encouraging foreign investment, and diversifying enterprises, to improve labor incentives by allowing election of company heads by employees, to transform a single banking system into a decentralized two-tier banking system, and to enact a bankruptcy law. \textit{REVESZ, supra} note 13, at 88-119; \textit{Brada \& Dobozi, supra} note 13, at 5-6.  
\textsuperscript{22} \textit{RICHET, supra} note 13, at 3.  
\textsuperscript{23} \textit{RICHET, supra} note 13, at 4.  
\textsuperscript{24} \textit{RICHET, supra} note 13, at 5.  
\textsuperscript{25} By 1984, the two principal sources of enterprise profits were subsidies and inflation. \textit{Clarke, supra} note 13, at 18.  
\textsuperscript{26} \textit{Brada \& Dobozi, supra} note 13, at 6.  
\textsuperscript{27} The reasons cited for the ineffectiveness of the reforms are political instability and lack of a truly competitive environment; political opposition by advocates for social justice; overambitious and misdirected economic policies; failure to reduce monopolies; protracted balance-of-payments problems; excessive reliance on fiscal distributions instead of real capital market mechanisms; failure to free enterprises from central control; excessive subsidization; short-term economic outlook; insulation of microeconomic mechanisms from macroeconomic considerations; price controls; and piecemeal nature of the reforms. \textit{Brada \& Dobozi, supra} note 13, at 7-12. \textit{See generally RICHET, supra} note 13, at 182-83 (arguing that the economic failures in Hungary during the 1960s and 1970s discredited the concept of combining a planned economy with market factors, and proved that Hungary needed to implement more radical reforms to meet the challenges of the future).
corporate structure in order to improve international competitiveness. Significantly, this new phase appears to be a wiser and more cautious approach, promoting not only economic growth but also recognizing the social and political pitfalls of quickly conceived and inadequately implemented reforms. However, in their efforts to provide a regulatory framework in conformity with the international community, the Hungarians appear to have promulgated securities regulations to allay fears on the part of foreign investors rather than to implement well-developed economic and social policies.

B. The Budapest Stock Exchange Today

The resurrection of the Budapest Stock Exchange was a gradual process. Initially, only state-owned companies could

28. Given the tremendous volume of recent legislation, it would be impractical to address every law relevant to the economy in Hungary today. However, a sampling of the more important legislation will provide an idea of the character of the legislation currently in effect and will provide a context in which better to understand the purpose and consequences of Hungary's insider dealing restrictions. The banking reforms enacted on January 1, 1987, devolved the traditional commercial and investment banking functions to the private sector. The new banking law enacted on November 13, 1992, is expected to ease certain restrictions against foreign investors in hopes of encouraging foreign investment in the Hungarian financial services sector. See Hungary's New Banking Law Expected to Encourage More Foreign Investment, INT'L TRADE REP. (BNA), (Dec. 18, 1991). In 1988 and 1989, a personal income tax, value-added tax, general turnover tax, and entrepreneurial profit tax were introduced to increase state revenue. See REVESZ, supra note 13, at 144-45; Clarke, supra note 13, at 23; HIERONYMI, supra note 11, at 81-82. Act XIII of 1989 on the Transformation of Business Organizations and Companies officially promulgated an aggressive privatization program to transform state or cooperatively owned entities into private companies. Acknowledging the need to raise capital and diversify corporate structure, Act XXIV of 1988 About Investments of Foreigners in Hungary was introduced to protect foreign investments in Hungary. Additionally, Act VI of 1988 on Economic Associations was enacted to raise private and foreign corporate investment and to provide more business organizational choices. See HIERONYMI, supra note 11, at 82; REVESZ, supra note 13, at 147. Finally, on January 25, 1990, the Hungarian Parliament enacted Act VI of 1990 on Issuing and Public Broking of Certain Securities and on Stock Exchange to provide a regulatory framework for the newly reopened Budapest Stock Exchange.

29. See Clarke, supra note 13, at 23 (arguing that the September 1987 Programme for Stabilization is a "de facto rejection of the economic concept . . . [and] hope for accelerated growth"). This consolidation program aims to ensure economic stabilization and long term prosperity by combining strict austerity regulations with market economic reforms. Danube Blues, supra note 11, at 48.

30. See also infra notes 109-13 and accompanying text for further development of this proposition.
issue stocks, and only state-owned banks and cooperatives could purchase stocks.\footnote{Hungary Capitalists, ECONOMIST, Nov. 5, 1988, at 90.} In 1981 bonds were first issued by local councils through the National Savings Bank.\footnote{Order Please, BANKER, Feb. 1988, at 14 (also noting that the first paper issued was actually the state paper of the 1950s).} Because their interest rates exceeded those of the traditional savings deposits, these bonds enjoyed quick popularity.\footnote{Id.} The right to issue bonds was later extended to businesses in 1983. The corporate bond market also experienced fast-paced growth, but reached its peak of thirty billion HUF in 1988.\footnote{Act of Faith, supra note 38, at 38.} In 1987 the right to issue bonds was granted to commercial banks, which, along with other financial institutions, conducted stock exchange trading on a weekly basis.\footnote{Act of Faith, supra note 35, at 38.} Over-the-counter facilities opened for bonds in the 1980s and for shares in 1989.\footnote{Bokros, supra note 34; Big Ambitions, BANKER, Apr. 1989, at 58.} Treasury bills and corporate certificates of deposit were introduced in 1988.\footnote{Big Ambitions, supra note 37, at 58; Hungary Capitalists, supra note 31, at 90.} On January 1, 1989, regulations allowing companies to issue shares to the public opened the secondary market for purchases by private individuals.\footnote{Torday, supra note 8, at 21.} Finally, following the legal regulatory framework provided by the 1990 Securities Act, the Budapest Stock Exchange was formally reopened on June 21, 1990.\footnote{Torday, supra note 8, at 21; Berniker, supra note 9, at 18A.}

The Budapest Stock Exchange of today is a fledgling market wrought by economic risks and political uncertainties.\footnote{Torday, supra note 8, at 21.} The securities market is plagued with both an inadequate supply of profitable and promising businesses to issue rewarding securities, and a low demand for securities by confident and wealthy investors. On the supply side, the primary market, composed of issuers of publicly traded shares, suffers from prevalent state ownership, underdeveloped financial infrastruc-

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\footnote{Hungary Capitalists, ECONOMIST, Nov. 5, 1988, at 90.}
\footnote{Order Please, BANKER, Feb. 1988, at 14 (also noting that the first paper issued was actually the state paper of the 1950s).}
\footnote{Id.}
\footnote{Act of Faith, supra note 38, at 38.}
\footnote{Bokros, supra note 34; Big Ambitions, BANKER, Apr. 1989, at 58.}
\footnote{Big Ambitions, supra note 37, at 58; Hungary Capitalists, supra note 31, at 90.}
\footnote{Torday, supra note 8, at 21.}
ture, inexperienced management, cash shortage, and weak investment capability.\textsuperscript{41} Acknowledging the need for foreign capital investment, technological expertise, and management know-how in order to increase profitability of its businesses, Hungary has diligently pursued an ambitious privatization program.\textsuperscript{42} However, privatization poses a special dilemma for Hungarians, who recognize the need for foreign expertise and investment, but simultaneously fear the prospect of foreign involvement in the Hungarian economy.\textsuperscript{43}

The Budapest Stock Exchange also suffers from an illiquid secondary market, whose domestic and foreign investors are unwilling to risk investing in an unreliable market of publicly traded shares.\textsuperscript{44} Low domestic demand has been largely fostered by a deeper ambivalence about capitalism as well as inexperience in the trading of securities on the part of Hungar-

\begin{enumerate}
\item Steven Greenhouse, \textit{East Europe's Sale of the Century}, N.Y. TIMES, May 22, 1990, at D1; Nigel Ash, \textit{The Privatisation Dilemma}, EUROMONEY, Sept. 1990, at 146, 148. Supply side problems include the low profitability of companies, the unsophisticated telecommunications system, the lack of modern accounting procedures and independent auditors, and the underdeveloped clearing and settlement procedures. \textit{Id.} at 148; Andy Zipser, \textit{Bid and Asked in Budapest, a Look at Hungary's Stock Scene}, BARRON'S, July 17, 1991, at 17, 42; Donlan, supra note 12, at 46; \textit{Now for the Acid Test}, EUROMONEY, Nov. 1990, at 40, 44. \textit{See also Ban, supra note 10} (noting the “growing number of corporations . . . slipping into the red”). Ilona Hardy, the former head of the Securities Trading Commission at the Budapest Stock Exchange, has more optimistically stated that most companies are largely undervalued and that the only thing holding back the “blossoming” primary market and its “vigorously” issuance of new securities is the lack of liquidity. Donlan, supra note 12, at 46. \textit{But see London's Lead Looks Impregnable}, EUROMONEY, May 1990, at 70 (emphasizing that liquidity is of primary importance and that, in fact, “[i]nvestors' choice of marketplace is dictated by liquidity, and issuers' choice by the amount of capital available on which they can draw”).\textsuperscript{42}

\item See Torday, supra note 8, at 21 (noting that the key to the success of the Hungarian securities market will be the privatization program of the Hungarian government). \textit{See also Emerging Stock Markets, supra note 6} (emphasizing that Hungary is the most advanced among the Eastern European countries in privatization success); Berniker, supra note 9, at 2A, 18A (describing Hungary as “leaping ahead of its East European neighbors” in its accelerated economic reforms and overhaul of its financial sector, as evidenced by the “flourishing” stock exchange, “surging” investment, and “sprouting” commercial banks). Of additional interest is that Hungary is the first Eastern European country to open a stock market, and this development is primarily a result of development in its private sector.\textsuperscript{43}

\item Ash, supra note 41, at 145-48.

\item \textit{Acid Test, supra note 41, at 44. See also Act of Faith, supra note 35, at 38; Donlan, supra note 12, at 46} (arguing that the problem with the exchange is not the growing primary market, but the stagnant secondary market). \textit{But see Humphreys, supra note 12, at 44} (claiming that there is a “real frenzy for shares”).\textsuperscript{44}
\end{enumerate}
ians as a whole. Reluctance on the part of foreign investors stems from the practical difficulties of evaluating an unpredictable future and of adjusting to an underdeveloped financial system. To increase the confidence of the investing public, Hungary has taken steps to improve its regulatory practices and technological systems.

