

MICHIGAN JOURNAL *of*  
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Spring 2014

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# INSIDER TRADING AND OTHER SECURITIES FRAUDS IN THE UNITED STATES: LESSONS FOR CHILE

*Dante Figueroa\**

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*This Article is a comparative analysis of insider trading law in the United States and Chile. The study summarily reviews the historical, political, and legal foundations of insider trading regulation in both jurisdictions, identifying areas of convergence, as well as areas in which the Chilean securities market could benefit vis-à-vis the more advanced experience of the considerably larger American securities market. The Article also highlights the axiological closeness between both jurisdictions concerning the protection of inside corporate information and the fiduciary role of those who intervene in securities markets in their various capacities (as investors, shareholders, corporate officers, consultants, advisors, or as other intermediary roles). The Article concludes by identifying a series of reforms that might potentially benefit the Chilean legal system as it works towards its stated purpose of protecting and promoting transparency in its national securities market.*

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## I. INTRODUCTION

The topic of “insider trading,” also called the “use of privileged information,” is perhaps one of the most complex and highly debated in corporate law, both in the United States and in Chile. The constant growth of diverse corporate, business, and entrepreneurial organizations in both countries has taken place in tandem with a growing web of legislative, administrative, and self-regulatory insider trading measures. These developments have also resulted in increased private litigation by parties seeking insider-trading-related damages. Chile’s openness to international markets will likely motivate continued growth in the field of insider trading, as has occurred in the United States at least since the late 1980s. Thus, there is a benefit of – and a need for – undertaking an updated comparative study of the problem of insider trading in both jurisdictions.

The current Chilean corporate structure is an “insider”<sup>1</sup> system, in which equity ownership of stock corporations is highly concentrated;<sup>2</sup> that is, a few corporate groups control the majority of companies.<sup>3</sup> This reality explains the perceived risk of oppression of minority shareholders.<sup>4</sup> Despite this, during the last two decades, Chile has witnessed an enormous inflow of foreign investment.<sup>5</sup> Furthermore, many Chilean corporations are also closely controlled by specific families that play a major role in the country’s economic organization.<sup>6</sup>

This Article identifies the current Chilean regulations on the “use of privileged information” as one of the most important corporate govern-

1. Manuel R. Agosin & Ernesto H. Pastén, *Corporate Governance in Chile 1* (Central Bank of Chile, Working Paper No. 209, 2003).

2. Matías Zegers Ruiz-Tagle & Ignacio Arteaga Echeverría, *Interés Social, Deber de Lealtad de los Directores y Conflictos de Interés en Empresas Multinacionales: Un Análisis Comparado con la Legislación de Los Estados Unidos de América*, 31 *REVISTA CHILENA DE DECHERO* 239, 260 (2004) (referring to the Chilean market as “highly concentrated . . . where the majority of controlling shareholders in publicly-traded stock corporations hold almost the totality of the shares issued by such corporations.”).

3. See Agosin & Pastén, *supra* note 1, at 3 (“The five largest groups account for 30 per cent [sic] of the market capitalization of the Santiago stock exchange[.]”); *id.* at 4 (“Almost three quarters of the average company’s shares are owned by the three largest shareholders[.]”).

4. See CLAUDIO ILLANES RÍOS, *RESPONSABILIDAD CIVIL DE LOS DIRECTORES Y GERENTES DE BANCOS Y SOCIEDADES ANÓNIMAS SEGÚN LEGISLACIÓN PERTINENTE* 12 (1993) (indicating that “the social economic function performed by commercial banks, the whole of their business operations, the credibility and security that the system needs, all of these factors deserve a delimitation of civil responsibilities beyond the normal requirements, but that would require a more stringent legislative framework guaranteeing more effectively the interests of shareholders, of minority shareholders and of shareholders related to the banking system, through a more precise and clearer legal regulation of the activities deemed unlawful . . .”).

5. See Agosin & Pastén, *supra* note 1, at abs.

6. *Id.* at 2.

ance regulatory regimes in that country.<sup>7</sup> The Article advances the thesis that, even though important legal improvements have recently taken place in Chile, it is advisable to introduce still greater improvements to these laws to establish: (i) a clearer and simpler description of forbidden conduct; (ii) a more precise determination of who the regulated individuals and entities are; (iii) a more certain demarcation of the duty of abstention binding directors of publicly traded stock corporations; and (iv) the existence of classes of information that are considered to *per se* influence the pricing of a company's stock.

Chilean jurisprudence has addressed many of these topics. As is typical in civil law countries, case law in Chile does not generally have a *stare decisis* effect.<sup>8</sup> However, the decisions issued by the highest courts of the land do typically carry a persuasive force over lower courts.<sup>9</sup> At any rate, a deeper level of legislative harmonization concerning the use of privileged information in Chile would bring a heightened degree of legal certainty. This Article presents several proposals in this regard.

This Article reviews insider trading regulation in the United States as a point of reference that may serve as a guideline for the future evolution of insider trading regulation in Chile. The particular areas of United States insider trading regulation assessed are: the basic element of insider trading responsibility under Section 17(a) of the 1933 Securities and Exchange Act (the "1933 Act");<sup>10</sup> Sections 10(b) & 16 and Rule 10b-5 of the 1934 Securities and Exchange Act (the "1934 Act"),<sup>11</sup> particularly the identification of regulated individuals and entities involved in insider trading or tipping under Section 10(b) and Rule 10b-5 of the 1934 Act; and Rule 14e-3 of the 1934 Act concerning insider trading or tipping in the context of public offerings.

This Article is divided into the following sections: Part II analyzes insider trading law in the United States, while Part III presents the historical background of insider trading in Chile. Next, Part IV focuses on the legislative regulation of insider trading in Chile, and Part V identifies the consequences of violating the obligations towards and prohibitions against insider trading or the use of privileged information in Chile. In turn, Part VI explains the most recent and relevant Chilean case law related to the use of privileged information. Finally, Part VII proposes potential improvements to the legislative framework of insider trading in Chile in the context of a comparative perspective with the United States system.

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7. Teodoro Wigodski & Franco Zúñiga, *Gobierno Corporativo en Chile Después de la Ley de Opas 11 (2002)* (unpublished manuscript), available at <http://www.dii.uchile.cl/~ceges/publicaciones/ceges38.pdf>.

8. See generally M.C. Mirow, *Borrowing Private Law in Latin America: Andres Bello's Use of the Code Napoleon in Drafting the Chilean Civil Code*, 61 LA. L. REV. 291 (2001).

9. *Id.*

10. Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (2012).

11. Securities Exchange Act of 1934, 15 U.S.C. § 78a-78pp (2012).

## II. INSIDER TRADING IN THE UNITED STATES

A. *The Political-Economic Foundation of Insider Trading Regulation in the United States*

One of the primary purposes of governmental regulation of insider trading is to eliminate the informational inequality between corporate insiders and public investors.<sup>12</sup> While the government cannot prevent individual members of the public from making poor investment decisions, it can attempt to ensure that those decisions are as well-informed as possible by prohibiting individuals with superior knowledge from using information that is not yet in the public domain. In the United States, the golden rule concerning the treatment of privileged information is “to not reveal the information or to abstain from transacting.”<sup>13</sup> Securities laws and regulations focus on information or facts related to the value of securities,<sup>14</sup> because insider trading regulation seeks to correct an inadequate performance of the market system<sup>15</sup> through one of its essential elements – the price of the security.

In effect, the investing public is harmed by insider trading because once the value of a particular piece of privileged information is used up, the opportunity for others to profit from that information is gone forever.<sup>16</sup> The legislative histories of the various insider trading-related provisions indicate that Congress views insider trading as unfair, unethical, and/or immoral.<sup>17</sup> Indeed, insider trading is considered a predatory practice that crosses the line between legitimate investment decisions and fraud.<sup>18</sup>

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12. STUART CHARLES GOLDBERG, SEC TRADING RESTRICTIONS AND REPORTING REQUIREMENTS FOR INSIDERS 43 (1973).

13. Jesse M. Fried, *Insider Abstention*, 113 YALE L.J. 455 (2003).

14. GOLDBERG, *supra* note 12, at 2.

15. Mauricio D. Amar, *Uso de información privilegiada: La relación entre empresa y política en el debate*, Serie Estudios N°4, Biblioteca del Congreso Nacional de Chile, Jan. 29, 2007, at 3, available at [http://www.bcn.cl/bibliodigital/pbcn/estudios/estudios\\_pdf\\_estudios/nro04-07.pdf](http://www.bcn.cl/bibliodigital/pbcn/estudios/estudios_pdf_estudios/nro04-07.pdf) (indicating that “[t]he use of privileged information is a source of distortion of the market[.]”).

16. JONATHAN R. MACEY, INSIDER TRADING: ECONOMICS, POLITICS, AND POLICY 10 (1991).

17. See generally *Illegal Insider Trading: How Widespread is the Problem and is There Adequate Criminal Enforcement?* Hearing Before the S. Comm. on the Judiciary, 109th Cong. (2006) [hereinafter *Illegal Insider Trading*]; *Examining Enforcement of Criminal Insider Trading and Hedge Fund Activity: Hearing Before the S. Comm. on the Judiciary*, 109th Cong. (2006) [hereinafter *Criminal Insider Trading*]; BERNARD D. REAMS, JR., INSIDER TRADING AND SECURITIES FRAUD: A LEGISLATIVE HISTORY OF THE INSIDER TRADING AND SECURITIES FRAUD ENFORCEMENT ACT OF 1988, PUB. L. NO. 100-704 (1989); BERNARD D. REAMS, JR., INSIDER TRADING AND THE LAW: A LEGISLATIVE HISTORY OF THE INSIDER TRADING SANCTIONS ACT OF 1984, PUB. L. NO. 98-376 (1989). Cf. *Chiarella v. United States*, 445 U.S. 222, 247-48 (1980) (Blackmun, J., dissenting) (arguing that insider trading is “inherently unfair” and that the Supreme Court should interpret the securities laws “flexibly” to increase the fairness of the securities markets), quoted in MACEY, *supra* note 16, at 23.