45. See Greenhouse, supra note 41 (noting that Hungarians want to enjoy the benefits of a market economy—greater efficiency, abundant and higher quality goods, high living standards, but are also beginning to recognize the drawbacks of capitalism—longer and harder workdays, more layoffs, and greater social divisions between the rich and the poor); Phyllis Berman, An Impolite Question: Were You a Communist?, FORBES, Oct. 15, 1990, at 131, 133 (observing that profit is "still a dirty word" and that "money-making has a kind of taint in Hungary."); See also Act of Faith, supra note 35, at 38 (commenting that the problem with the exchange is that for Hungarians the act of buying and selling securities is "more an act of faith than a habit of buying"). Cf. Humphreys, supra note 12, at 44 (stating that "Hungarians tend to spend what they have immediately as a means of coping with inflation"); BUDAPEST STOCK EXCHANGE, GENERAL INFORMATION 4 (1991) (emphasizing that while the financial savings of Hungarians increased significantly in 1991, these resources were not invested in the stock exchange, but transformed into more secure bank deposits and deposit-like securities issued by banks, and that this more cautious savings attitude was induced by increasing unemployment, social problems, competitive deposit rates pursued by banks, and a vicious circle of lower demand for securities and falling prices).

46. See Greenhouse, supra note 41 (quoting a foreign banker as saying that "the future is more difficult to tell in Eastern Europe than elsewhere because things are changing so rapidly"). See also Torday, supra note 8, at 21 (stating that the dearth of profitable Hungarian enterprises is partially caused by the absence of anything resembling a western balance sheet or profit and loss statement); Hamilton, supra note 11, at 1 (commenting that the typical prospectus, accounting practices, and ownership identification procedures in Hungary fail to satisfy Western demands and generally accepted standards); Capital Markets: Big Ambitions, BANKER, Apr. 1989, at 48 (recognizing the need for more and better equipped brokers, rating agencies, analysts, auditors, and electronic data-processing services); Humphreys, supra note 12, at 45 (noting the problem of converting dividends and capital gains into hard currency).

47. For example, the United States Securities Exchange Commission, the Hungarian Supervisory Board of Securities, and the Budapest Stock Exchange have signed a statement of understanding regarding American technical assistance in the development of Hungarian securities markets. The purpose of the SEC consultations is to identify specific types of technical assistance which may be provided in the future. Future assistance may be in one or all of the following areas: personnel training, information, and advice relating to the development of order handling systems; trade recording and comparison systems; quotation and transaction data; transmission systems; clearing and settlement mechanisms; regulatory requirements relating to market professionals and capital adequacy; systems and related regulatory mechanisms relating to accounting and disclosures; systems necessary for market surveillance and enforcement programs; and, investor protection practices and procedures. SEC, Hungarian Stock Officials Sign Statement on U.S. Technical Assistance, SEC. L. DAILY (BNA) (June 29, 1990).
Despite the ambiguities associated with Hungary's capital market, there are also indications that the Budapest Stock Exchange will succeed in the future. Recently, the economy has shown signs of improvement. Furthermore, Hungary is still the most economically advanced among its Central and Eastern European neighbors. Specifically, its privatization program is recognized as the most advanced in Central and Eastern Europe, and the reopening of its stock exchange is a first in the area. With a securities regulatory framework, privatization program, and foreign investment incentive package in place, there is hope for a more profitable future.

By including an insider dealing restriction in its 1990 Securities Act, Hungary appears to have adopted a policy against insider dealing in its securities markets. However, it remains unclear whether the primary motivation in enacting this prohibition was to protect inexperienced Hungarian investors from market exploitation by corporate insiders or to enhance the international reputation of and confidence in the Budapest Stock Exchange. Because the driving force behind most of the recent legislation seems to be the stimulation of foreign investment, it appears likely that the main purpose behind the insider trading regulation is to conform to the growing international consensus of prohibiting such activity, rather than to protect the virtually nonexistent domestic investing public.

Notwithstanding the official policy against insider trading, it is additionally unclear whether the Hungarian stat-

48. Positive signs include increased hard currency reserves, population savings of HUF 814 billion, falling inflation and interest rates, stability of the forint, positive balance of payments, and capital flow of USD 1.1 to 1.2 billion. Negative signs include the lagging tax revenue, a budgetary deficit of HUF 66.7 billion, increasing unemployment, and frequent bankruptcy. BUDAPEST STOCK EXCHANGE, REPORT ON APRIL, 1992, at 3-4 (1992). For specific numbers regarding market activity, see also BUDAPEST STOCK EXCHANGE, REPORT ON THE 1ST QUARTER OF 1992 (1992).

49. Hungary is "still the brightest star in Eastern Europe, ... the most Westernized nation of the former East bloc, [the place] where outsiders feel most comfortable plunking down their money." Gail E. Schares & Ken Olsen, Hungary: A Giant Step Ahead, BUS. WK., Apr. 15, 1991, at 58.

50. For an optimistic, albeit biased, view, see ARPAD ABONYI, HUNGARY, THE FIRST CHOICE FOR BUSINESS IN CENTRAL-EASTERN EUROPE (a brochure developed as part of the Canadian government's technical assistance to the Hungarian Investment and Trade Promotion Agency). For more information on investment opportunities in Hungary, contact Investcenter—Tradeinform in Budapest, Hungary.

51. See infra text accompanying notes 111-13; see also infra note 113.
ute will remain as a mere showcase of Hungarian efforts to conform, or will be vigorously enforced as an important economic policy. After all, while Hungarians may be desperate to play it straight, inside information may be the only information available on the small market, and insider trading is at least trading.\footnote{52. Tozsde Kurir, Hungary: Report on Insider Trading, REUTER TEXTLINE, Sept. 20, 1990, at 1; Torday, supra note 8, at 21; Hamilton, supra note 11, at 1.}

III. AN OVERVIEW OF INSIDER TRADING REGULATION

A. Insider Trading Regulation in the United States

The United States relies on centralized regulation and disclosure mechanisms in its governance of public trading of securities.\footnote{53. Elyse Diamond, Note, Outside Investors: A New Breed of Insider Traders?, 60 FORDHAM L. REV. 5319, 5320 (1992). See also BARRY A. K. RIDER & H. LEIGH FFRENCH, THE REGULATION OF INSIDER TRADING 9-24 (1979) (providing a survey of the disclosure scheme in relation to insider trading). The preventative role of the disclosure requirements and the deterrent effect of enforcement by the SEC are crucial to the successful regulation of insider trading.} The development of securities law in the United States has been a complex blend of statutory, legislative, and administrative activity by Congress, the courts, and the Securities Exchange Commission.\footnote{54. For thorough treatises on the development of insider trading law in the United States, see, e.g., Bloomenthal, supra note 2, ch. 9; LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION, chs. 7F, 9B (1988 & 1992 Supp.); RIDER & FFRENCH, supra note 53, chs. 2-4.} Despite the absence of any statutory definition of insider trading, the term has generally come to mean "the act of purchasing or selling securities while in possession of material, nonpublic information concerning an issue of securities."\footnote{55. Richard J. Hunter & Philip Friese, The Genesis of an Ethical Imperative: The SEC in Transition, 25 GONZ. L. REV. 28 (1989-90) (quoting STUART C. GOLDBERG, ESQ., SEC TRADING RESTRICTIONS AND REPORTING REQUIREMENTS FOR INSIDERS 2-3 (1973)).} The three primary legislative sources of federal regulation of the trading of securities based on inside information are: (1) rule 10b-5, the antifraud provisions promulgated pursuant to section 10(b) of the Securities and Exchange Act of 1934; (2) section 16(b), the strict liability against short-swing trading provided under the Securities and Exchange Act of 1934; and (3) rule 14e-3, the insider trading prohibitions in the context of tender offers, promulgated pursu-
1. Rule 10b-5

Rule 10b-5 has become the primary judicial tool and administrative policing device to combat securities trading on the basis of material nonpublic information. Rule 10b-5 makes the following activities unlawful: (1) employing any device, scheme, or artifice to defraud; (2) misstating a material fact or omitting a statement of material fact which would cause previous statements to be misleading; or (3) operating a fraud or deceit on any person in connection with the purchase or sale of any security. Ironically, rule 10b-5 was not originally designed to deal with the insider trading problem. Neverthe-
less, the wide scope of insider trading covered by rule 10b-5 has engendered broad insider trading liability and diverse judicial interpretations of the nature of an insider trading violation.\textsuperscript{60}

\subsection*{a. The Disclose or Abstain Doctrine}

The disclose or abstain doctrine forms the predominant concept of insider trading liability under rule 10b-5. The rule, which was first introduced in \textit{In re Cady, Roberts \& Co.},\textsuperscript{61} requires “anyone in possession of material inside information” to “disclose it to the investing public,” or to “abstain from trading in or recommending the securities concerned” until such information is disclosed.\textsuperscript{62} Under the \textit{Cady} rationale, the duty to disclose or abstain arises when two elements exist: (1) “a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone”; and (2) “[an] inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.”\textsuperscript{63} \textit{Cady} was significant because it appeared to extend the applicability of rule 10b-5 from face-to-face negotiations to open market transactions, and from traditional corporate insiders to all persons with access to inside information.\textsuperscript{64} The disclose or abstain rule did not ban trading based on inside information, nor did it require disclosure of inside information. The rule enables investors to trade on the basis of inside information provided that they disclose the information prior to trading, and conversely, allows insiders to avoid disclosing confidential information so long as they refrain from any trading activity until public disclosure.

\textsuperscript{60} See DONALD C. LANGEVOORT, INSIDER TRADING REGULATION 36 (Securities Law Series 1990).
\textsuperscript{62} SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968) (citing \textit{In re Cady, Roberts \& Co.}, 40 S.E.C. 907 (1961)).
\textsuperscript{63} 40 S.E.C. at 911-12.
\textsuperscript{64} BERGMANS, supra note 57, at 10.
b. The Informational Parity Approach

The informational parity theory contends that all investors trading on impersonal exchanges should have equal access to material information. The equality of information approach would extend 10b-5 liability from traditional corporate insiders, who trade with a shareholder on the basis of inside information, to outsider tippees completely unaffiliated with the issuer, who trade on an impersonal exchange without disclosing the tip. During the post-Cady era, United States case law seemed to move toward this broader policy, and courts appeared to adopt this fairness-based rationale to expand 10b-5 liability to tippees. Because of the confusing case law, the access to information theory is neither clear nor consistent, but the common denominator is the focus on the relationship between the trader and the inside information. One commentator has argued that the theory is merely a generic term designating the three criteria used to impose a duty to disclose or abstain—access to information, possession of information, and informational advantage resulting from unequal access or unequal possession. Because of its potentially unlimited scope, the Supreme Court has explicitly rejected the parity of information rationale.

65. See SEC v. Texas Gulf Sulphur Co., 401 F.2d at 848 (seemingly adopting the broad informational parity policy by stating that "Rule [10b-5] is based in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information.").


67. BERGMANS, supra note 57, at 45.

68. BERGMANS, supra note 57, at 45.

c. The Fiduciary Duty Approach

The fiduciary duty approach limits the scope of 10b-5 liability by requiring that a fiduciary nexus exist between the corporate insider who trades or tips while in possession of inside information and the issuer whose securities are being traded or whose confidential information is being disclosed.70 Under this restrictive approach, a duty to disclose or abstain does not arise out of the possession of material nonpublic information, but rather is contingent upon the existence of some relationship of trust or confidence between the parties to the transaction. The fiduciary relationship requirement has been imposed by the United States Supreme Court in recent years to limit the broad scope of 10b-5 liability characteristic of the post-Cady era.71 Specifically, 10b-5 liability is limited to traders who possess inside information by virtue of some fiduciary relationship with the issuer, to tippers who disclose inside information in breach of a fiduciary duty to the issuer and for personal gain, and to tippees who receive tips from tippers that they know or should know are breaching their fiduciary duty to the issuer.

d. The Misappropriation Theory

Under the misappropriation theory, a violation of rule 10b-5 occurs when a person entrusted with confidential inside information misuses that knowledge by secretly trading on it

70. The fiduciary aspect of insider trading liability derives from the mention of fraud in section 10 and rule 10b-5. Given the traditional common law notions connecting fraud and misrepresentation with issues of fiduciary duty, a large portion of judicial attention, especially in the context of private causes of action, has focused on the elements required to establish a breach of fiduciary duty under common law. The important issues in fiduciary law are: (1) nondisclosure, (2) materiality, (3) reliance, (4) causation, (5) privity, (6) scienter, and (7) market information. See Rider & Frenich, supra note 53, at 76-90 (providing an overview of fiduciary issues in the context of civil liability).

71. See Chiarella, 445 U.S. at 222 (holding that a financial printer who decoded the names of certain target companies in the course of his employment and made purchases in those target companies had not violated rule 10b-5); Dirks v. SEC, 463 U.S. 646 (1983) (holding that a corporate officer who disclosed that the company's assets were overstated and a securities analyst who disclosed that information to his clients were not liable under rule 10b-5). See infra parts IV.C.1. and IV.C.2. for a more detailed analysis comparing these cases to the Hungarian statute. See also Langevoort, supra note 1, at 7.
for personal gain.\textsuperscript{72} The theory imposes a sort of fiduciary duty upon persons in possession of market information.\textsuperscript{73} A person who has misappropriated material nonpublic information is held to have an absolute duty to disclose that information or refrain from trading.\textsuperscript{74} This is an exception to the general rule that parties have no obligation to disclose absent a fiduciary relationship.\textsuperscript{75} Because of the restrictive effect of the traditional fiduciary duty requirement, a number of courts have sought to expand insider trading liability by adopting the misappropriation theory.\textsuperscript{76} However, this theory has yet to be expressly adopted or rejected by the Supreme Court, and its validity remains unclear.

e. Materiality

In determining the scope of insider trading liability under rule 10b-5, defining the nature of inside information is as important as identifying insiders. Inside information is generally defined as material nonpublic information. The standard of materiality articulated by the Supreme Court in \textit{Basic Inc. v. Levinson} requires "a showing of a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."\textsuperscript{77} Furthermore, where information or events are contingent or speculative in nature, materiality depends on "a balancing of both the indi-
cated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity. The Basic Court also adopted what has become known as the fraud-on-the-market theory, which is "based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business." The theory presupposes an efficient capital market, where the current price of a security is the best estimate of what the price of that security will be in the future.

2. Section 16(b) Short-Swing Liability

In sharp contrast to the flexibility and scope of rule 10b-5 liability under United States case law, section 16(b) imposes strict liability on a narrow group of statutorily defined insiders. This short-swing trading provision prohibits directors, officers, and beneficial owners of more than ten percent of any class of any equity security from selling and purchasing or purchasing and selling the same class of securities within a time period of six months. Section 16 prohibits short-swing trading by corporate insiders in three ways: (1) by requiring disclosure of the transactions and holdings by corporate insiders; (2) by providing for corporate recovery of short-swing profits; and (3) by strictly prohibiting short-swing trading by corporate insiders. Section 16 differs from section 10(b) in four significant ways: (1) in its application to a narrow group of corporate insiders for a limited time period; (2) in its imposition of strict liability without regard to whether inside information actually existed or was actually used; (3) in its unique remedy allowing recovery by the issuer to the exclusion of other aggrieved parties; and (4) in its explicit prohibition against trading by corporate insiders.

78. Basic, 485 U.S. at 238 (quoting SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968)).
79. 485 U.S. at 241 (quoting Peil v. Speiser, 806 F.2d 1154, 1160-62 (3d Cir. 1986)).
82. The purpose of section 16 was to provide an objective standard without
3. Tender Offers and Rule 14e-3

Rule 14e-3 represents a congressional attempt to codify insider trading law in the context of tender offers. This rule prohibits any person in possession of information relating to a tender offer from trading in the target company's securities if: (1) the bidder has taken a substantial step toward initiating a tender offer; (2) the person possessing the information knows or has reason to know that the information originated from the bidder or target company; and (3) the person possessing information knows or has reason to know that the information is nonpublic.

Rule 14e-3 applies to all persons in possession of inside information, but only in the context of tender offer-related activity. Thus, a fiduciary relationship between the trader or tipper and the target company or its shareholders is not required to impose liability for trading while in possession of information relating to a tender offer.

The exact language of rule 14e-3 is set out below:

(a) If any person has taken a substantial step or steps to commence, or has commenced, a tender offer (the "offering person"), it shall constitute a fraudulent, deceptive, or manipulative act or practice within the meaning of Section 14(e) of the Act for any other person who is in possession of material information relating to such tender offer which information he knows or has reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from:

(1) The offering person,

(2) The issuer of the securities sought or to be sought by such tender offer, or

(3) Any officer, director, partner or employee or any other person acting on behalf of the offering person or such issuer, to purchase or sell or cause to be purchased or sold any of such securities or any securities convertible into or exchangeable for any such securities or any option or right to obtain or to dispose of any of the foregoing securities, unless within a reasonable time prior to any purchase or sale such information and its source are publicly disclosed by press release or otherwise.


Rule 14e-3 was enacted in direct response to the insider trading scandals of the 1980s.

LANGEVOORT, supra note 60, at 195-96. In determining whether liability for trading in possession of information related to a tender offer was limited by the common law fiduciary duty requirement, the Second Circuit held that the promulgation of rule 14e-3 by the SEC was a valid exercise of its administrative rulemaking authority. United States v. Chestman, 903 F.2d 75 (2d Cir. 1990); United States v. Chestman, 947 F.2d 551 (2d Cir. 1991) (en banc). Whether courts
4. Increased Sanctions Under ITSA and ITSFEA

The Insider Trading Sanctions Act of 1984 (ITSA) authorizes the Securities Exchange Commission to seek civil penalties up to a maximum of three times the profit gained or loss avoided from the unlawful purchase or sale of securities. The ITSA also increases the maximum fine for criminal violation from $10,000 to $100,000. The Insider Trading and Securities Fraud Enforcement Act of 1988 (ITSFEA) was enacted to ensure closer supervision of employees with access to material nonpublic information. The ITSFEA imposes liability on securities firms and other controlling persons who knowingly or recklessly fail to take appropriate steps to prevent insider trading violations by their employees, and thereby places some of the regulatory burden on institutional entities.

B. Insider Dealing Regulation in Hungary

Insider dealing in Hungary is governed primarily by a single provision entitled “Restriction of Insider Dealing” in the Hungarian statute regulating securities and stock exchanges, and is enforced by the Supervisory Board of Securities, an administrative body supervised by the Ministry of Finance. The Hungarian regulatory scheme is a single nationwide system of securities regulation which focuses on the Budapest Stock Exchange. The stated policy of the securities regulations is to foster capital flow, to promote securities mar-

have the authority to limit the broad liability under rule 14e-3 by imposing a fiduciary duty requirement based on common law remains unclear.

89. The Hungarian statute refers to insider trading as insider dealing.
90. 1990 Securities Act, supra note 6, at pt. VI. Transactions conducted on the Budapest Stock Exchange, currently the only public stock exchange in Hungary, are also regulated by the Charter of the Budapest Stock Exchange and the Rules of the Budapest Stock Exchange Regarding the Requirements of the Listing and Trading of Securities on the Stock Exchange.
91. 1990 Securities Act, supra note 6, at pt. II.
The regulations recognize the importance of disclosure of information to promote equality of information among investors and to foster confidence of prospective investors.94

The Hungarian statute prohibits the dealing of securities based upon "confidential inside information."95 The materiality standard of the statute requires that such dealing or disclosure "may effect substantially the value of securities."96 Confidential inside information is further defined as information "relating to the financial, economic and legal situations of the Issuer, Broker and Warrantor," particularly "new issues, major deals, structural changes, turn-round projects and winding up."97

The statute identifies two main categories of insiders. The first group, "qualified insiders," contains three subcategories: (1) chief executives and executive officers of the issuer, of the issuer-broker, and of any legal person owning a major interest in the issuer, as well as the close relatives of such executives; (2) owners of ten percent or more of the issuer's authorized capital and their close relatives; and (3) persons who have been employed by or established "any kind of close working contact with the Issuer... in a capacity giving them access to confidential inside information," including auditors, legal advisors, and tax consultants.98 The second group, "insiders," includes two subcategories: (1) qualified insiders to whom confidential information is handed; and (2) persons who have obtained confidential information in any manner and who have knowingly had access to confidential inside information.99 The first subcategory refers to qualified insiders who are direct tippees of inside information. The second subcategory refers to all persons with access to inside information.

Insiders are prohibited from personally dealing in the relevant securities, from dealing by proxy, and from divulging

93. 1990 Securities Act, supra note 6, pmbl.
95. 1990 Securities Act, supra note 6, pt. VI, ¶ 75.
96. 1990 Securities Act, supra note 6, pt. VI, ¶ 75(2).
97. 1990 Securities Act, supra note 6, pt. VI, ¶ 75(2).
98. 1990 Securities Act, supra note 6, pt. VI, ¶ 76(1).
99. 1990 Securities Act, supra note 6, pt. VI, ¶ 76(2).
inside information to whomever may be likely to benefit from or to pass on such knowledge within the stock exchange. Qualified insiders are further presumed to have committed insider dealing when they resell or rebuy securities to or from the same person within three months. However, qualified insiders can rebut this presumption by proving that confidential information was not available. Furthermore, qualified insiders completely escape liability if they can prove that their short-swing transaction falls under one of two statutory exceptions: (1) selling of a security as liquidator to pay creditors; or (2) selling or purchasing of a security to or from a person who had the same inside knowledge available.