18. GOLDBERG, *supra* note 12, at 42.

In a 2006 Congressional testimony concerning the criminal prosecution of insider trading, Professor John C. Coffee noted that:

Everyone [is injured by insider trading]. . . . As informed traders increase their trading on the basis of asymmetric information, bid/ask spreads are likely to widen on all stocks (thus increasing the cost to investors to trade). Ultimately, insider trading causes the cost of equity capital to rise, and this in turn has a macro-economic effect on GNP, employment, and the economy as a whole.<sup>19</sup>

Insider trading can also harm the issuing corporation itself by contaminating the incentives and decisions of managers.<sup>20</sup> For example, corporate officers might try to decrease the value of the firm so as to personally profit from trading on the stock of a rival company. Or, corporate managers might opt to take an inordinate amount of risk because the resulting volatility could present an opportunity for insider trading profits. Transparency and flow of information within the business might, too, be harmed as insiders seek to protect their privileged positions.<sup>21</sup> Even when the employer of an inside trader is not the issuing corporation, the employer may nonetheless be harmed. Namely, the employer's reputation for maintaining clients' confidences or reporting information objectively is likely to suffer, potentially causing profits to decrease.<sup>22</sup>

A property rights perspective represents an alternative viewpoint. Under this theory, privileged information belongs to the firm, which should, therefore, be allowed to allocate such privileged information in order to maximize the welfare of its investors.<sup>23</sup> According to this view, insider trading is neither inherently good nor bad and could benefit both shareholders and society under certain circumstances.<sup>24</sup> For example, Professor Jonathan R. Macey argues that, to the extent that insider trading causes securities markets to be inefficient or illiquid, firms themselves would ban the practice, making insider trading self-regulated,<sup>25</sup> rather than requiring the devotion of other resources to perform a regulatory function. Professor Macey's optimistic approach implies that self-regulation by firms in the area of insider trading would be based on an expectation that all investors have relatively equal access to material information.<sup>26</sup> However, as even Professor Macey acknowledges, often-times insiders will be naturally inclined toward generating immediate prof-

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19. *Illegal Insider Trading*, *supra* note 17, at 62 (statement of John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia University Law School).

20. WILLIAM K.S. WANG & MARC I. STEINBERG, *INSIDER TRADING* § 2.3.2 (3rd. ed. 2010).

21. *See id.* § 2.3.3.

22. *Id.*

23. MACEY, *supra* note 16, at 3.

24. *Id.* at 70.

25. *Id.* at 9-10 (according to Professor Macey's view, the perceived short-term benefits that a company would derive from insider trading would not be sufficient to justify the permanence of insider trading conduct in the long term. Consequently, firms would be naturally inclined to avoid such conduct without the need of government intervention).

26. *Id.* at 22.

its from insider trading. Thus, the insider trading-driven incentive to delay disclosure of confidential information to the public may not only impede market efficiency, but render unrealistic the notion of equal access to information.<sup>27</sup>

Despite the sometimes dubious intentions of non-disclosure, corporate secrecy may serve legitimate corporate purposes. Indeed, it is only when non-public information is *improperly* used that the anti-fraud provisions of the 1934 Act are violated.<sup>28</sup> In drafting those provisions, Congress intended for the Exchange Act to dispel the notion that use of insider information for personal advantage was a legitimate emolument of corporate office.<sup>29</sup> To that extent, insider trading laws are generally believed to have a positive impact on stock markets.<sup>30</sup>

In recent decades, U.S. courts have greatly expanded the scope of insider trading-related legislation to include multiple situations that were not initially foreseen by Congress. Insider trading law now covers the notion of “tipping,” which is the extension of liability to intermediaries, and even to family members, of those possessing privileged information who unduly reveal it.<sup>31</sup> Additionally, under the current legal framework, the Securities and Exchange Commission (“SEC”) requires that all intermediaries, stock exchange operators, and registered investment advisors implement and maintain reasonably written policies and procedures that take into consideration the nature of their activities in order to avoid wrongful uses of privileged information<sup>32</sup> either by their employees or any person associated with them.<sup>33</sup> These policies and procedures, deemed warranted by public interest and the protection of investors, are commonly referred to as a “Chinese wall” (or simply, a “wall”) and will be reviewed later in this Article.

27. *Id.* at 11.

28. GOLDBERG, *supra* note 12, at 43.

29. *Id.*

30. *See, e.g., Illegal Insider Trading, supra* note 17, at 53 (statement by Laura N. Beny, Assistant Professor, University of Michigan Law School).

31. *Insider Trading*, U.S. SEC. & EXCH. COMM’N, <http://www.sec.gov/answers/insider.htm> (last visited June 17, 2014) (“Insider trading violations may also include ‘tipping’ such information, securities trading by the person ‘tipped,’ and securities trading by those who misappropriate such information.”).

32. Stephen L. Sapp, Partner, Locke, Liddell & Sapp LLP, Presentation to the National Society of Compliance Professionals: Insider Trading Under the Federal Securities Laws: An Overview For a Diversified Financial Services Company Compliance Program 5 (2000), available at <http://www.lockelord.com/> (indicating that the non-public information refers to information not disclosed to the market in a way that is available to investors in a general manner).

33. *See* Securities Exchange Act of 1934 § 15(f), 15 U.S.C. § 78(f) (2012); Investment Advisers Act of 1940 § 204A, 15 U.S.C. § 80b-4a (2012).

B. *General Aspects of the Legislative Regulation of Insider Trading in the United States*

Insider trading is typically defined as the unlawful trading in securities by persons who possess material, non-public information about a publicly traded company (the issuer) or regarding the market for the company's shares.<sup>34</sup> The concept of insider trading developed over the years through both administrative jurisprudence of the SEC and judicial opinions, mainly from the U.S. Supreme Court. Nonetheless, the legal framework for most insider trading regulation is based on (i) Section 10(b) of the 1934 Act and its corresponding Rule 10b-5,<sup>35</sup> (ii) Section 16 of the 1933 Act, (iii) Section 14(e) of the 1934 Act and its corresponding Rule 14e-3, and (iv) the legal amendments enacted in the 1980s to the Acts, including the Insider Trading Sanctions Act of 1984 ("ITSA")<sup>36</sup> and the Insider Trading and Securities Fraud Enforcement Act of 1988 ("ITSFEA").<sup>37</sup> Additionally, three other regulations are indirectly applicable to insider trading: (i) the Investment Advisers Act of 1940,<sup>38</sup> (ii) the Sarbanes-Oxley Act of 2002 ("SOX"),<sup>39</sup> and the (iii) Dodd-Frank Act of 2010 ("Dodd-Frank").<sup>40</sup>

While the emblematic example of an insider is a corporate manager, "insider trading" also encompasses the notion of insider tipping, which is not confined strictly to individuals employed by the issuer.<sup>41</sup> Thus, insider trading, as understood by most authorities, is actually a quite broad term that has the potential to catch within its purview more than just technical insiders.<sup>42</sup>

To protect the investing public, insider trading rules establish generally that,

[A]nyone who, trading for his own account in the securities of a corporation, has access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone may not

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34. DONALD C. LANGEVOORT, *INSIDER TRADING: REGULATION, ENFORCEMENT & PREVENTION* § 1:1 (2013); *see also* WANG & STEINBERG, *supra* note 20, § 1.1; Christopher M. Gorman, *Are Chinese Walls The Best Solutions to The Problem of Insider Trading and Conflicts of Interest in Brokers-Dealers?*, 9 *FORDHAM CORP. & FIN. L.J.*, 475, 476 (2004).

35. It is interesting to note that neither Section 10(b), nor Rule 10b-5 of the Exchange Act, actually refer to "insider trading." *See* Sapp, *supra* note 32, at 2.

36. Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264.

37. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677; *see also* Gorman, *supra* note 34, at 477.

38. Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 to -21 (2012).

39. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

40. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

41. *Insider Trading*, U.S. SEC. & EXCH. COMM'N, <http://www.sec.gov/answers/insider.htm> (last visited June 17, 2014).

42. WANG & STEINBERG, *supra* note 20, § 1.2.

take advantage of such information knowing it is unavailable to those with whom he is dealing, i.e., the investing public.<sup>43</sup>

The passage of ITSFEA amended a number of critical aspects of the insider trading legal regime. In particular, the Act (i) expanded the definition of “controlling” shareholders, (ii) imposed supervisory responsibility on managers of companies dealing with capital management, (iii) required the creation and implementation of “reasonably written policies and procedures” to avoid insider trading, (iv) obligated companies to implement policies and procedures to avoid insider trading by intermediaries, registered operators, and investment advisors, (v) increased penalties for violations of insider trading rules, and (vi) authorized the SEC to pay bounties to those providing information on insider trading, under certain conditions.<sup>44</sup> Despite the important changes brought about by ITSFEA, the primary purpose of this law was not to regulate the practice of insider trading, but rather to increase the damages and prison terms for convicted inside traders.<sup>45</sup> Therefore, the most applicable legislation governing insider trading actually stems from the 1934 Act.

#### 1. Basic aspects of Insider Trading Responsibility Under Section 10(b) and Rule 10b-5 of the 1934 Act

Rule 10b-5,<sup>46</sup> which implements Section 10(b) of the 1934 Act, is the SEC’s principal weapon against insider trading.<sup>47</sup> Notably, neither Section 10(b), nor its corresponding Rule 10b-5, explicitly address “insider trading.” Despite the absence of this terminology, both the provision and the rule have been applied to a special class of securities traders, i.e. insiders.

The language of Rule 10b-5 has been construed liberally by the courts.<sup>48</sup> Indeed, the word “*purchase*” (of the phrase “*purchase or sale*”) has been understood to include any contract to buy, purchase, or otherwise acquire, and “*sale*” has been understood to encompass any contract

43. GOLDBERG, *supra* note 12, at 43 (explaining the rule established in *SEC v. Texas Gulf Sulfur Co.*, 401 F.2d 833, 848 (2d Cir. 1968)).

44. Sapp, *supra* note 32, at 2.

45. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, §§ 3-4, 102 Stat. 4677, 4677-80.

46. Rule 10b-5 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (2014).

47. MACEY, *supra* note 16, at 49.

48. GOLDBERG, *supra* note 12, at 3



to sell or otherwise dispose of a security.<sup>49</sup> Given these broad interpretations of the statutory language, Rule 10b-5 is believed to cover essentially any transfer of securities other than an absolute gift<sup>50</sup> (e.g., the transfer of securities by reason of merger is covered by the statute).