IV. A COMPARATIVE ANALYSIS OF INSIDER TRADING REGULATION IN HUNGARY AND THE UNITED STATES

A. Prohibiting Insider Trading

The first question one should address before comparing different regulatory approaches toward the trading of securities is whether insider trading should be outlawed at all. The ethical rationale offered in favor of prohibiting insider trading is that allowing a select group of investors to acquire pecuniary advantages simply by virtue of their inside status is inherently unfair. Furthermore, some fairness arguments suggest that all investors owe a moral obligation to others in the marketplace to negotiate openly and on equal footing. The economic rationale supporting a ban on insider trading is that unequal access to information will undermine the confidence of investors and the integrity of the market and deter prospective investors from entering a risky and capricious market, inevitably resulting in the demise of the market. Arguably, the market should reward investors and market analysts for the toils of intensive and insightful market research rather than arbi-

100. 1990 Securities Act, supra note 6, pt. VI, ¶ 77.
101. 1990 Securities Act, supra note 6, pt. VI, ¶ 78.
102. 1990 Securities Act, supra note 6, pt. VI, ¶ 78.
103. 1990 Securities Act, supra note 6, pt. VI, ¶ 79.
104. "One of the truly intriguing aspects of the entire problem of insider trading is the fact that, despite its having been widely written about and discussed for many decades, few have paused to consider why insider trading should be regulated." W. PAINTER, FEDERAL REGULATION OF INSIDER TRADING 348 (1968), quoted in BERGMANS, supra note 57, at 99.
A number of commentators have also argued that insider trading should not be prohibited. Some authors have criticized the underlying fairness rationales which have "haunted" the subject of insider trading as based on the unsophisticated moral proposition that "it's just not right," promulgated by angry "foot-stampers." Attempting to remove the moralistic tinge from insider trading, these commentators have shifted the focus to market efficiency rationales. For example, it has been argued that because inequalities are inherent in a capitalist market economy and because unequal access to information is but one aspect of the risk factor, efforts to eliminate insider trading and equalize the availability of material information tend to destabilize the very essence of capitalism. More recent articles contend that inside information is merely another form of property and suggest that a regulatory scheme should protect property rights in the use of inside information. Finally, free market economists contend that the market should be left unregulated and that the leaking of inside information by the "invisible hand" will spread the wealth appropriately.

Despite the simmering academic debate, the international condemnation of insider trading has survived, and the anti-insider trading policy, long established in the United States, has since been adopted by Hungary and others in the international community. Interestingly, the policy behind most of

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107. RIDER & FFRENCH, supra note 53, at xiii.
the restrictions has linked the fairness and economic efficiency rationales, reasoning that unequal access to information undermines the confidence of investors, which in turn adversely affects the market. Recognizing that regulation of securities trading and stock exchanges is necessary to prevent abuses and foster markets that merit and retain investor confidence, Hungary included a restriction on insider dealing when enacting its Act on Securities and Stock Exchange. The Ministry of Finance claims that the restrictions were enacted with the conviction that the two crucial driving forces behind a developed securities market are openness and confidence of prospective investors. It remains unclear whether the purpose of the law was to protect domestic investors or to attract foreign investors. However, given the acute need for foreign investment and relative inexperience with a functioning securities market, it appears that Hungary has adopted an insider trading ban as part of a larger economic reform which requires international recognition.3

B. Defining Insider Dealing by Statute

One major difference between insider trading law in Hungary and the United States is that the civil law of Hungary defines insider dealing by statute, while the definition of insider trading in the United States emerges from both statutory and common law.4 Hungary has defined in-
sider dealing as dealing in securities based on confidential inside information, or divulging such information, which may effect substantially the value of securities. Insider trading in the United States has also come to mean trading in securities based on material nonpublic information, or divulging such information.

Proponents of a uniform statutory definition argue that a vague definition produces unpredictable patterns of exoneration and liability, which may in themselves discourage investors from entering the market. Ambiguous standards may also inconsistently deter the cautious and honest while encouraging the risk-takers and dishonest to make inside deals. Finally, inconsistencies may hinder fair and effective enforcement, and vague standards are unfair to honest and naive investors who may be vulnerable to liability without notice.

Advocates of a case-by-case definition emphasize the benefits of flexibility. Some argue that the definition of insider trading in the United States is clear, and that attempts at a uniform definition would unnecessarily risk underinclusiveness. Others suggest that a statutory definition would reduce room for interpretation and increase opportunities to create loopholes. Furthermore, vagueness may even enhance deterrence. Some arguments suggest that allowing trading on the basis of inside information enhances market efficiency, and that prohibiting insider trading unnecessarily restricts the free and efficient flow of information.

The adverse consequences of a broad or vague definition of insider trading may be exacerbated in an underdeveloped mar-

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115. 1990 Securities Act, supra note 6, pt. VI, ¶ 75, 77.
116. BERGMANS, supra note 57, at 17.
117. Vagueness would produce two types of “trading errors” which would obviate the free flow of information. First, “transactions that may in fact be legal will be avoided by the risk averse because of the chilling effect that results from ambiguous standards.” Second, “other transactions that may be illegal will be entered into by those who are relatively risk prone.” Salbu, supra note 66, at 856.
118. This is the official position of the United States Securities Exchange Commission.
ket economy such as Hungary's today. The need for clear standards may be especially vital to the successful development of an emerging market which has not yet risen to the same level of maturity and efficiency as that existing presently in the United States.\textsuperscript{120}

C. Identifying the Scope of Insiders

The Hungarian Securities Act identifies three categories of insiders: (1) traditional corporate insiders, including executive officers of the issuer, close relatives of such officers, and beneficial owners of ten percent or more of the securities in question,\textsuperscript{121} (2) a special category of insiders identified as such by virtue of their working relationships with the issuer;\textsuperscript{122} and (3) two categories of tippees.\textsuperscript{123} The statute prohibits three forms of insider dealing transactions: (1) dealing in securities related to confidential inside information; (2) dealing by proxy of another person in such securities; and (3) divulging confidential inside information to whomever may be likely to benefit from such knowledge or to pass on such knowledge within the stock exchange. Thus, the Hungarian definition of insiders includes traditional and nontraditional insiders in the form of traders, tippers, and tippees.

\textsuperscript{120} See Act of Faith, supra note 35, at 37 (stating that "a proper capital market will never re-emerge unless the framework is first in place"). See also Big Ambitions, supra note 37, at 58 (noting a study by a securities trading commission listing the absence of a legal framework as an obstacle to the proper development of a capital market).

\textsuperscript{121} 1990 Securities Act, supra note 6, pt. VI, \S 76(1)(a)-(c).

\textsuperscript{122} The Hungarian statute defines these insiders as persons who have had any kind of close working contact with the issuer within the last six months in a capacity giving them access to confidential inside information. 1990 Securities Act, supra note 6, pt. VI, \S 76(1)(d).

\textsuperscript{123} The Hungarian statute identifies two types of tippees: (1) traditional corporate insiders or insiders by virtue of their working relationship to whom confidential information is handed; and (2) persons who obtained such information in any manner and who knowingly had access to confidential inside information. 1990 Securities Act, supra note 6, \S 76(2)(d). It is unclear why the statute makes an extra effort to identify qualified insiders as tippees, given that such qualified insiders would presumably be liable for insider trading or tipping regardless of the manner in which they received confidential information. Perhaps the provision was added to emphasize that qualified insiders may be liable as tippees and to prevent qualified insiders from escaping liability under the exceptions to the prohibition on short-swing trading. See 1990 Securities Act, supra note 6, \S\S 76, 77. For a more thorough treatment of tippees, see infra parts IV.C.2.a., IV.C.2.c., IV.C.3.a-c.
In the United States, insiders are identified by the courts on a case-by-case basis. The ad hoc approach in the United States has produced a rather unclear definition of insider. Still, the following categories of insiders have emerged: (1) traditional corporate insiders, as defined by section 16(b) of the Securities Act; (2) persons with direct or indirect access to inside information, as per the Cady rationale; (3) persons with some form of fiduciary duty to the other parties in the transaction; and (4) persons who obtain an informational advantage by unlawful means. Thus, American courts have included in their definition of insider traditional and nontraditional traders, tippers, and tippees. However, an examination of Chiarella v. United States, Dirks v. S.E.C., and United States v. Chestman in light of the Hungarian statute will reveal that the scope of insiders encompassed by the Hungarian definition is broader.

1. Insiders With a Fiduciary Duty v. Insiders With Informational Access

a. Chiarella's Fiduciary Duty Approach

The Supreme Court decision in Chiarella v. United States was significant because it delineated the boundaries of 10b-5 liability under the broad "disclose or abstain" rule. The post-Cady and pre-Chiarella years were an era of expansive insider trading liability under the informational parity rationale. By imposing a fiduciary duty requirement on insider liability, the Supreme Court put a halt to the growing scope of insiders to whom the disclose or abstain rule applied.


130. 947 F.2d 551 (2d Cir. 1991) (en banc).

131. See BERGMANS, supra note 57, at 11-12; Salbu, supra note 66, at 841-43. See also supra part III.A.1.c.
Vincent Chiarella was a mark-up man employed at a financial printing company. During the course of his employment, Chiarella handled five documents containing the concealed identities of the acquiring and target corporations to be involved in upcoming corporate takeover bids. Chiarella artfully decoded the names of the target companies, purchased stock in the companies without disclosing his knowledge, and sold the shares at a profit of $30,000 immediately after the takeover attempts were publicly announced. Following investigation by the Securities Exchange Commission, Chiarella was charged with and convicted of violating section 10(b) of the Securities and Exchange Act of 1934 and rule 10b-5.

The crucial question in Chiarella was whether a person, who was neither a corporate insider nor a recipient of confidential information from a target company, was an insider subject to rule 10b-5 criminal liability. The Court reversed Chiarella’s conviction on the grounds that Chiarella owed no affirmative duty to the selling target companies to disclose his use of the information before trading. The Court refused to recognize a general duty between participants in impersonal market transactions to forego trading based on material nonpublic information. Rejecting the parity of information rationale, the Court emphasized that not every instance of financial unfairness constitutes a 10b-5 violation, reasoning that Chiarella was a complete stranger who dealt with sellers through an impersonal market. Thus, a duty to disclose did not arise from the mere possession of material nonpublic information. Chiarella established the requirement that some form of a relationship exist between the parties of a securities transaction such as to give rise to a fiduciary duty to disclose or abstain in order to impose liability.

133. Id.
134. Id.
135. Id. at 225.
136. Id. at 231-33.
137. Id. at 233.
138. Id. at 232-33.
139. Id. at 233-35. But see SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), cert. denied sub nom., Coates v. SEC, 394 U.S. 976 (1969) (seemingly holding that anyone possessing inside information is subject to the disclose or abstain rule).
140. The particular holding under Chiarella has been subsequently overruled by
b. Hungary's Access to Information Approach

Under the Hungarian insider dealing restrictions, Chiarella would have been convicted for insider dealing. Chiarella would not fall within the scope of traditional corporate insiders under Hungarian or United States law because Chiarella was neither an executive officer of the issuer nor a beneficial owner of more than ten percent of the issuer's equity securities. Nevertheless, Chiarella would qualify as an insider under Hungarian law pursuant either to his close working contact with the target company \(^{143}\) or to his access to inside information and knowledge of its confidential nature. \(^{142}\)

Hungarian law broadens the scope of insiders to include certain professional relationships. Specifically, the Hungarian statute provides that insiders may be "those who within the last six months have or had been employed or established any kind of close working contact with the Issuer—individually of whether they are natural or legal persons—in a capacity giving them access to confidential inside information." \(^{143}\) Auditors, legal advisors, and tax consultants are listed as examples. \(^{144}\) Because this section requires the existence of some sort of relationship, the provision is roughly analogous to the fiduciary duty approach, but expands the scope of liability by not requiring that the relationship be one of trust and confidence between the insider and the issuer. Chiarella's employment status does not subject him to liability because he was not an employee of the target companies whose securities he purchased. However, his professional relationship with the issuer and his position in that relationship subject him to potential liability. The question is whether the relationship between a financial printing company and its corporate customers establishes the kind of close working contact contemplated by the statute, and whether the position of a financial printing

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141. 1990 Securities Act, supra note 6, pt. VI, \(\S\) 76(1)(d).
142. 1990 Securities Act, supra note 6, pt. VI, \(\S\) 76(2).
143. 1990 Securities Act, supra note 6, pt. VI, \(\S\) 76(1)(d).
144. Because the statute lists these as examples, presumably the list is not exhaustive.
employee allows that employee to gain access to confidential inside information. Arguably, the requisite link is not established because a corporate client does not share the same level of trust with its financial printer as it does with auditors, legal advisors, and tax consultants, all of whom routinely review confidential documents. On the other hand, perhaps the required relationship is established because the position of a financial printer routinely entrusted with concealed documents is the type of working capacity the statute envisions.

The Chiarella case can be more easily resolved under Hungarian law by the access to information test. Another statutory provision extends the scope of insiders to qualified insiders to whom confidential information is handed, or persons who obtained confidential information in any manner and who knowingly had access to confidential inside information. Because this section focuses on the relationship between the insider and the inside information, it is roughly analogous to the misappropriation theory, but the provision does not require any wrongdoing on the part of the insider to impose liability. Because Chiarella is not a qualified insider, only the second part of the provision applies.

Chiarella would easily qualify as an insider under the access to information test. First, the way in which a person comes into possession of inside information is immaterial. The fact that Chiarella obtained confidential inside information about target companies of a tender offer by decoding the concealed names of companies contained in documents in the course of his employment is not significant. Second, the person must know that he or she has had access to confidential inside information. The names of the target and offering companies were concealed. The information was related to an unconsummated tender offer, indicating that Chiarella, a financial printer customarily entrusted with confidential corporate documents, must have known of the confidential inside nature of the information he used. Thus, Chiarella would have been convicted under the Hungarian statute.

The Hungarian definition of insiders is broader in scope than the United States definition under both the fiduciary duty and misappropriation theories. Both the Hungarian statute

145. 1990 Securities Act, supra note 6, pt. VI, ¶ 76(2). See supra note 123.
and American case law acknowledge that persons with a special relationship with the issuer should be defined as insiders and prohibited from trading on the basis of information obtained by virtue of their relationship with the company. However, the Hungarian statute extends insider liability to those without a fiduciary duty to the issuer who have knowingly had access to confidential inside information. Thus, while United States case law emphasizes a duty running between the parties to the transaction, the Hungarian definition recognizes that an unfair informational advantage is obtained whenever inside information is knowingly used.

2. The State of Mind of Tippers v. the Likely Actions of Tippees

a. Dirks's Tippers With a Motive and Derivative Tippees

Dirks v. SEC, 146 through the same fiduciary duty approach used in Chiarella, restricted insider trading liability for tippers and tippees. The Supreme Court reduced the potential scope of insider trading liability for tippers by requiring a personal benefit from tipping, and for tippees by requiring a fiduciary breach on the part of the tipper.

Raymond Dirks was an investment analyst who received information from Ronald Secrist, a former officer of Equity Funding of America. 147 Secrist informed Dirks that the assets of the company were overstated due to fraudulent corporate practices and urged Dirks to verify the fraud and disclose it publicly because previous complaints to regulatory agencies had been ignored. 148 For a two-week period, Dirks openly investigated the allegations and discussed Secrist's charges, and the price of stock correspondingly dropped. 149 While neither Dirks nor his firm owned or traded any stock in Equity Funding, because Dirks openly discussed the information with clients and investors, a number of investors avoided tremendous losses by selling their holdings. 150 In an administrative proceeding conducted by the Commission, Dirks was found to have

147. Id. at 648-49.
148. Id. at 649.
149. Id. at 649-50.
150. Id. at 649.
violated section 17(a) of the Securities Act of 1933, section 10(b) of the Securities and Exchange Act of 1934, and rule 10b-5.\(^{151}\)

The first issue the Court confronted in *Dirks* was whether a tippee who has knowingly received material nonpublic information from an insider was subject to the same duties as an insider, and therefore liable for tipping potential traders. The Court reaffirmed the principle articulated in *Chiarella* that a duty to disclose arises from the relationship between the transacting parties and not merely from the ability to acquire information based on a particular position in the market.\(^{152}\) The Court sought to avoid the possible "inhibiting influence" on market analysts that extending the duty to disclose or abstain to persons who knowingly receive material nonpublic information from an insider would have on a healthy market.\(^{153}\) However, the Court did not eradicate all possibilities of tippee liability. Instead, the Court declared that tippee liability was derivative of an insider's breach of fiduciary duty.\(^{154}\) The test for tippee liability entailed a consideration of two factors: (1) whether the act of tipping constituted a breach of the tipper's fiduciary duty; and (2) whether the tippee knew or should have known such a breach had occurred.\(^{155}\)

The second issue the Court addressed was the question of tipper liability, which had become a prerequisite of tippee liability. Here the Court noted that the question of whether tipping constituted a breach of fiduciary duty largely depended on the purpose of the disclosure.\(^{156}\) The test for tipper liability became whether the insider received a direct or indirect personal benefit from the disclosure, such as pecuniary gain or reputational benefit.\(^{157}\) The Court held that because Secrist was motivated only by a desire to expose fraud, he had com-


\(^{152}\) *Dirks*, 463 U.S. at 657-58.

\(^{153}\) *Id.* at 658.

\(^{154}\) *Id.* at 659.

\(^{155}\) *Id.* at 660-61.

\(^{156}\) *Id.* at 662.

\(^{157}\) *Id.* at 663.
mitted no breach of duty; consequently, there had been no
derivative breach on the part of Dirks.\footnote{Id. at 667.}

b. Hungary's Independent Tippers

Under the Hungarian statute, persons are liable for tipping if they are insiders\footnote{There are two broad categories of insiders: qualified insiders and persons who have obtained confidential information in any manner and who have knowingly had access to such information. 1990 Securities Act, supra note 6, pt. VI, § 77(c).} and if they divulge inside information to a person likely to benefit from or pass on such knowledge within the stock exchange.\footnote{1990 Securities Act, supra note 6, pt. VI, § 77(c).} Applying this test of tipper liability to the \emph{Dirks} case, Secrist easily satisfies the "insider" requirement. Secrist would be an insider within the meaning of the Hungarian statute, either as an executive officer or as a person who had been employed by the issuer within the last six months.

The "tipping" requirement is more difficult to apply because the standard is unclear. The first question is: what is the threshold probability of "may be likely"? For example, does the fact that Secrist disclosed the information to Dirks for purposes of revealing the fraud possibly show that Dirks was not likely to benefit from or pass on the information? On the other hand, does the fact that Dirks was an investment analyst with clients on the stock exchange indicate the possibility of benefit or of future tipping on the part of the tippee? The second question which emerges is: from whose point of view will the determination be made as to whether the tippee may be likely to benefit or tip in the future? There is no requirement under the Hungarian statute that the tipper know or have reason to know that the tippee may be likely to benefit or to tip. Under the Hungarian approach, Secrist's motivations in disclosing the information to Dirks are irrelevant.\footnote{The Hungarian statute provides that a tipper is liable for insider dealing upon divulging inside information to whomever may be likely to benefit from such knowledge or to pass on such knowledge within the Stock Exchange. The statute is silent as to the requisite mental state of the tipper. 1990 Securities Act, supra note 6, pt. VI, § 77(c).} The only issue is whether Dirks may have been likely to benefit or tip. Thus, the determination as to whether a tipper is liable depends entirely
on an after-the-fact judicial determination of the likelihood of a benefit being received or a tip being disclosed by the tippee.

The main difference between the two approaches to tipper liability is that, while the United States definition focuses on the tipper's motivation behind making the tip, the Hungarian definition concentrates on the likely actions of the tippee upon receiving the tip. The Hungarian approach is arguably more consonant with a concern for the integrity of the market and parity in information.\textsuperscript{162} While the United States' approach appears to focus more on the state of mind of the tipper, the Hungarian approach appears to focus more on the potential harmful effects of the tip on the market. In fact, the Hungarian statute seems to have contemplated the very harm done to the value of securities as a result of Dirks's disclosures. On the other hand, disregarding the knowledge and motivation of the tipper in making the tip ignores the level of culpability of the tipper, and imposes a form of strict liability, the deterrence value of which is questionable.

c. Hungarian Tippees With Informational Access

The Hungarian statute identifies two types of tippees. The first category of tippees is comprised of qualified insiders to whom confidential information is handed.\textsuperscript{163} The second category includes persons who obtain confidential information regardless of the manner in which it was obtained and who knowingly have access to confidential inside information.\textsuperscript{164} Dirks does not fall within the first category of tippees because he was not an executive of the issuer, a close relative of an executive, a beneficial owner of the issuer, an employee of the issuer, or a person with a close working contact with the issuer. Dirks would qualify as a tippee under the second category because he obtained confidential information and knew that the information was confidential.

Having classified Dirks as a tippee, the next issue under the statute is to determine whether his disclosures represented

\textsuperscript{162} See infra text accompanying notes 163-66 (similarly arguing that tippee liability in Hungary discards the \textit{mens rea} emphasis found in United States case law).

\textsuperscript{163} See supra note 123.

\textsuperscript{164} 1990 Securities Act, supra note 6, pt. VI, ¶ 76(2).
a prohibited form of insider activity. Because Dirks did not deal himself or by proxy, he must have engaged in a prohibited form of tipping in order to be subject to insider liability. The fact that some of his clients avoided losses and that the value of the corporation's securities decreased so dramatically demonstrates that certain persons benefited from the disclosure and passed on the information. Thus, presumably Dirks's actions would pass the probability threshold required to impose liability for tipping.

Tippee liability under Hungarian law is broader than the approach by the Supreme Court in Dirks. Hungarian tippees do not escape liability when the tipper has not breached a fiduciary duty, because tippee liability in Hungary is independent of tipper liability. A similarity between the approaches lies in the scienter requirement. Both countries require that the tippee know of the nature of the information received. However, there is a subtle distinction between a tippee knowing that the tipper is breaching a duty and a tippee knowing that he or she has access to inside information. Arguably, this gap becomes negligible because knowledge of a tipper's breach and knowledge of one's own access to information are triggered by the confidential inside nature of the information itself. Still, because the requisite knowledge by the tippee under Hungarian law is not limited by fiduciary duty concerns, tippee liability in Hungary is more consistent with the goal of an honest and open market.