The phrase “*in connection with*” has similarly been construed broadly. To violate the rule, a person need not have participated directly in the related fraudulent or deceptive securities transactions.<sup>51</sup> This expansive notion of connectivity under Rule 10b-5 authorizes the SEC to regulate the use of any manipulative or deceptive practice that the SEC finds detrimental to an investor’s interests.<sup>52</sup> However, despite the rule’s reach, if a corporation has exercised the required due diligence to ensure that its disclosures were accurate, full, and not misleading at the time they were made, it might escape Rule 10b-5 liability, even if those disclosures were later found to be misleading or inaccurate.<sup>53</sup>

According to Rule 10b-5, receipt of material gives rise to essentially two legal options: (i) *disclose and trade*, or (ii) *do not disclose and do not trade*. In other words, insiders or other individuals who possess more than the same relevant investment decision-making information available to the public must not trade in those securities unless they disclose the information at issue. Since insiders are under no obligation to trade, the clearest solution is to forego any such transaction. However, it is important to note that the insider information must be material to invoke liability<sup>54</sup> for insider trading. A determination of materiality turns on whether the information in question would be likely to cause a reasonable investor to reevaluate the stock, given the total mix of information available to the investor about the issuer.<sup>55</sup>

The mere possession of undisclosed material information does not itself trigger responsibility to abstain from trading under federal securities laws.<sup>56</sup> In fact, under the traditional insider trading scheme, there was not even a duty to disclose when the person who traded on inside information

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49. See THOMAS LEE HAZEN, 3 *LAW OF SECURITIES REGULATION* § 12.6 (6th ed., 2014).

50. See Rick Tulli, *Insider Gifts of Securities to Charities*, FROM THE SOX UP (Dec. 20, 2011), <http://www.fromthesoxup.com/2011/12/insider-gifts-of-securities-to-charities/>.

51. See *SEC v. Texas Gulf Sulfur Co.*, 401 F.2d 833, 860 (2d Cir. 1968) (“We do not believe that Congress intended that the proscriptions of the Act would not be violated unless the makers of a misleading statement also participated in pertinent securities transactions in connection therewith[.]”).

52. GOLDBERG, *supra* note 12, at 47; see also Erika L. Robinson et al., *SEC Reaffirms the Broad Reach of Rule 10b-5 to Private Companies*, WILMERHALE (Dec. 22, 2011), <http://www.wilmerhale.com/pages/publicationsandnewsdetail.aspx?NewsPubId=90979>.

53. GOLDBERG, *supra* note 12, at 20.

54. See generally David S. Ruder & Neil S. Cross, *Limitations on Civil Liability Under Rule 10b-5*, 1972 DUKE L.J. 1125.

55. LANGEVOORT, *supra* note 34, § 5:2.

56. See *Questions and Answers of General Applicability*, U.S. SEC. & EXCH. COMM’N (May 16, 2013), <http://www.sec.gov/divisions/corpfin/guidance/8-kinterp.htm>.

was not a fiduciary to the company.<sup>57</sup> This situation has changed with recently enacted legislation and case law.<sup>58</sup>

## 2. Rule 10b-5 Refers to Individual Plaintiffs Who May Sue Insider Traders for Damages

Prosecution by the SEC is the most common method of enforcing insider trading rules, although private suits by parties damaged by fraudulent conduct also play a notable role.<sup>59</sup> Professor Donald C. Langevoort states that “private rights of action by marketplace traders [are] something of relatively small practical importance in the world of insider trading enforcement.”<sup>60</sup> Under Section 20A(b)(3) of the 1934 Act,<sup>61</sup> there is an express right to recover against any controlling person of a tipper or trader under the standards set forth in Section 20A(a) of the Securities Exchange Act<sup>62</sup>:

Any person who violates any provision of this title or the rules or regulations thereunder by purchasing or selling a security while in possession of material, nonpublic information shall be liable in an action in any court of competent jurisdiction to any person who, contemporaneously with the purchase or sale of securities that is the subject of such violation, has purchased (where such violation is based on a sale of securities) or sold (where such violation is based on a purchase of securities) securities of the same class.

Section 20A requires a predicate showing of a violation of some other provision (e.g., Rule 10b-5 or 14e-3), without which a 20A case will be dismissed.<sup>63</sup> Section 20A(c) then imposes joint and several liability on persons who violate the insider trading rules by simply communicating mate-

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57. *Dirks v. SEC*, 463 U.S. 646, 653-54 (1983) (citing *Chiarella v. United States*, 445 U.S. 222, 227 (1980)) (“In *Chiarella*, we accepted the two elements . . . for establishing a Rule 10b-5 violation: (i) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure.” (internal quotation marks omitted)).

58. See generally Case Law, Dodd Frank Update, (<http://www.doddfrankupdate.com/DFU/ArticlesDFU.aspx?taxonomy=CaseLaw1>).

59. Cf. LANGEVOORT, *supra* note 34, § 9:6; see also MACEY, *supra* note 16, at 58.

60. LANGEVOORT, *supra* note 34, § 9:6.

61. Section 20A(b)(3) of the Exchange Act states:

No person shall be liable under this section solely by reason of employing another person who is liable under this section, but the liability of a controlling person under this section shall be subject to section 20(a) of this title.

15 U.S.C. § 78t-1(b)(3) (2012).

62. Section 20A(a) of the Exchange Act provides:

Any person who violates any provision of this title or the rules or regulations thereunder by purchasing or selling a security while in possession of material, non-public information shall be liable in an action in any court of competent jurisdiction to any person who, contemporaneously with the purchase or sale of securities that is the subject of such violation, has purchased (where such violation is based on a sale of securities) or sold (where such violation is based on a purchase of securities) securities of the same class. *Id.* § 78t-1(a).

63. LANGEVOORT, *supra* note 34, § 9:6 n.1.

rial, nonpublic information, in addition to those to whom the communications were directed and who then traded improperly.<sup>64</sup>

For a private claim to be actionable under Rule 10b-5, the plaintiff must establish the following requisite elements: (i) federal jurisdiction; (ii) materiality of the misstatement or omission; (iii) reliance; (iv) damages;<sup>65</sup> and (v) scienter.<sup>66</sup>

Jurisdictional means can almost always be easily established through facilities of interstate communication (e.g., phone call, mail, email). Information need only be proven as having been “transmitted” via interstate means, not necessarily proven to be the fraudulent communication.<sup>67</sup> As discussed in Part I.B.1, the materiality standard questions whether a reasonable person would attach importance to the information in deciding how to invest.<sup>68</sup> Though proof of reliance remains a required element to establish a Rule 10b-5 claim, courts sometimes assume reliance based upon the factual circumstances.<sup>69</sup> To establish damages, the plaintiff must prove that he suffered an out-of-pocket pecuniary loss.<sup>70</sup> The ceiling for damages is the insider trading profit, or “actual damages,” per Section 28(a) of the 1934 Act.<sup>71</sup> Courts can measure these actual damages in a variety of ways to achieve different outcomes.<sup>72</sup> However, only compensatory recovery is allowed in private actions, not punitive.<sup>73</sup> Scienter is the final required element of 10b-5 actions for private damages.<sup>74</sup> In the 1980s, the U.S. Supreme Court held in two separate cases that “scienter is an element of a violation of § 10(b) and Rule 10b-5, regardless of the identity of the plaintiff or the nature of the relief sought.”<sup>75</sup>

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64. *Id.* § 9:3; *see also* Exchange Act § 20A(c), 15 U.S.C. § 78t-1(c).

65. GOLDBERG, *supra* note 12, at 49.

66. WANG & STEINBERG, *supra* note 20, § 4.1.

67. *See* Gorman, *supra* note 34, at 478 (stating that “[t]he fraud is based on the failure of the party in possession of the inside information to disclose it to the other party.”); *see also* Exchange Act § 10(b), 15 U.S.C. § 78j(b)

68. GOLDBERG, *supra* note 12, at 49.

69. *See, e.g.*, Basic Inc. v. Levinson, 485 U.S. 224, 245 (1988) (“The presumption of reliance employed in this case is consistent with, and, by facilitating Rule 10b-5 litigation, supports, the congressional policy embodied in the 1934 Act.”).

70. GOLDBERG, *supra* note 12, at 74.

71. Securities Exchange Act of 1934 § 28(a), 15 U.S.C. § 78bb(a) (2012); *see also* WANG & STEINBERG, *supra* note 20, §§ 4.8.2-.3.

72. *See* WANG & STEINBERG, *supra* note 20, § 4.8.2.

73. *Id.*

74. *Id.* § 4.4.1 (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976)).

75. Aaron v. SEC, 44 U.S. 680, 691 (1980); *see also* Hochfelder, 425 U.S. at 193; WANG & STEINBERG, *supra* note 20, § 4.4.1.

### 3. Government Enforcement of Federal Rules and Laws on Frauds

Insider trading is subject to criminal enforcement by the Department of Justice and civil enforcement by the SEC.<sup>76</sup> “Where probability of detection is low, very high penalties are necessary to deter potential law-breakers.”<sup>77</sup> To that end, the SEC generally seeks treble damages under the ITSA of 1984,<sup>78</sup> and has a wide range of enforcement measures available to it, including equitable remedies, such as injunctions, disgorgement, cease-and-desist orders, and trading bans against individuals.<sup>79</sup>

The vast majority of criminal insider trading cases are brought under Section 24 of the 1933 Act and Section 32(a) of the 1934 Act.<sup>80</sup> Section 24 of the 1933 Act<sup>81</sup> and Section 32(a) of the 1934 Act<sup>82</sup> require that the government demonstrate that the defendant “willfully” violated an SEC rule or statutory provision (such as Rule 10b-5).<sup>83</sup> Prosecutions are also brought under the federal mail and wire fraud statutes,<sup>84</sup> which establish that a defendant (or a defendant’s associate) can be convicted if he or she knowingly causes something to be delivered by mail or causes a use of the wires,<sup>85</sup> in furtherance of a fraudulent scheme.<sup>86</sup> Finally, the Sarbanes-Oxley Act of 2002 dictates that securities and commodities fraud may be punishable by up to 25 years in prison.<sup>87</sup> A prima facie criminal insider trading case is comprised of the following elements, which the government must prove: (i) a willful and fraudulent purchase or sale of a security, (ii) the breach of a fiduciary duty or other relationship of trust and confidence by virtue of the sale, and (iii) possession and use of material nonpublic information about that security at the time of the sale.<sup>88</sup> For a criminal conviction, prosecutors must demonstrate that the defendant’s conduct was a willful violation of the law, meaning that it must be proven “that the

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76. *Illegal Insider Trading*, *supra* note 17, at 29-30 (submission of James H. Clinger, Acting Att’y Gen., Dep’t of Justice, noting that the Federal Bureau of Investigation has a financial crimes division). *See generally* *Criminal Insider Trading*, *supra* note 17.

77. MACEY, *supra* note 16, at 6.

78. *Illegal Insider Trading*, *supra* note 17, at 7 (statement of Linda Thomsen, Dir., Div. of Enforcement, SEC).

79. WANG & STEINBERG, *supra* note 20, § 7.1.1.

80. *Id.* § 7.2.1.

81. 15 U.S.C. § 77x (2012).

82. *Id.* § 78ff(a).