3. Remote Tippees

a. American Remote Tippees

The disparity between the Hungarian and United States approaches to insider trading liability becomes especially clear upon examining the subject of remote tippees. The issue of remote tippees is one of the more complicated problems in the law of insider trading, because of the difficulty in distinguishing market rumor from material nonpublic information, and complete strangers transacting in an impersonal market from

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165. 1990 Securities Act, supra note 6, pt. VI, ¶ 77. See also text accompanying notes 159-60.

166. See supra part IV.C.2.b. (revealing the same theoretical consistency in the statutory treatment of tipper liability).
market participants transacting through a traceable chain of derivative tipping.\footnote{167}

The scope of remote tippee liability in the United States remains unclear for reasons of the unsettled nature of the law on the subject and the special circumstances surrounding most remote tippee cases. First, the Supreme Court has not explicitly addressed the issue of remote tippees. Second, there is no express statutory authorization for imposing insider trading liability on tippees in general, much less indirect or remote tippees.\footnote{168} Third, the “silence” scenario in which the typical remote tippee case arises makes it difficult to prove that the defendant was aware of and traded on the basis of information unknown to the marketplace and undisclosed by the defendant.\footnote{169} Fourth, the typical impersonal market transaction during which most remote tippee violations occur makes it difficult to prove that market participants were defrauded and would not have sold their stock had they known of the inside information.\footnote{170}

Notwithstanding the difficulties in assessing remote tippee liability, American courts and commentators have crafted three theories on which to predicate remote tippee liability. The first theory treats the misappropriation theory as a cornerstone of tippee liability.\footnote{171} The misappropriation theory contends that “one who misappropriates nonpublic information in breach of a fiduciary duty and trades on that information to his own advantage violates Section 10(b) and Rule 10b-5.”\footnote{172} The strict theory of tippee liability, by viewing the tippee as a possible misappropriator, encompasses tippees who are directly privy to material nonpublic information from an inside source and who trade silently while in possession of that information.\footnote{173} This restrictive approach limits the scope of remote tippee liability.

\begin{thebibliography}{9}
\bibitem{168} Pitt & Groskaufmanis, \textit{supra} note 167.
\bibitem{169} Pitt & Groskaufmanis, \textit{supra} note 167.
\bibitem{170} Pitt & Groskaufmanis, \textit{supra} note 167.
\bibitem{171} Pitt & Groskaufmanis, \textit{supra} note 167.
\bibitem{173} See Pitt & Groskaufmanis, \textit{supra} note 167.
\end{thebibliography}
by requiring that the ultimate tippee be a direct recipient of inside information from an insider.\textsuperscript{174}

The second theory imposes a fiduciary duty on the tippee and creates a chain of persons with a duty to disclose.\textsuperscript{175} This theory more specifically requires that each person in the chain receive the tip under the following circumstances: (1) expressly for purposes of aiding in the trading of securities based on inside information; (2) knowing that the information was material and nonpublic; and (3) knowing or having reason to know that the information arose as a result of some breach of duty by an insider.\textsuperscript{176} On the one hand, this moderate approach expands the scope of remote tippee liability by not requiring the penultimate tippee to be an insider. On the other hand, this middle approach restricts the range of potential violators by requiring that every participant in a chain of communication of inside information know of the prior tippee's breach of a specific fiduciary duty and accept the information with an understanding to keep the information confidential.\textsuperscript{177} Thus, while this theory encompasses a greater number of remote tippees than the strict approach, the difficulty in establishing the requisite state of mind for each tippee in a long chain of derivative tipping makes the imposition of liability unlikely.

The third theory contends that a remote tippee who trades on the basis of material nonpublic information violates rule 10b-5 only when the tippee knows that his or her source has breached a fiduciary duty or has garnered an inappropriate benefit.\textsuperscript{178} This approach requires proof that: (1) the tipper breached a fiduciary duty or received a personal benefit; (2) the tippee knew that the information received was material and nonpublic; and (3) the tippee knew that the information was obtained via a fiduciary breach by an insider.\textsuperscript{179} By focusing primarily on the state of mind of the ultimate tippee and treating the tippee as an after-the-fact participant in the fiduciary

\textsuperscript{174} See Zachary Joseph, A Comparative Analysis of the European Community Insider Trading Directive, 3 TRANSNAT'L LAW. 231, 244 (1990); ARNOLD S. JACOBS, LITIGATION AND PRACTICE UNDER RULE 10B-5, § 65.02[a][iii][C][F], at 3-494.23 (2d ed. 1993); LANGEVOORT, supra note 60, at 123-30.

\textsuperscript{175} Joseph, supra note 174, at 246.

\textsuperscript{176} Joseph, supra note 174, at 246.

\textsuperscript{177} See Pitt & Groskaufmanis, supra note 167.

\textsuperscript{178} Pitt & Groskaufmanis, supra note 167.

\textsuperscript{179} Pitt & Groskaufmanis, supra note 167.
breach of the original source of the information, this broad approach expands remote tippee liability beyond the scope delineated by both the strict and moderate theories.

b. Chestman's Remote Tippees

United States v. Chestman\(^{180}\) was significant because it marked the limits of remote tippee liability in the Second Circuit.\(^{181}\) The Chestman Court\(^{182}\) reversed the 10b-5 conviction of a stockbroker who traded for his own account and on behalf of his customers based on inside information obtained from his client, the husband of the niece of a majority shareholder in a company about to be sold to a corporate buyer.\(^{183}\) The Second Circuit set “rigorous standard[s] of proof in insider trading cases involving remote, or indirect, tippees,”\(^{184}\) by requiring that the remote tippee know of the breach of a confidential duty by the previous tippee and that each remote tippee in the chain accept the duty to maintain confidentiality.\(^{185}\)

Robert Chestman was a stockbroker and financial advisor

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180. 903 F.2d 75 (2d Cir. 1990); United States v. Chestman, 947 F.2d 551 (2d Cir. 1991) (en banc).
182. There are two Chestman decisions. The Second Circuit first ruled on the case in United States v. Chestman on May 2, 1990. The Second Circuit reconsidered the case on October 7, 1991. The “Chestman Court” refers to both panels and their decisions. The “first panel” refers to the Second Circuit panel in United States v. Chestman, 903 F.2d 75 (2d Cir. 1990), which consisted of Circuit Judges Mahoney, Miner, and Carman; the “en banc panel” refers to the Second Circuit panel in United States v. Chestman, 947 F.2d 551 (2d Cir. 1991) (en banc), which consisted of Circuit Judges Kearse, Mahoney, McLaughlin, Miner, and Winter, and Chief Judge Newman.
183. Chestman, 947 F.2d at 551.
184. Pitt & Groskaufmanis, supra note 167.
185. Levine & Mathews, supra note 181, at 474.
for the brokerage house of Gruntal & Co. Keith Loeb met with Chestman in hopes of consolidating his and his wife’s holdings in Waldbaum, Inc. (Waldbaum). During their initial meeting, Loeb indicated that his wife, Susan, was the granddaughter of Julia Waldbaum, a Waldbaum director, the wife of the company’s founder, and the niece of Ira Waldbaum, the president and controlling shareholder of Waldbaum, whose immediate family owned fifty-one percent of the outstanding Waldbaum stock.

Ira Waldbaum entered into negotiations for the sale of Waldbaum to the Great Atlantic and Pacific Tea Company, Inc. (A & P). The resulting stock purchase agreement required Ira, as attorney-in-fact for the Waldbaum family stockholders, to tender a controlling block of Waldbaum shares to A & P at a price of fifty dollars a share. Ira told various family members, including his sister, Shirley Witkin, about the sale, offered to tender their shares as well, and cautioned them that the sale was confidential and should not be discussed. Nevertheless, Shirley told her daughter, Susan, about the sale and cautioned her not to tell anyone except her husband, because disclosure could ruin the sale. Susan informed her husband about the pending tender offer and reiterated the same warning. Loeb contacted Chestman, disclosed his “definite” and “accurate” information that Waldbaum was about to be sold at a “substantially higher” price than its market value, and asked for his advice. Chestman responded that he could not advise Loeb “in a situation like this.” Chestman subsequently purchased 3,000 shares for his own account at $24.65 per share, and 8,000 shares for his clients’ accounts at prices ranging between $25.75 and $26.00 per share, including 1,000 shares for the Loeb account. Loeb recontacted Chestman for advice, but Chestman restated that he could not advise Loeb “in a situation like this,” but that his research revealed that Waldbaum was a “buy.”

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186. Chestman, 903 F.2d at 77.
187. Id.; 947 F.2d at 555.
188. 903 F.2d at 77; 947 F.2d at 555.
189. 903 F.2d at 77; 947 F.2d at 555.
190. 903 F.2d at 77; 947 F.2d at 555.
191. 903 F.2d at 77; 947 F.2d at 555.
192. 903 F.2d at 77; 947 F.2d at 555.
193. 947 F.2d at 555.
1,000 shares of Waldbaum stock. Finally, the tender offer was publicly announced, and the stock correspondingly rose to forty-nine dollars per share.

The National Association of Securities Dealers and the SEC commenced investigations into the Waldbaum transactions. Loeb entered into a cooperation agreement with the government. Chestman was indicted and convicted of ten counts of fraud in violation of section 10(b) and rule 10b-5, ten counts of fraud in violation of section 14(e) and rule 14e-3, ten counts of mail fraud, and one count of perjury.

The Chestman Court affirmed the rule 14e-3 conviction, but reversed the rule 10b-5, mail fraud, and perjury convictions. The 10b-5 convictions were based on the misappropriation theory, under the rationale that Chestman aided or abetted the misappropriation by Loeb or that Chestman was a tippee of the information misappropriated by Loeb. In addressing the issue of 10b-5 liability, the court first distinguished between the traditional and misappropriation theories of insider trader liability, and expressed concerns for

194. 903 F.2d at 77; 947 F.2d at 555.
195. 903 F.2d at 78; 947 F.2d at 555.
196. 903 F.2d at 78; 947 F.2d at 556.
197. On en banc reconsideration, the Second Circuit affirmed the rule 14e-3 conviction, reversed the rule 10b-5 and mail fraud convictions, and vacated the previous panel's decision on all three issues. However, the court did not rehear the appeal from the perjury conviction and thus, the panel's reversal of that conviction stands. 947 F.2d at 554.

The Chestman treatment of the rule 14e-3, mail fraud, and perjury convictions is not crucial to this analysis of remote tippee liability. See 903 F.2d at 80-84; 947 F.2d at 556-64, 571 for the specific reasoning behind those decisions.

198. 947 F.2d at 564, 570.
199. The traditional theory claims that a duty to disclose or abstain arises only from "a fiduciary or other similar relation of trust and confidence between [the] parties to the transaction." 947 F.2d at 565 (quoting Chiarella v. United States, 445 U.S. 222, 228 (1980)). Under the traditional theory, tippee liability attaches in two circumstances: (1) when an "insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach;" Id. (quoting Dirks v. Securities Exchange Commission, 463 U.S. at 660); and (2) "when the outsider obtains access to confidential information solely for corporate purposes in the context of 'a special confidential relationship.'" Id. Both circumstances of tippee liability are restricted by two principles underlying the traditional theory of 10b-5 liability: (1) "the predicate act of fraud must be traceable to a breach of duty to the purchasers or sellers of securities;" and (2) "[the] fiduciary duty does not run to the purchasers or sellers solely as a result of one's possession of material nonpublic information." Id. These restrictions thwart liability in the case of most remote tippes.

200. The misappropriation theory asserts that "a person violates rule 10b-5
the potentially unlimited scope of tippees encompassed by a broad reading of the misappropriation theory.

The court, in observing that a fiduciary duty is not created by "entrusting a person with confidential information" or by "mere kinship," concluded that the "gratuitous reposal of a secret to another who happens to be a family member" is not, in itself, sufficient to establish the requisite fiduciary relationship, or its functional equivalent. The court reasoned that the essence of a "fiduciary or similar relationship of trust and confidence" was the existence of confidence and dependency on one side and superiority and influence on the other. The court, in examining the requirement that there exist a fiduciary breach by the misappropriator, determined that Loeb's status as Susan's husband did not establish the requisite fiduciary status and that Susan's gratuitous communication of confidential information to Loeb did not imply an acceptance of a duty of confidentiality. Thus, absent a fiduciary breach by Loeb, Chestman could not be derivatively liable as Loeb's tippee or as his aider and abettor.

c. Hungarian Remote Tippees

The Hungarian approach to tippee liability would hold remote tippees like Chestman liable for trading on the basis of an inside tip. Under the Hungarian statute, remote tippees are liable if they obtain and knowingly have access to confidential information. Thus, Chestman would be liable merely because he possessed and knowingly had access to "definite" and "accurate information that Waldbaum's could be sold at a 'sub-

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201. 947 F.2d at 567.
202. Id. at 568.
203. Id.
204. Id. 568-69.
205. 1990 Securities Act, supra note 6, pt. VI, § 76(2).
stantially higher’ price than its market value.” Because such information is the type of information which remains confidential until disclosure, Chestman would be liable however he obtained the information, and regardless of whether he knew that Loeb was privy to inside information.

The Hungarian statutory definition encompasses more remote tippees than each of the three American theories of remote tippee liability. First, because the Hungarian definition does not require the penultimate tippee to be an insider, Chestman would be deemed a violator regardless of whether he obtained the inside information from Loeb, Susan, Shirley, or Ira. The “attenuated passage of the information” from Ira to Shirley to Susan to Loeb to Chestman does not attenuate Chestman’s liability in Hungary. Apparently, the Hungarians were not concerned that extending remote tippee liability beyond the confined sphere of shareholder relationships would risk “taking over [the] ‘whole corporate universe.’”

Second, because the Hungarian statute does not require knowledge of the confidentiality of the information or assumption of the duty of confidentiality on the part of the tippee, Chestman would be convicted as a remote tippee irrespective of how Loeb obtained the tip from his wife. Under the Hungarian approach, it would be irrelevant whether Loeb learned of the tip upon gratuitous bestowal by his wife, as a result of Susan’s desire to advance her own interests, upon prompting by Loeb, or following a pattern of sharing business confidences.

Third, the Hungarian approach is most analogous to the broad theory of remote tippee liability in the United States, because both approaches focus on the state of mind of the ultimate tippee. However, the Hungarian statute requires a different sort of knowledge on the part of the remote tippee. Under the American approach, Chestman must know not only that information regarding a pending tender offer is confidential, but that the information was obtained by a fiduciary breach. In contrast, if Chestman were in Hungary, he need

206. 947 F.2d at 555.
207. See supra part IV.C.3.a.
208. 903 F.2d at 79.
209. 947 F.2d at 567 (quoting United States v. Chiarella, 588 F.2d 1358, 1377 (2d Cir. 1978) (Meskill, J., dissenting) (quoting Santa Fe Industries v. Green, 430 U.S. 467, 480 (1977))).
only know that he himself was privy to confidential information. This informational access was arguably established as far back as his initial encounter with Loeb, when Loeb revealed his family connections. Thus, while all three American approaches are restricted by some form of fiduciary requirement, the Hungarian approach generates more expansive liability by focusing on each individual’s access to information.

d. Interpreting the Meaning of Inside Information

In comparing different insider trading laws, defining what sort of information raises confidentiality concerns is as significant as delineating the scope of insiders prohibited from using or disclosing that information. Briefly, the Hungarian statute defines inside information as “confidential insider information.” American courts have similarly defined inside information as “material nonpublic information.” Both definitions require that the information be valuable in some way, and not be publicly known. While the definitions initially appear to be similar, there are some subtle differences, especially in their treatment of materiality.

i) Materiality v. Substantial Effect on the Value

The primary difference between the two countries’ definitions of inside information lies in their evaluations of materiality. In the United States, the materiality standard for inside information requires “a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” Furthermore, when the information concerns a contingent or speculative event, materiality “will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the


company activity.\textsuperscript{212}

The Hungarian approach looks to whether the publication of the confidential inside information "may effect substantially the value of Securities."\textsuperscript{213} The statute regards as material "information relating to the financial, economic and legal situations of the Issuer, Broker and Warrantor." The statute also lists as examples "new issues, major deals, structural changes, turn-round projects and winding up."\textsuperscript{214}

The two approaches differ with respect to the threshold of probability, character of proof, and timing of judicial review. The probability threshold under the Hungarian statute appears to be lower than that required under United States case law. The Hungarian statute only requires the \textit{mere} possibility that the information will change the value of securities. The American definition requires a \textit{substantial} possibility that the information will change the character of information available.

The two approaches also differ in terms of what changes are required to prove the materiality of the information in question. While the Hungarian approach looks for a change in the \textit{value of securities}, the American approach emphasizes a change in the \textit{total mix of information available}. Arguably, Hungary's emphasis on the real effect of the information on the market is in line with its official recognition of the relation between informational access and market efficiency. Similarly, the United States' emphasis on the availability of information is arguably consistent with its policy favoring disclosure as the primary regulatory mechanism in the context of public trading of securities.

Finally, the primary difference between the two standards of materiality is the time at which the value of information is determined. The Hungarian approach looks to the probability that the information will have a substantial effect on the value of the securities. This evaluation is made from the standpoint of a judge in Budapest presumably after the trading has occurred and after the disclosure or nondisclosure of information has already been shown to have had an impact on the price of the stocks concerned. In contrast, an American judge views the

\textsuperscript{212} Basic Inc., 485 U.S. at 238 (citing SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968)).

\textsuperscript{213} 1990 Securities Act, supra note 6, pt. VI, ¶ 75(2).

\textsuperscript{214} 1990 Securities Act, supra note 6, pt. VI, ¶ 75(2).
information from the point of view of the "reasonable investor" at the time of the trade. Arguably, the type of information which would be relevant to a reasonable investor is likely to be the type of information which would have an impact on the value of the security. However, at the moment of trading, the American investor may still be in a better position to judge the materiality of inside information, and thus whether such trading is prohibited.

ii) Confidential v. Nonpublic

Another component of the definition of inside information is its nonpublic or confidential nature. While the notion of confidentiality conjures up trust relationships and fiduciary duties, the nonpublic nature of the information merely signifies its informational status in the marketplace. Ironically, while American common law emphasizes fiduciary duty, Hungarian law emphasizes informational parity. Because the connotations appear to be reversed, the differences between confidential and nonpublic are primarily semantic.

e. Implementing Effective Enforcement

i) Criminal Liability

Both Hungary and the United States subject insider trading violators to criminal liability. Insider traders in Hungary and the United States face possible criminal fines and imprisonment. In Hungary, the Public Prosecutor, aided by the Supervisory Board of Securities, the Hungarian rendition of the SEC, may bring criminal charges against insider dealing violators. In the United States, the Justice Department, with the investigative and legal assistance of the Securities Exchange Commission, may charge insiders with criminal liability for violations of the federal securities regulations.

Although both countries impose criminal liability for insider trading violations and although the Supervisory Board of Securities enjoys the same nominal powers as the SEC, the enforcement of the securities regulations has been more vigorous and more effective in the United States for several reasons. First, the number of cases prosecuted and convicted in the United States far exceeds the absence of actions brought against insiders by the Hungarian government. Second, the
publicity surrounding the insider trading scandals of the 1980s has increased public awareness of the risks of insider trading, and arguably the deterrent value of the securities regulations as well. Third, the long existence of and the generous grants of authority by Congress to the SEC have created a legion of experienced securities regulators and strengthened the Commission's administrative and investigative power to better implement and enforce the vague prohibitions of Congressional legislation. Thus, despite the formal similarities, there are real differences in the effectiveness of the enforcement in the two countries.

ii) Civil Liability

Another major difference between Hungarian and American insider trading law is the absence of civil liability for insider trading in Hungary. Conversely, individuals in the United States have an implied private cause of action in cases where they are victimized by insider trading. This private right of action is complicated by differing judicial standards of the fiduciary elements of materiality, reliance, causation, and scienter. Proponents of a private right of action argue that victims of insider trading deserve compensation, that the additional threat of civil liability provides a necessary and effective deterrent, and that civil liability avoids the stricter burdens of criminal proof. Arguments against a private cause of action point primarily to the judicial impropriety that has led to this implied remedy. Although the deterrence value of civil liability would improve the effective enforcement of the securities regulations in Hungary, it is highly unlikely that courts in a civil code system like Hungary's would have the wide discretion necessary to create derivative private rights of action. Penalties for violations of the law must be explicitly established by the Civil Code.

iii) Short-Swing Liability

The major difference between the Hungarian and United States approaches to short-swing trading is the strict liability imposed in the United States on traditional corporate insiders

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engaged in short-swing trading. In contrast, the Hungarian statutory provision dealing with short-swing transactions explicitly provides three loopholes: (1) proof that confidential information was not available; (2) proof that the security had to be sold as liquidator to pay creditors; or, (3) proof that the transaction was concluded with a contemporaneous insider. Additionally, while Hungary has limited the restrictions to securities transactions conducted to and from the same person and completed within a period of three months, the United States imposes short-swing liability regardless of the status of the other party and for a longer period of six months. The policy behind the Hungarian limitations to short-swing liability is unclear. Perhaps this reluctance to impose strict liability on short-swing traders reflects a deeper fear that excessive regulation will stifle trading activity. After all, short-swing trading may encompass the majority of trading activity on the Stock Exchange, and despite the official policy against insider trading, Hungarians may be

216. The Commission was given specific rulemaking authority to exempt transactions that are not comprehended within the purpose of section 16(b). For example, an extremely narrow exception to the objective standard of section 16(b) exists when a transaction is "unorthodox" or "borderline." In such circumstances, courts are instructed to adopt a "pragmatic approach in imposing Section 16(b) liability which considers the opportunity for speculative abuse, i.e., whether the statutory 'insider' had or was likely to have access to inside information." However, courts have varied in their application of the exemption and situations to which the exemption applies remains unclear. Edward J. Yodowitz, Avoiding Liabilities Under the Securities Law: Preventive Maintenance, Corporate Compliance, 443 (PLI Litig. & Admin. Practice Course Handbook Series No. 657 1992) PLI ORDER NO. H4-5138 Lit 657 (Securities Litigation 1992: Strategies and Current Developments) (1992).