83. *Illegal Insider Trading*, *supra* note 17, at 2 (statement of Ronald J. Tenpas, Assoc. Deputy Att’y Gen., Dep’t of Justice).

84. *See generally* 18 U.S.C §§ 1341-51 (2012).

85. *See* WANG & STEINBERG, *supra* note 20, § 11.3.

86. *Id.* § 11.2 (citing *Schmuck v. United States*, 489 U.S. 705, 721 (1989); *Pereira v. United States*, 347 U.S. 1, 8 (1954); *United States v. Lo*, 231 F.3d 471, 475 (9th Cir. 2000); *United States v. Bailey*, 123 F.3d 1381, 1390 (11th Cir. 1997); *Chisolm v. Transouth Fin. Corp.*, 95 F.3d 331, 336 (4th Cir. 1996)).

87. 18 U.S.C. § 1348 (2012).

88. *See* *Illegal Insider Trading*, *supra* note 17, at 116 (prepared statement of Ronald J. Tenpas, Assoc. Deputy Att’y Gen., Dep’t of Justice).

defendant was aware, at the time of the insider trade, that he or she was doing something in violation of the law.”<sup>89</sup>

The U.S. Congress has recommended that civil enforcers and prosecutors cooperate more.<sup>90</sup> Some academics have also argued that there should be more of a focus on prevention and less on raising penalties.<sup>91</sup>

### C. *Particular Aspects of Insider Trading in Financial Services Companies*

One of the most important pieces of legislation regulating financial services firms is the Investment Advisers Act of 1940.<sup>92</sup> This law contains provisions that work to combat insider trading via, among other means, the adoption of a corporate code of ethics.<sup>93</sup> The Act also requires the institution of “Chinese Walls.”<sup>94</sup>

The purpose of a so-called Chinese Wall is to serve as a “barrier that prevents insider trading”<sup>95</sup> and as a “structural technique to help reduce analysts’ conflicts of interest.”<sup>96</sup> Chinese Walls were initially conceived of as voluntary policies and procedures to be established autonomously by securities brokers, but, overtime, and based on its legal powers, the SEC has made them mandatory.<sup>97</sup> These tools arose for the first time as a part of an extra-judicial compromise between SEC and Merrill Lynch in 1968.<sup>98</sup> Chinese Wall policies and procedures are designed on a case-by-case basis, based on the nature of the firm involved.<sup>99</sup> In most instances, they are a part of a company-wide written code of ethics and the contractual obligations of each firm employee.<sup>100</sup>

In addition to the safeguards that these “walls” reinforce within a firm, such policies must also monitor operations in securities performed by an employee outside of his firm. This goal is accomplished by requiring the employee to obtain duplicates of trade confirmations and account statements. Further, the internal review of an employee’s external operations must be documented with an annotation stating the period of time and frequency of the review, as well as who executed it. For all transactions, whether through direct operations of the employee or in observation or

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89. *Id.*

90. *See Criminal Insider Trading*, *supra* note 17, at 1 (statement of Sen. Arlen Specter, Chairman, S. Comm. on the Judiciary).

91. *See Illegal Insider Trading*, *supra* note 17, at 67-68 (statement of John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia University Law School).

92. Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 to -21 (2012).

93. 17 C.F.R. 275.204A-1 (2014).

94. *See* Investment Advisers Act § 204A, 15 U.S.C. § 80b-4a.

95. Gorman, *supra* note 34, at 475.

96. *Id.*

97. *Id.* at 483.

98. *Id.*

99. *Id.* at 485.

100. *Id.* at 486.

restricted access lists,<sup>101</sup> the securities must be verified in a periodic report made available for inspection by the SEC.

While Chinese Walls have been very useful in the fight against insider trading in the United States, they have not been efficient in all circumstances and have been subject to criticism.<sup>102</sup> The fact that many investment banks did not maintain or comply with their Chinese Walls was one of the main instigators for the enactment of the 2002 Sarbanes-Oxley Act.<sup>103</sup>

#### D. *The Punitive Legal Framework Against Insider Trading and Other Abuses*

The U.S. legal system contemplates severe penalties against inside traders to protect investors in cases of insider trading violations. Penalties apply not only to individuals subject to fiduciary duties, but also to “temporary insiders,” that is, those placed in a temporary fiduciary relationship with a firm, and even to those who do not have any fiduciary relationship with the firm and its shareholders, under the “misappropriation” theory.<sup>104</sup>

Administrative, civil, and criminal penalties may be meted out for insider trading violations. An example of an administrative penalty is the prohibition of those persons from serving as corporate officers, directors, employees, intermediaries, or investment advisors in the future.<sup>105</sup> Civil penalties consist of the reimbursement of all amounts unduly received (“disgorgement”) and punitive payments (“civil penalties”) of up to three times the profits obtained or the losses avoided through insider trading. Furthermore, controlling shareholders found guilty are subject to these civil penalties *in personam*.<sup>106</sup> Finally, criminal penalties may be a maximum of one million dollars in the case of individuals, two and a half million dollars when concerning corporations, and up to ten years of imprisonment for each intentional violation of insider trading.<sup>107</sup> Part VI will further develop specific aspects of U.S. insider trading legislation and case law, with the aim of presenting proposals for the reinforcement of the Chilean insider trading legal framework.

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101. See U.S. SEC. & EXCH. COMM’N, STAFF SUMMARY REPORT ON EXAMINATIONS OF INFORMATION BARRIERS: BROKER-DEALER PRACTICES UNDER SECTION 15(G) OF THE SECURITIES EXCHANGE ACT OF 1934, at 24 (2012), <http://www.sec.gov/about/offices/ocie/informationbarriers.pdf>.

102. Gorman, *supra* note 34, at 475.

103. *Id.* at 489.

104. See *infra* Part VII.G.

105. Sapp, *supra* note 32, at 16.

106. *Id.* at 15.

107. *Id.*

## III. HISTORICAL BACKGROUND OF INSIDER TRADING IN CHILE

The Chilean securities market was created in 1893 with the establishment of the Commerce Exchange *Bolsa de Comercio* of Santiago.<sup>108</sup> However, it was not until the 1981 Securities Market Act (“SMA”)<sup>109</sup> that insider trading was first regulated.<sup>110</sup> By comparison, insider trading regulation was established in the United States by virtue of the 1934 Act, more than fifty years prior.<sup>111</sup>

Insider trading in Chile was originally referred to as the “use of reserved information.”<sup>112</sup> In fact, until 1994, former Article 13 of the SMA<sup>113</sup> prescribed that:

Any person that, per reason of his office or position, obtains access to the information of a company and its businesses, that has not yet been officially divulged to the market by the company in compliance with the present law, and that has the ability to influence the price of the company’s securities, must keep *strict reserve* about that information.

Likewise, it is forbidden for the persons mentioned in the previous paragraph to use the *reserved information* to obtain for himself or others advantages through the purchase or sale of stock.

Such persons must ensure that this does not occur through their subordinated employees and third parties.

The persons mentioned in the first paragraph that act in violation of this provision must reimburse the company all profit that they have obtained through the transaction in securities of the company.

All persons harmed by the violation of this Article shall have a right to request an indemnification from all of the persons indicated in the first paragraph, except if that person had knowledge of the reserved information.<sup>114</sup>

Article 13 was largely criticized before its repeal in 1994 for multiple reasons, including: (i) its failure to define the “use of privileged information”—an omission that confounded the definition of “reserved information;”<sup>115</sup> (ii) its restrictive scope, which limited prohibited conduct to the purchase and sale of a company’s stock using information about the com-

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108. See generally JUAN RICARDO COUYOUMDJIAN & JOSEFINA TOCORNAL, *HISTORIA DE LA BOLSA DE COMERCIO DE SANTIAGO, 1893-1993* [HISTORY OF THE SANTIAGO STOCK EXCHANGE, 1893-1993] (1993).

109. Law No. 18045, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile) (original version). All citations to Law 18045 refer to the most recent version unless otherwise specified.

110. José Miguel Reid Undurraga, *Fundamentos de la Prohibición del Uso de la Información Privilegiada en Chile: Una Visión Crítica*, 31 REVISTA CHILENA DE DERECHO 439, 440 (2004); see also FRANCISCO GUZMÁN ANRIQUE, *INFORMACIÓN PRIVILEGIADA EN EL MERCADO NACIONAL* 47 (2007).

111. Sapp, *supra* note 32, at 1.

112. Arturo Prado Puga, *Acerca del Concepto de Información Privilegiada en el Mercado de Valores Chileno: Su Alcance, Contenido y Límites*, 30 REVISTA CHILENA DE DERECHO 237, 240 (2003).

113. Law No. 18045, art. 13, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile).

114. *Id.*; see also Prado Puga, *supra* note 112, at 240 (emphasis added).

115. María Fernanda Vásquez Palma, *Revisión del Ámbito de Aplicación Subjetivo y Objetivo de la Noción de Información Privilegiada en Chile: Un Examen de la Normativa a la*

pany that had not been “officially” revealed;<sup>116</sup> (iii) the provision’s failure to regulate fraudulent conduct that was directly related to the use of confidential corporate information, such as “the communication or the recommendation of privileged information to third parties;”<sup>117</sup> (iv) its obligation to disgorge profits to the company, which seemed to indicate that what was being protected was the property right that the company had over the information, and the failure to base the penalty in the use and misappropriation of information by the third party instead;<sup>118</sup> (v) the lack of stringent penalties for the harm caused to the market, generally;<sup>119</sup> and finally, (vi) Article 13’s absence of a definition for insider trading, on the one hand, and its confounding of insider trading with reserved information, on the other.<sup>120</sup>

With respect to confusion between the concept of “use of privileged information” and that of “use of reserved information,” the *Superintendencia de Valores y Seguros* (“SVS”), Chile’s stock market and company regulator, directed, in 1987, that:

[T]he person who purchases or sells publicly traded securities using reserved information, is in a position of privilege with respect to the rest of the market, since that person is using information that, given its character, must be considered as privileged information. Thus, and in accordance with this interpretation, reserved information is also, with respect to the individual who uses it, privileged information. In consequence, both terms may be applied to the same situation.<sup>121</sup>

Furthermore, Article 10, Paragraph 3 of the SMA,<sup>122</sup> in accordance with Article 43 of the Stock Corporations Act (“SCA”),<sup>123</sup> allowed directors and administrators to determine which facts were to be considered reserved information. Consequently, because insider trading was tied to the use of reserved information, and directors and administrators categorized company information, those very directors and administrators were the ones to decide when their own insider trading liability arose under Articles

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*Luz de las Tendencias Doctrinales y Jurisprudenciales*, 17 REVISTA DE DERECHO UNIVERSIDAD CATÓLICA DEL NORTE 239, 247-48 (2010).

116. Prado Puga, *supra* note 112, at 240.

117. MARÍA AGNES SALAH ABUSLEME, RESPONSABILIDAD POR USO DE INFORMACIÓN PRIVILEGIADA EN EL MERCADO DE VALORES 146 (2004).

118. Reid Undurraga, *supra* note 110, at 441.

119. SALAH ABUSLEME, *supra* note 117, at 146 (indicating that such penalties were included later on, through criminal provisions).

120. Vásquez Palma, *supra* note 115, at 247-48.

121. Prado Puga, *supra* note 112, at 241 (quoting SVS, Circular No. 2506 (July 10, 1987)) (noting that insider trading was arguably regulated, as a part of the broader concept of reserved information).

122. Law No. 18045, art. 10, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile).

123. Law No. 18046, art. 43, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile).



41 and 43 of the SCA,<sup>124</sup> and in what cases they were not obliged to reveal corporate information.<sup>125</sup>

Prior to 1994,<sup>126</sup> the Chilean concept of insider trading was limited to corporate information “not yet officially disclosed to the market.”<sup>127</sup> However, Law 19,301 of 1994<sup>128</sup> introduced new title XXI to the SMA (“Of Privileged Information”).<sup>129</sup> The aim of this new legislation – which was likely based on the U.S. securities system<sup>130</sup> – was to protect the “equality and transparency of the Securities Market, punishing those who manipulate[d] it or threaten[ed] its correct operation[.]”<sup>131</sup> and to also “increase competitiveness.”<sup>132</sup> In addition, this Law introduced to Chile a broader concept of insider trading. Law 19,389 of 1995<sup>133</sup> and Law 19,705 of 2000<sup>134</sup> complemented Law 19,301. These two laws dictated, among other matters, “the persons affected by the prohibition; the presumptions affecting those who have access to privileged information; the regulation of securities intermediation activities; and established civil liability provisions.”<sup>135</sup>

Finally, the last relevant legal amendment concerning insider trading in Chile was introduced by Law 20,382 of 2009,<sup>136</sup> regarding corporate governance, which was passed with the general purpose of facilitating Chile’s entry into the OECD.<sup>137</sup> This Law introduced new areas of regulation into Chile’s broader regulatory scheme. Examples of these regulations include the creation of a presumption of access to information by persons who interact with the company, restrictions on stock transactions by securities brokers who have access to privileged information, the requirement that certain companies set up self-regulatory mechanisms to prevent insider

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124. *See id.* art. 41 (stating that directors are jointly liable for damages caused to the corporation and the shareholders due to their fraudulent or negligent actions); *id.* art. 43 (providing that directors must protect corporate information that they receive by virtue of their position and that has not been made public by the corporation).

125. *See* Prado Puga, *supra* note 112, at 240.

126. *Id.* at 242.

127. Law No. 18045, art. 13, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile).

128. Law No. 19301, Marzo 7, 1994, DIARIO OFICIAL [D.O.] (Chile).

129. *Id.* tit. XXI; *see also* Reid Undurraga, *supra* note 110, at 441.

130. *See* Prado Puga, *supra* note 112, at 242 (referring to the U.S. legislature’s strong influence on the insider trading regulatory realm and stating that the “addition through Law 19,301, of March 19, 1994, of the new Title XXI into Law 18,045 [was] clearly inspired by U.S. legislation.”).

131. *Id.*

132. Vásquez Palma, *supra* note 115, at 246 (referring to the purposes of Law No. 18045 of 1981).

133. Law No. 19389, Mayo 18, 1995, DIARIO OFICIAL [D.O.] (Chile).

134. Law No. 19705, Diciembre 20, 2000, DIARIO OFICIAL [D.O.] (Chile).

135. Vásquez Palma, *supra* note 115, at 248.

136. Law No. 20382, Octubre 20, 2009, DIARIO OFICIAL [D.O.] (Chile).

137. ROBERTO GUERRERO V & JOSÉ MIGUEL REID, *NEW CORPORATE GOVERNANCE RULES IN CHILE 1* (2011), available at <http://www.iflr1000.com/pdfs/Directories/24/Chile.pdf>.

trading opportunities, and the prohibition on selling securities by persons with access to privileged information.<sup>138</sup>

In sum, the regulation of insider trading in Chile began almost a century after the securities market was created in that country and about half a century after the regulation of insider trading began in the United States. Several legislative amendments since 1994 have extended the scope of insider trading regulations, creating new duties and prohibitions, with the clear goal of protecting the equality and transparency of the Chilean securities market and, ultimately, the national public economic order.<sup>139</sup>

It is possible to draw commonalities between the U.S. and Chilean insider trading regulatory systems: both systems were traditionally focused on the protection of shareholders and have evolved in recent years toward a more holistic or “institutional” perspective centered on the overall protection of securities markets. In the original model, the aim was to protect investors as individual actors in the economy, and, to that end, the proprietary approach was deemed sufficient. This view was congruent with the general focus of Chilean legislation on property rights, which relies heavily on the individual nature of ownership rights.<sup>140</sup> In the new model, the legal protection of securities markets and the criminalization of insider trading is aimed at protecting the “correct performance of the securities market.”<sup>141</sup> In this latter orientation, the essential value protected is “the ‘public faith’ or ‘public confidence’ in the transparent performance of securities markets, and in the equality of access to information.”<sup>142</sup>

#### IV. LEGISLATIVE REGULATION OF INSIDER TRADING IN CHILE

##### A. *Concept of Insider Trading in Chile*

In Chile, insider trading is chiefly regulated by Title XXI of the SMA. Article 164, which governs the use of privileged information, uses three classifications to define insider trading, namely: (i) “any information regarding one or more issuers, their businesses or one or more securities issued by them, not disclosed to the market, and whose knowledge, by its nature, has the aptitude to influence the price of the issued securities[.]”<sup>143</sup> (ii) “the reserved information referred to in article 10 of this law[.]”<sup>144</sup> and

138. See Vásquez Palma, *supra* note 115, at 249.

139. See María Fernanda Vásquez Palma, *Caso LAN y Uso de Información Privilegiada: Un Análisis de la Correcta Delimitación de las Infracciones Legales*, 16 IUS ET PRAXIS 461, 477 (2010) [hereinafter Vásquez Palma, *Caso LAN*].

140. Dante Figueroa & Arturo Fermandois, *Comparative Constitutional Protection of Contracts in the United States and Chile*, INT’L L. RESEARCH INFORMER, Summer 2012, at 7, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2112318](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2112318) (“Chilean legislation follows the traditional French civil law model regarding the protection of property rights.”).

141. GUZMÁN ANRIQUE, *supra* note 110, at 78.

142. *Id.* at 78.

143. Law No. 18045, art. 164, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile).

144. *Id.* Concerning reserved information, paragraph three of article 10, *id.* art. 10, provides that: “three fourths of the directors in office may approve to give a reserved character

(iii) “information concerning decisions for the purchase, sale, or rejection of specific offers made by an institutional investor in the securities market.”<sup>145</sup>

The essence of the concept of privileged information refers to information “not yet known by the public,”<sup>146</sup> whose use benefits exclusively one specific individual and not all market participants – a so-called “asymmetry of information.”<sup>147</sup> The expression “any information,” used in Article 164, has been understood to refer to “any data, antecedent, fact, event, message, symbol, circumstance, communication, intention or rumor, whether verbal or written, that has the potential to qualify as privileged information.”<sup>148</sup> Importantly, it is not necessary for the information to be in writing to qualify as “privileged.”<sup>149</sup>

### 1. Essential Elements in the Definition of Article 164 of the Securities Market Law

There are three essential elements of privileged information, as defined in Article 164. First, the information must be unknown to the market,<sup>150</sup> that is, not yet “absorbed or evaluated.”<sup>151</sup> Second, the information must pertain to securities issuers, their businesses, or securities issued by them.<sup>152</sup> And third, the information must have the ability to influence the price of the securities.<sup>153</sup>

With respect to the first element, it is no longer required that the information be “officially” disclosed to the public for the information to lose its

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to certain facts and information regarding pending negotiations that if revealed, may prejudice the interests of the corporation. With respect to issuers not administered by a board or similar committee, the decision about reservation must be adopted by the unanimity of the administrators.” In turn, paragraph two of article 10, *id.*, directs that the respective entities “must disclose truthfully, sufficiently and timely any fact or essential information related to them and their businesses in the moment when the fact occurs or when it becomes known to such entities.”

145. *Id.* art. 164.

146. Prado Puga, *supra* note 112, at 239.

147. Vásquez Palma, *supra* note 115, at 242.

148. FRANCISCO PFEFFER URQUIAGA, CONCEPTO DE INFORMACIÓN PRIVILEGIADA Y DEBERES DE CONDUCTA DE QUIENES ESTÁN EN POSESIÓN DE ELLA, A LA LUZ DE LA JURISPRUDENCIA EMANADA DE LA EXCMA. CORTE SUPREMA 10 (2008), available at [http://www.pfeffer.cl/publicaciones/doc/com\\_revista\\_d\\_com\\_uch\\_vf\\_%2021\\_05\\_08.pdf](http://www.pfeffer.cl/publicaciones/doc/com_revista_d_com_uch_vf_%2021_05_08.pdf).

149. *Id.* at 13 (“it is not necessary to comply with the requirement that the information be in writing to configure the generic concept of privileged information.”).

150. Prado Puga, *supra* note 112, at 243.

151. *Id.* at 244.

152. Vásquez Palma, *supra* note 115, at 250-51.

153. See Prado Puga, *supra* note 112, at 243-46.

“privileged” character; it suffices that the information be communicated to outsiders by any appropriate means.<sup>154</sup>

Concerning the second element, “issuers of securities” are those who have the ability to make public offerings of securities and are registered in the Securities Registry maintained by the SVS.<sup>155</sup> Article 3 of the SMA defines securities as “any transferable instrument including stocks, purchase and sale options, bonuses, debentures, mutual fund quotas, saving plans, effects of commerce and, in general, all credit or investment instruments.”<sup>156</sup> Examples of information that has the potential to influence the price of securities include internal decisions related to staff, the distribution of dividends, the outcome of significant litigation, developments affecting the reputation of the company, labor issues, potential mergers or acquisitions, public offerings, environmental matters,<sup>157</sup> resignation of key officers, government investigations, and information on profit estimates.<sup>158</sup>

Importantly, not every piece of information qualifies for the purpose of Article 164.<sup>159</sup> The information must be both precise and concrete.<sup>160</sup> For example, information about general market trends and simple rumors do not suffice, unless the latter refers to an upcoming public offering of a given company.<sup>161</sup> Moreover, the information must be material or essential, since information of this nature is precisely the kind whose protection is sought by the obligations to report established in Articles 9 and 10 of the SMA.<sup>162</sup>

Despite this explication of Article 164’s elements, several critics contend that the provision’s deficient drafting does not clarify whether the

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154. GUZMÁN ANRIQUE, *supra* note 110, at 53 (stating that the judge has discretion to determine the appropriate parameters of the case and to consider whether the information has been revealed to the market).