217. The three loopholes are more precisely one rebuttal mechanism, which shifts the presumption, and two exceptions, which preclude liability completely. The statute provides that "qualified insiders," who within three months resell to or repurchase from the same person from which or to which the security was originally purchased or sold, are presumed to have engaged in a prohibited form of insider dealing. However, this presumption is rebutted by proof that confidential information was not available. Furthermore, liability is not imposed when the sale of the security was necessary to provide a "liquidator" for creditors and when the transaction was conducted with a person who had the same inside knowledge available. 1990 Securities Act, supra note 6, pt. VI, ¶¶ 78, 79.

218. 1990 Securities Act, supra note 6, pt. VI, ¶ 78.
220. 1990 Securities Act, supra note 6, pt. VI, ¶ 79(b).
221. 1990 Securities Act, supra note 6, pt. VI, ¶ 78.
more concerned with the existence of trading than the problem of insider trading. 223

V. OBSERVATIONS AND IMPLICATIONS

A comparative analysis of the insider trading laws in Hungary and the United States reveals that the statutory liability of insiders in Hungary is broader than insider liability in the United States. The broad liability in Hungary may be a function of one or more of the following reasons: First, statutory definitions are necessarily more general than judicial interpretations which emerge from specific analyses of different factual scenarios. Second, Hungarian liability is not confined by the constraints of American common law fiduciary concerns. Third, the Hungarian securities regulations were quickly and erratically conceived in a vacuum by inexperienced legal analysts. Fourth, the Hungarian Parliament was truly guided by its official policy in favor of informational equality and market integrity. Fifth, the Hungarian Parliament was really motivated by the desire to conform its economic reforms to the definitions adopted by other European entities. This section will explore the foundations for the broader insider liability of the Hungarian statute.

The broader scope of Hungarian insider liability may partially result from the lawmaking mechanism characteristic of civil code legal systems. The process of statutory lawmaking is difficult and obscure. Defining complex activity by statute requires legislators to define the prohibited activity in general terms rather than risk underinclusiveness. The absence of a statutory definition of insider trading in the United States may have produced a narrower scope of liability in the United States. The differences in the scope of insider liability reflected in the Hungarian statute and American case law may reflect deeper differences between lawmaking under civil code systems and common law jurisdictions, especially in light of the closer connection between insider trading laws in Hungary and other European civil code countries.

223. Tibor Papp, a spokesperson for the Budapest Exchange’s Securities Trading Committee, stated, “We have a small market and with insider trading, at least it’s trading. If we put too many rules, it will kill the market.” Hamilton, supra note 11, at 1.
Hungarian insider liability may be broader than liability in the United States because the scope of Hungarian statutory liability is not restricted by American common law notions of fraud and fiduciary duty. The Hungarian definitions of insiders, tippers, and tippees encompass more insiders than the American definitions, not only because of the differences in the definitions themselves, but also because of the American requirement that a fiduciary relationship connect parties to a securities transaction. The scope of insiders is broader under Hungarian law because the Hungarian definition includes persons in any kind of close working contact with the issuer giving them access to confidential inside information, and persons who obtain confidential information in any kind of manner and who knowingly have access to confidential inside information. In contrast, the American definition requires that the professional or misappropriator be connected through some form of a fiduciary relationship involving trust or confidence. Thus, because Hungarian law focuses on the informational status of the insider itself while American law concentrates on the connection between the transacting parties, the Hungarian statute remains the broader of the two approaches.

The expansive nature of the Hungarian insider liability may not have been intended. Hungary is in a state of great economic flux, and its legal reforms have been criticized as overambitious, misguided, and sporadic. Discussions with SEC consultants to Hungary suggest that the securities regulations were drafted through hasty deliberations by inexperienced policymakers whose primary goal was to complete the Act quickly before the formal reopening of the Budapest Stock Exchange. Present efforts to amend the laws, with the help of securities institutions from all over the world, also indicate ambiguities surrounding the wisdom of the current legislation.

On the other hand, the broad reach of the Hungarian law may have been specifically contemplated by the Hungarian Parliament in keeping with the official policy to foster capital flow, to promote securities markets, and to safeguard investors. Perhaps the Hungarian Government did adopt the rationale that insider trading is economically inefficient and ethically unfair. However, the fast pace of Hungary's economic transformation and the sporadic nature of its legal reforms suggest that the enactment of the securities regulations was not the result of arduous policymaking.
The expansive character of insider liability in Hungary appears to have been a deliberate effort to gain international recognition by conforming to the growing international consensus in favor of prohibiting insider trading. The fact that many of the economic reforms have been "radically conceived" but "modestly implemented" suggests that Hungary endeavored to actualize the regulations on paper for appearance purposes, rather than to embrace an economic policy in reality for genuine purposes.²²⁴

In light of the ambiguous policy underlying its present regulatory scheme, Hungary should reevaluate the assumptions and merits behind its insider dealing restriction. Moreover, because effective implementation is crucial to the success of any regulatory scheme, Hungary should enact reasonable regulations based on its own policy determinations, and implement effective mechanisms in line with those policies. In fact, Hungary is currently in the process of amending its securities regulations with help from central securities institutions from all over the world. Moreover, Hungary is presently an associate member of the European Community and presumably seeks to become a full member in the future. Thus, regardless of the true intentions behind the present reforms, Hungary will need to critically reassess its economic objectives to ensure the future success of its new reforms.

It is unclear whether the current state of Hungary's insider trading regulations is the circumstantial result of Hungary's civil code lawmaking process and piecemeal economic transformation, or the intentional product of a deliberate governmental effort to promote informational equality, pursuant to its own policies, or to enhance the market's international reputation, pursuant to foreign concerns. If the effects of the regulations are the product of external legal and economic circumstances, then Hungary needs to realign its official policies with the market realities of the Budapest Stock Exchange. However, if Hungary is truly concerned with the inefficiency and unfairness risked by insider trading, then the broad scope of its regulations must be actively implemented by effective enforcement mechanisms. On the other hand, if Hungary is primarily motivated by a desire to attract foreign investment and gain inter-

²²⁴ Clarke, supra note 13, at 14.
national confidence, then upon seeking membership to the European Community it will need to conform its laws to the standards set by that entity. 225 Regardless of its true intentions, Hungary should still critically reassess the value of its current regulations as well as the merits of its future economic policies. Although the American model has been recognized as the most developed securities regulatory framework in the world, Hungary should not assume that all aspects of the United States scheme are effective or appropriate to its unique form of market economy. For example, the strict and unforgiving liability under section 16(b) may chill the majority of trading activity on the Budapest Stock Exchange. In addition, the narrowing effect on liability by the American fiduciary relationship requirement might become too restrictive in a civil code system and might allow too many traders to escape liability. Finally, a more flexible analysis may be especially dangerous in an underdeveloped securities market, where insider trading is common, investment is risky, domestic investors are inexperienced, and foreign investors are wary. A broad policy encouraging informational equality and market integrity may be particularly crucial to the success of an emerging securities market, which needs confident investors and foreign investment.

VI. CONCLUSION

In Hungary's economic transformation from a command to a market economy, Hungarians must overcome economic inefficiencies, legal inconsistencies, and psychological ambiguities. In a rapid series of sporadic reforms between 1968 to the present, the Hungarian government has struggled to establish a new economy by mixing socialism and capitalism. Although many have criticized the past reforms for being quickly con-
received and inadequately implemented, Hungary has been a leader in most areas of economic reform in Central and Eastern Europe, and appears to have adopted a more sophisticated approach for the future. While the dearth of promising businesses and confident investors makes investment in the Budapest Stock Exchange appear risky, accelerated privatization programs, attractive investment incentives, and new securities regulations promise a brighter economic future.

Given the growing international concern for insider trading and the progressive economic developments in Hungary, a comparison between the insider trading laws in the United States and Hungary is both economically and legally educational. Hungary appears to have enacted an insider trading ban in deference to a growing international consensus, rather than in acceptance of the view that insider trading encourages market inefficiency and informational inequality. Regardless of Hungary's true intentions, the clarity and predictability of the statutory definition are particularly crucial to the successful development of the immature Hungarian securities market.

Insider trading liability is broader in Hungary, primarily because the statutory definitions are not confined by the constraints of the American fiduciary emphasis. While the Hungarian definition of insiders focuses on the insider's access to information, the American definition requires a fiduciary duty between the parties to the transaction. Because the Hungarian definition of tippers does not require a personal benefit, but rather focuses on the effect of the tip on the market, tipper liability in Hungary is broader than in the United States. Similarly, tippee liability in Hungary is more encompassing than in the United States, because Hungarian tippees need not know of a fiduciary breach by the tipper, but need only know of their own access to information. Finally, because remote tippee liability under Hungarian law cannot be avoided by breaking a chain of derivative tippees, the Hungarian approach generates more expansive liability by focusing on the remote tippee's access to information alone. In sum, while the American approach narrows the scope of insiders, tippers, and tippees by predicking liability upon the existence of a fiduciary duty, the Hungarian approach encompasses more potential violators by focusing on the informational access of the alleged violator. Thus, the Hungarian approach is more consistent with market efficiency and informational parity rationales.
Another difference between the two approaches is the differing definitions of inside information. The Hungarian standard for materiality is lower in threshold probability, more objective in its proof of materiality, and more arbitrary in its assessment by a judge. Thus, an American investor may be on better notice to determine whether to disclose or abstain from trading.

A final difference between the regulatory schemes in Hungary and the United States lies in the effectiveness of their enforcement. Although the criminal liability in both countries is nominally similar, the administrative discretion and investigative powers of the SEC have resulted in much better enforcement of insider trading in the United States. While the deterrence value of imposing civil liability in Hungary cannot be questioned, the possibility of creating such an implied remedy in a civil code jurisdiction is virtually nonexistent. Finally, despite the benefits of strict liability in short-swing trading, the loopholes under the Hungarian approach may be necessary to avoid eradicating the limited market activity.

Hungary should be praised for its ambitious economic and legal reforms. Despite the market risks and regulatory uncertainties associated with the Budapest Stock Exchange, the securities regulations remain untested, and it will take time for these markets to mature and benefit from the new economic policies. From a Western standpoint, progress is slow and obstacles abundant, but Hungary should be careful to follow its own pace. Thus, in its outlook to the future, Hungary must closely examine its own policies before integrating itself into the international community.

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