155. Vásquez Palma, *supra* note 115, at 253.

156. Law No. 18045, art. 3, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile).

157. Vásquez Palma, *supra* note 115, at 263-64.

158. *See* Sapp, *supra* note 32, at 4-5.

159. Vásquez Palma, *supra* note 115, at 256.

160. *Id.*

161. *Id.*; *see also* GUZMÁN ANRIQUE, *supra* note 110, at 54-55.

162. *See* Vásquez Palma, *supra* note 115, at 256. The author notes that article 10 of the SMA, Law No. 18045, art. 10, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile), requires entities registered in the Securities Registry to “disclose in a true, sufficient and timely manner, all essential facts or information related to themselves and their business when such facts or information become known to them.” Further, article 9 of the SMA, *id.* art. 9, provides that: “Registration in the Securities Registry requires the issuer to disclose in a true, sufficient, and timely manner all essential facts or information related to itself, or to the offered securities and the offer. Essential information is defined as the information that a reasonable man would consider important for his investment decisions.”

three above-mentioned elements must be present in each of the three categories of privileged information.<sup>163</sup>

## 2. Reserved Information

Article 10 of the SMA defines “reserved information” as “facts or materials related to pending negotiations, that when known may harm the interest of the company, when three fourths of the board members agree to qualify such information as reserved.”<sup>164</sup> As originally drafted, Article 10, Paragraph 4 established that a board resolution rendering certain facts or materials reserved was to be communicated to the SVS on the next day after its approval via the technological means specified by the SVS.<sup>165</sup> Law 19,301, passed in 1994, abolished the requirement that a company (through its board) expressly declare that given information is reserved or otherwise protected in order for insider trading to occur.<sup>166</sup> In sum, reserved information is currently understood as a type of privileged information, or information that is not widely known and whose use will benefit only a few, rather than all market participants.

### B. *Persons Subject to the Prohibition on the Use of Privileged Information*

#### 1. Persons Expressly Mentioned in Article 165 of the SMA

Article 165 of the SMA delineates which individuals are subject to Article 164’s prohibitions on the use of privileged information. The statutory language reads: “Any person who, per reason of his office, position, activity or relationship with the respective issuer of securities, or with the persons indicated in the next article [166], possesses privileged information . . . .”<sup>167</sup> “Office” refers to corporate officers of the issuers; “position” alludes to permanent or sporadic interaction with the company (such as an external auditor, risk rating agencies, or a consultant); “activity” refers to the tasks performed within a corporation; and “relationship” refers to the link between the recipients of the information with its source of the information.<sup>168</sup> The phrase “any person” targets individuals as well as legal entities.<sup>169</sup>

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163. See, e.g., Vásquez Palma, *supra* note 115, at 251 (criticizing the language of the provision and arguing that it does not clearly determine whether such elements apply to all the typologies mentioned therein. However, despite this critique, the author leans towards the affirmative).

164. GUZMÁN ANRIQUE, *supra* note 110, at 56.

165. Law No. 18045, art. 10, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile) (original version).

166. See *id.*

167. *Id.* art. 165.

168. Prado Puga, *supra* note 112, at 262-63.

169. See Vásquez Palma, *supra* note 115, at 272; see also *id.* at 272-73 & n.93 (citing Corte Suprema de Justicia [C.S.J.] [Supreme Court], 27 octubre 2005, “Hurtado Vicuña, Juan & otros c. Superintendencia de Valores y Seguros,” Rol de la causa: 4930-2004 (Chile)

## 2. Institutional Investors at the Securities Market

The appearance of enormous Pension Fund Administrators (“PFAs”) during the 1980s spurred a revolution in the Chilean securities market.<sup>170</sup> In response, the SMA incorporated a new Article 4(e) defining institutional investors as banks, financial companies, insurance companies, national re-insurance entities, fund administrators authorized by law, and other entities identified by SVS regulation which were made subject to legal restrictions related to the use of privileged information.<sup>171</sup> Since the 1980s, the Chilean Supreme Court has also greatly expanded the list of individuals subject to legal restrictions concerning the use of privileged information. For example, in 2005, the Court held that “the law does not require a direct link between the source of information and the person who receives it: ‘any person’ may be an active user of privileged information.”<sup>172</sup>

## 3. Presumptions of Possession of Privileged Information

Article 166 of the SMA creates a presumption regarding the possession of privileged information to which two sets of people are subject. For those individuals covered by the first paragraph of Article 166, the presumption always applies. On the other hand, under paragraph 2, the presumption applies only if such persons had direct access to the privileged information.

Under paragraph 1 of Article 166, certain persons are always presumed to possess privileged information about an issuer. Among them are directors and persons with management responsibilities within the company, controlling shareholders, and financial advisors and securities brokers.

Per paragraph 2 of Article 166, other individuals are subject to a presumption of possession of privileged information insofar as they have had direct access to such information. This category includes external auditors, members of the boards of risk rating agencies that rate securities of the issuer, supervised persons within the company, consultants, public employees of institutions that enforce legal regulations against issuers of publicly traded securities or funds, and certain family members of persons listed in paragraph 2 of Article 166. Since “direct access” to the information is re-

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(“[G]iven the breadth of the aforementioned provision, its scope of application is broad and includes all persons that by reason of their office, position, activity, or relationship have access to privileged information; ‘any person’ includes not only individuals but also legal entities, since the legislator did not make a distinction between them.”).

170. See Organization of Economic Co-operation and Development [OECD], *The Chilean Pension System* 6 (OECD Ageing Working Papers, Working Paper No. AWP 5.6), available at <http://www.oecd.org/els/public-pensions/2429310.pdf>.

171. Law No. 18045, art. 4(e), Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile); see also GUZMÁN ANRIQUE, *supra* note 110, at 57.

172. Corte Suprema de Justicia [C.S.J.] [Supreme Court], 26 julio 2007, “Elesur S.A. c. Superintendencia de Valores y Seguros,” Rol de la causa: 3364-2006 (Chile) (on file with author).

quired for the presumption established in this paragraph to attach, the presumption does not absolve plaintiffs from bearing the burden of proof against such persons.<sup>173</sup> To be effective, the presumption ought to make a *de jure* inference that the relevant persons have access to privileged (or reserved) information. Of course, until such a legislative amendment takes place, courts will continue to resolve this matter on a case-by-case basis.

#### 4. Obligations and Prohibitions

In keeping with the global trend, Chile has gradually adopted a regulatory model that prohibits, but also seeks to prevent, insider trading behavior through the creation of conflicts-of-interest restrictions.<sup>174</sup> The new rules impose unique obligations and prohibitions on several different classes of people.

In general, the rules require all those who have access to privileged corporate information to observe duties of confidentiality, refraining from disclosing such information or from deriving personal benefit from it.<sup>175</sup> For the purpose of assessing insider trading, a transaction is deemed to have occurred as of the date of acquisition or transfer of securities, independent of the date when such transactions are formally registered by the issuing entity.<sup>176</sup>

##### a. *Securities Brokers*

Securities brokers may perform operations related to securities, despite their possession of privileged information pertaining to those securities, under certain conditions only. The operations must be “for others, not related to the securities brokers,”<sup>177</sup> “the order and the specific conditions of the operation [must] originate from the client, without the intermediary’s advice or recommendation,”<sup>178</sup> and “the operation [must] compl[y] with the internal regulations, in conformity with [A]rticle 33.”<sup>179</sup>

Where securities brokers perform director or administrative duties for an issuer of publicly traded securities,<sup>180</sup> they must provide notice of their relationship to the issuer to their clients, as specified by the SVS, and must also abstain from performing any operation or transaction of shares issued by such issuer for themselves or related third parties.<sup>181</sup> These conditions

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173. GUZMÁN ANRIQUE, *supra* note 110, at 62.

174. SALAH ABUSLEME, *supra* note 117, at 151.

175. See Vásquez Palma, *Caso LAN*, *supra* note 139, at 471-72.

176. Law No. 18045, art. 165, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile)

177. *Id.*

178. *Id.*

179. *Id.*

180. *Id.* art. 168 (specifically stating that “directors, administrators, agents, main corporate officers or brokers participate in the administration of an issuer of publicly traded securities through their performance as directors, administrators, managers, main corporate officers or liquidators thereof, of its parent or affiliate companies.”).

181. *Id.*

do not apply to intermediaries that are subsidiaries of the issuer of shares, provided that they exclusively share common *directors* and those directors *do not directly participate* in their intermediation decisions.<sup>182</sup>

In contrast to the permissible, albeit limited, activities permitted brokers under Article 168, Article 169 of the SMA describes a series of activities performed by securities intermediaries and institutional investors in which irreconcilable conflicts of interest exist. These conflicts of interest give rise to a duty of abstention concerning those activities.<sup>183</sup> For example, certain members of institutional investors may not legally participate in a Pension Fund Administrator controlled by a third party.<sup>184</sup>

Paragraphs 1 and 2 of Article 169 have introduced into Chilean law the notion of a so-called “Chinese Wall.”<sup>185</sup> As discussed in Part II, these walls are recommended by U.S. legal experts as a preventative measure for insider trading.<sup>186</sup> The overarching objective of Article 169 “is to avoid the transfer of information between different units of the same institution.”<sup>187</sup>

b. *External Auditors of Financial Statements Submitted by Institutional Investors and Securities Brokers*

External auditors have an obligation to review the internal mechanisms that institutional investors and securities brokers establish and use to generate financial statements in order to guarantee compliance with the requirements of Title XXI and Article 33 of the SMA. Likewise, auditors must analyze the systems by which such institutions record the data of transactions performed with their own resources or those of third parties, whether they administer or intermediate those transactions.<sup>188</sup>

c. *Participants in Decisions Regarding the Acquisition of Securities Held by Institutional Investors and Securities Brokers*

In accordance with Article 171, paragraph 1 of the SMA, those individuals directly involved in decision-making with respect to the acquisition of securities held by institutions and securities brokers, or those who have access to such information by virtue of their position, must inform their managers of any acquisition or transfer of publicly traded securities within 24 hours of the transaction.<sup>189</sup>

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182. Law No. 18045, art. 168, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile) (emphasis added).

183. *See id.* art. 169.

184. *Id.* (providing that “directors, administrators, managers, main corporate officers, financial advisors, money desk operators of a broker, may not participate in the administration of a Pension Fund Administrator controlled by third parties authorized by law.”).

185. *See supra* Part II.C.

186. SALAH ABUSLEME, *supra* note 117, at 169.

187. *Id.* at 169.

188. *See* Law No. 18045, art. 170, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile).

189. *See id.* art. 171 (excluding long term deposits from these transactions).



d. *The Company*

Finally, per Article 171, paragraph 2, the company is responsible for informing the SVS, within the time period and in the manner prescribed, of any transactions whose amount reaches 500 *Unidades de Fomento*<sup>190</sup> and are performed by any of the aforementioned persons.<sup>191</sup>

5. Survival of Obligations

Article 167 of the SMA prescribes that the obligations and prohibitions described in the prior section remain in force indefinitely, regardless of whether the persons with access to the privileged information gained access directly from the issuer or institutional investor, or from persons who are presumed to have possession of such information, have ceased to be in the relevant relationship or position.<sup>192</sup> The SMA does not establish a temporary framework for the enforcement of this *ultra vires* obligation.

V. CONSEQUENCES FOR VIOLATIONS OF INSIDER  
TRADING REGULATION

A. *General Provisions*

1. General Responsibility for the Violation of the SMA

The violation of Article 169 of the SMA, concerning insider trading obligations and prohibitions,<sup>193</sup> may be subject to administrative, civil and criminal penalties.<sup>194</sup>

a. *Joint and Several Liability*

Per Article 55, Paragraphs 3 and 4, of the SMA, joint and several liability attaches in two distinct circumstances. First, directors, managers, and auditors of issuers of publicly-traded securities may be held jointly and severally liable for damages caused by the violation of either Chilean insider trading laws and regulations or the bylaws governing the internal operations of the organization. In the second instance, when two or more bidders in a public offer violate Title XXV of the SMA (provisions known as “OPAS,” governing the public offering of shares), securities issuers are, too, held jointly and severally liable for damage caused.

b. *Administrative, Civil, and Criminal Penalties*

Paragraph 1 of Article 55 of the SMA establishes a violator’s obligation to pay damages, in addition to any administrative and criminal penalties rendered.<sup>195</sup> Adding further punishment, Paragraph 2 of the same

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190. Chilean monetary unit.

191. *Id.*

192. *Id.* art. 167.

193. *See supra* Part IV.B.4.

194. *See* Law No. 18045, art. 172, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile).

195. *Id.* art. 55.

provision prescribes that same obligation on the violator's administrators or legal representatives, except when they are able to demonstrate their lack of participation or their opposition to the action or circumstance constituting the violation.<sup>196</sup>

2. Specific Liability for Violation of Title XXI of the SMA for the Use of Privileged Information

Article 172 of the SMA states the right of "any person harmed by activities constituting a violation of provisions"<sup>197</sup> related to privileged information – as discussed in Title XXI of the SMA<sup>198</sup> – to sue for damages against the violators.

a. *Statute of Limitations for an Action for Insider Trading*

Paragraph 2 of Article 172 establishes a four-year statute of limitations from the date upon which the privileged information "was disclosed to the market and to the investing public" for bringing an insider trading suit.<sup>199</sup>

b. *Disgorgement of the Benefits Obtained When There Are No Other Injured Parties*

If there are no other injured parties by virtue of transactions performed in violation of Title XXI, then all profits or pecuniary benefits stemming from those transactions must be disgorged to the National Treasury, per Article 172, paragraph 3.<sup>200</sup> The amount to be disgorged is determined by the SVS, without prejudice to other penalties that might also be imposed.<sup>201</sup>

B. *Administrative Responsibility*

Administrative repercussions stemming from the use of privileged information are principally imposed through resolutions of the SVS.<sup>202</sup> However, the Superintendencia de Bancos e Instituciones Financieras, "SBIF") also plays an important enforcement role, since all banks must be legally organized as stock corporations in Chile.<sup>203</sup>

Article 58 of the SMA directs that the SVS shall impose the pertinent administrative penalties for violations of its provisions. As discussed above, Article 172 similarly prescribes that when an improper transaction

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196. *See id.*

197. *Id.* art. 172.

198. *Id.* tit. XXI.

199. *Id.* art. 172.

200. *See* Law No. 18045, art. 172, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile).

201. Reid Undurraga, *supra* note 110, at 442.

202. SALAH ABUSLEME, *supra* note 117, at 186.

203. Decree with Force of Law No. 3, art. 27, Noviembre 26, 1997, DIARIO OFICIAL [D.O.] (Chile).

has occurred, but no one has been injured by it, profits or pecuniary benefits must be disgorged. In conformity with Article 4(q) of Decree Law 3,538,<sup>204</sup> the SVS is empowered to determine the amount of such penalties.<sup>205</sup> In doing so, the agency considers “the average market price of the public offering during the previous 60 days[.]” converting such amounts to their equivalent in *Unidades de Fomento*.<sup>206</sup>

Concurrently with SVS enforcement, the SBIF regulates the activities of bank directors with respect to insider trading. SBIF’s Updated Compilation of Norms (the *Recopilación Actualizada de Normas*, or “RAN”) devotes a special section to this precise topic, Chapter 18-11.<sup>207</sup> The chapter states that, in accordance with Articles 171 and 69 of the SMA, banks must comply with information requests from the SVS and, in doing so, deliver certain kinds of information.<sup>208</sup> Violation of Chapter 18-11 is punished according to Article 19 of the General Banking Law (*Ley General de Bancos*).<sup>209</sup>

There is a general consensus among experts that banks in Chile do comply with the standards of corporate governance established by law and the SBIF,<sup>210</sup> within which the prohibition on use of privileged information (or insider trading) is included. Indeed, many banks publish their manuals for the prevention of use of privileged information on their websites,<sup>211</sup> speaking to their confidence in their adherence with the applicable rules and regulations.

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204. Decree Law No. 3538, art. 4(q), Diciembre 23, 1980, DIARIO OFICIAL [D.O.] (Chile).

205. Reid Undurraga, *supra* note 110, at 442.

206. Decree Law No. 3538, art. 4(q), Diciembre 23, 1980, DIARIO OFICIAL [D.O.] (Chile).

207. SUPERINTENDENCIA DE BANCOS E INSTITUCIONES FINANCIERAS, RECOPIACIÓN ACTUALIZADA DE NORMAS DE LA SUPERINTENDENCIA DE BANCOS E INSTITUCIONES FINANCIERAS DE CHILE [*Updated Compilation of Norms of Chile’s Superintendence of Banks and Financial Institutions*] ch. 18-11 (2011), available at [http://www.sbif.cl/sbifweb3/internet/archivos/norma\\_98\\_1.pdf](http://www.sbif.cl/sbifweb3/internet/archivos/norma_98_1.pdf).

208. *Id.*

209. Decree with Force of Law No. 3, art. 27, Noviembre 26, 1997, DIARIO OFICIAL [D.O.] (Chile) (establishing fines for actions or omissions incurred by institutions subject to the enforcement powers of the Superintendency of Banks and Financial Institutions).

210. See *Expertos: Bancos Cumplen Estándar De Gobierno Corporativo* [*Experts: Banks Comply with Corporate Governance Standards*], LA TERCERA (May 25, 2013), <http://www.latercera.com/iphone/noticia/negocios/2013/05/655-525045-9-expertos-bancos-cumplen-estandar-de-gobierno-corporativo.shtml>.

211. See, e.g., BANCO DE CHILE, MANUAL DE MANEJO DE INFORMACIÓN DE INTERÉS PARA EL MERCADO [MANUAL FOR THE MANAGEMENT OF INFORMATION OF INTEREST FOR THE MARKET] (2008), available at <http://www.bancoedwards.cl/wps/wcm/connect/326414804b4b545c93a9f7bad1441276/manual.pdf?MOD=AJPERES>; CORPBANCA, POLÍTICAS PARA EVITAR QUE INFORMACIÓN PRIVILEGIADA O RESERVADA SEA DIVULGADA A PERSONAS DISTINTAS A LAS QUE DEBAN CONOCERLA [POLICIES TO AVOID THAT PRIVILEGED OR RESERVED INFORMATION BE DISCLOSED TO PERSONS OTHER THAN THOSE WHO MUST KNOW IT], available at [http://www.corpbanca.cl/storage/Políticas\\_reserva.pdf](http://www.corpbanca.cl/storage/Políticas_reserva.pdf) (last visited June 12, 2014).

### C. Civil Liability

A systematic survey of the civil liability rules affecting individuals in violation of Chilean corporate governance standards shows that the “regulation of civil liability [that affects those individuals] is much more rigorous [on paper] than [under] the common law.”<sup>212</sup> One example is the sanction of nullity, as applied to “directors’ exoneration or limitation of liability clauses.”<sup>213</sup> Except in cases where directors expressly “cause their opposition to the respective resolution to be recorded in the board minutes, thus ‘saving’ them from liability,”<sup>214</sup> directors who abstain from voting or simply do not voice their opposition to the respective board resolution in the aforementioned manner are thereafter equally jointly and severally liable for the damages caused by the resolution undertaken.<sup>215</sup>

#### 1. General Requirements

To establish the civil liability of those who violate insider trading-related provisions or use privileged information, it is necessary both to assess compliance with the specific requirements of insider trading regulation delineated by the SMA, the SCA, and their implementing regulations, and to analyze “the existence of an action or omission, negligence, the existence of a harm, and causation between the action or omission and the damage,”<sup>216</sup> that is, to determine whether the civil liability requirements under Chilean law are met.<sup>217</sup>

#### 2. Requirements Concerning Directors of Stock Corporations

##### a. *The Duty of Loyalty, Diligence, and Confidentiality Binding Directors of Stock Corporations*

In general, directors in Chile are bound by three duties: (i) the duty of care, according to which “directors must use in the performance of their duties the care and diligence that men ordinarily use in their own businesses, and the directors are jointly and severally liable for the damages caused to the company and to shareholders by their intentional or negligent actions;”<sup>218</sup> (ii) the duty of loyalty, regulated in Articles 39, 40 and 44 of the SCA,<sup>219</sup> which provides that directors must prioritize the interests

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212. Osvaldo Lagos Villareal, *La Responsabilidad Civil de los Directores de Sociedades Anónimas*, FORO DE DERECHO MERCANTIL, Apr.-June 2005, at 119, 124.

213. *Id.* at 126.

214. *Id.* at 136.

215. *Id.*

216. ILLANES RÍOS, *supra* note 4, at 3.

217. SALAH ABUSLEME, *supra* note 117, at 185.

218. Law No. 18046, art. 41, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile).

219. *Id.* arts. 39-40, 44; *see also* LAGOS VILLAREAL, *supra* note 212, at 146.

of the company and the shareholders over their own interests;<sup>220</sup> and (iii) the duty of confidentiality of corporate information. The latter two duties are particularly important with respect to the topic of use of privileged information, or insider trading. In fact, while the duty of care is an obligation and expectation germane to all those engaged in legal transactions, the duty of loyalty and confidentiality directly applies to those who manage businesses on behalf of another, such as directors and other corporate managers.

With regard to the duty of loyalty, Article 42(6) and (7) of the SCA provide specifically that directors may not “use for their own benefit or for the benefit of related third parties, to the harm of the company, commercial opportunities of which they gained knowledge through their position,”<sup>221</sup> or “perform illegal acts or acts contrary to the bylaws or to corporate interests or otherwise use their position to obtain undue advantages for themselves or related third parties in prejudice of corporate interests.”<sup>222</sup>

Article 43 of the SCA establishes the so-called “duty of confidentiality” of directors of stock corporations.<sup>223</sup> This provision sets forth the obligation of directors to “reserve . . . corporate businesses and corporate information to which they gain access by reason of their position, and that has not been officially disclosed by the company.”<sup>224</sup> Article 165 of the SMA clarifies this confidentiality duty, elaborating that the prohibition is applicable while the information is non-public.<sup>225</sup>

Furthermore, while not explicitly included in the language of Chilean securities legislation, there is also an understood duty of diligence requiring directors to “[become] informed, investigate, and monitor.”<sup>226</sup> The existence of this obligation of diligence is apparent from the multiple

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220. *Id.* at 144 (stating that the duty of loyalty is violated in the following situations, among others: “(i) execution of contracts with the corporation in conditions artificially favorable to the administrator; (ii) determination of an exaggerated compensation, taking advantage of the corporate office, or of the assets or information of the company; and (iii) taking advantage of business opportunities about which information is [obtained] while serving in a corporate office and that should benefit the company, or by competing with the company.”).

221. Law No. 18046, art. 42(6), Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile); *see also id.* art. 148.

222. *Id.* art. 42(7).

223. Joaquín Miguel Rodríguez Díez, *Directors and Officers Insurance: Can Chilean Corporate Directors Protect Themselves from Possible Liability Through Insurances?*, 19 CURRENTS: INT’L TRADE L.J. 40, 43-44 (2010).

224. Law No. 18046, art. 43, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile) (“In the case of publicly-traded stock corporations, such disclosure is presumed when the information has been disclosed through disclosure systems to the market established by the Superintendencia, in accordance with [A]rticle 10 of [the SMA], or under another modality compatible with [A]rticle 46.”).

225. SALAH ABUSLEME, *supra* note 117, at 157.

226. LAGOS VILLAREAL, *supra* note 212, at 145.

presumptions of culpability for individuals who are negligent in the performance of their corporate duties. <sup>227</sup>

Therefore, the most relevant obligations of stock corporations' directors under the duties of loyalty and confidentiality, as pertain to the matter of insider trading, are to: (i) "[k]eep strict confidentiality of [corporate] information;" (ii) abstain from using corporate information, either "directly or indirectly, for [their] own benefit or that of a third-party;" (iii) "[r]efrain from recommending the purchase or sale of the securities concerned;" and (iv) to "[e]nsure that their subordinates and trusted third parties do not perform such operations."<sup>228</sup>

### 3. Type of Responsibility of Directors of Stock Corporations: Contractual or Tort

There is a long-standing debate among Chilean academics concerning the type of liability to be bestowed upon directors for the violation of insider trading-related provisions – whether contractual or tort.<sup>229</sup> Whether liability sounds in contract or tort is relevant because of the differences in “their constitutive requirements, the burden of proof, the graduation of negligence, the scope of the remedy, joint or several liability, statutes of limitation, etc.”<sup>230</sup> Many Chilean authors hold that no contractual relationship exists between directors and shareholders and, as such, shareholders must sue pursuant to tort liability rules.<sup>231</sup> Notwithstanding this theory, debate still persists about whether there is a contractual or other legal relationship between directors and stock corporations.<sup>232</sup>

To resolve this dilemma, Chilean authors have historically made use of two theories to explain the type of relationship existing between directors and stock corporations. The first is the “Theory of Representation” (or “Agency Theory”<sup>233</sup>), under which there does exist a contractual relationship and directors are, therefore, the representatives (agents) of the corporation.<sup>234</sup> Under this theory, directors' liability is naturally governed by contractual liability rules.<sup>235</sup> The alternative theory, the “Theory of the

227. See, e.g., Law No. 18045, art. 62, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile) (presuming fraud in certain cases of bankruptcy of stock brokers); *id.* art. 110(d) (presuming a “relationship” between certain persons and a company based on family or business grounds); *id.* art. 166 (presuming access to privileged information).

228. Rodríguez Diez, *supra* note 223, at 43-44.

229. PRIETO, ANÍBAL, BUSINESS LAWS OF CHILE, STOCK CORPORATIONS—LIABILITY OF DIRECTORS IN A CORPORATION UNDER CHILEAN LAW § 1:34 (2013).

230. *Id.*

231. See ILLANES RÍOS, *supra* note 4, at 7.

232. LAGOS VILLAREAL, *supra* note 212, at 129; see also SALAH ABUSLEME, *supra* note 117, at 186.

233. HUGO LAVADOS MONTES, EL PROYECTO DE REFORMA AL MERCADO DE CAPITAL Y LOS DIRECTORES DE SOCIEDADES ANÓNIMAS ABIERTAS 2 (1993).

234. *Id.*

235. RAÚL VARELA MORGAN, RESPONSABILIDAD GENERAL DE LOS DIRECTORES Y GERENTES DE SOCIEDADES ANÓNIMAS 6-7 (1993).

Organ,”<sup>236</sup> holds that stock corporations –as fictitious entities – may not act in real life without an administrative organ, that is, a board of directors. In this circumstance, the directors’ civil liability is imposed as a matter of law from the moment that the individuals accept their appointment as directors.<sup>237</sup>

The traditional majoritarian position promoted the Theory of Representation, whereby an *undue* use of privileged information required a previous fiduciary relationship between the defendant and the corporation. Over time, Chilean legal doctrine has evolved, such that most authors currently accept the Theory of the Organ, requiring no previous fiduciary relationship for insider trading to exist.<sup>238</sup> Indeed, the majority of Chilean experts on the matter, including the SVS, agree that the relationship between the directors of a corporation and the stock corporation itself is organic and legal in nature.<sup>239</sup> Because no agency agreement exists, the directors may be held liable under tort liability.

#### D. Criminal Responsibility

Traditionally in Chile, under the *societas delinquere non potest*<sup>240</sup> principle, individuals alone may be subject to criminal liability.<sup>241</sup> Because of this peculiarity of Chilean law, criminal responsibility for insider trading in Chile falls exclusively to “the administrators”<sup>242</sup> of an entity.

The SMA and the Decree Law 3,500 of 1980 on the Pension Funds System<sup>243</sup> regulate criminal responsibility for the use of privileged information. Article 60(d), (e), (g), and (h) of the SMA spell out who “shall be subject to the penalty of imprisonment in any degree.”<sup>244</sup> This list includes partners, administrators and, in general any person that by reason of his or her office or position at risk rating agencies, has access to reserved information of classified issuers and reveals the content of that information to third parties.<sup>245</sup> Also included are the persons referred to in article 166

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236. *Id.* at 7.

237. LAGOS VILLAREAL, *supra* note 212, at 130.

238. PFEFFER URQUIAGA, *supra* note 148, at 21.

239. LAGOS VILLAREAL, *supra* note 212, at 130.

240. Meaning a company may not commit a crime.

241. LUIS ORTÍZ QUIROGA, *RESPONSABILIDAD PENAL DE LOS DIRECTORES Y GERENTES DE BANCOS Y SOCIEDADES ANÓNIMAS* 3 (1993).

242. *Id.* at 4 (mentioning Article 39 of the Criminal Procedure Code, Law No. 1853, art. 39, Febrero 13, 1906, DIARIO OFICIAL [D.O.] (Chile), according to which “criminal liability may only be imposed on individuals.”).

243. *See* Decree Law No. 3500, art. 159, Noviembre 13, 1980, DIARIO OFICIAL [D.O.] (Chile); *see also* Gonzalo García Palominos, *Modelo de Protección en Normas Administrativas y Penales que Regulan el Abuso de Información Privilegiada en la Legislación Chilena*, 8 POLÍTICA CRIMINAL 23, 24 (2013), available at [http://www.politicacriminal.cl/Vol\\_08/n\\_15/Vol8N15A2.pdf](http://www.politicacriminal.cl/Vol_08/n_15/Vol8N15A2.pdf).

244. Law No. 18045, art. 60, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile).

245. *Id.* art. 60(d).

who, when performing transactions or operations on publicly traded securities in the securities market or in private negotiations, intentionally use privileged information.<sup>246</sup> Those who, taking advantage of privileged information, actively perform an act with the aim of obtaining a monetary benefit or avoiding a loss through any transaction with publicly traded securities are likewise subject to criminal penalties.<sup>247</sup> And, finally, the law proscribes the conduct of those who merely reveal privileged information with the purpose of obtaining a monetary benefit or avoiding a loss in operations or transactions with publicly traded securities.<sup>248</sup>

Decree Law 3,500 of 1980, by contrast, expressly establishes more severe imprisonment penalties for directors, managers, agents, liquidators, money desk operators, and employees of Pension Fund Administrators<sup>249</sup> that use privileged information and take advantage of their office or position to perform an act for the “purpose of obtaining a monetary benefit for himself or another, through any operation or transaction of publicly traded securities,”<sup>250</sup> or to divulge “privileged information related to investment decisions of any Pension Fund Administrators to persons other than those whose duty is to perform . . . operations of publicly traded securities on behalf . . . of such Funds.”<sup>251</sup>

## VI. MOST RELEVANT CHILEAN CASES RELATED TO THE USE OF PRIVILEGED INFORMATION

### A. *Chispas Case*

The *Chispas* case<sup>252</sup> is perhaps the most famous Chilean case concerning director liability for the violation of Chilean corporate governance and insider trading rules. This case arose from *Chispas*' sale of *Energis*, Chile's largest operating company in the electric utilities sector at that time,<sup>253</sup> to *Endesa España*,<sup>254</sup> a Spanish electric company. The sale was executed in 1997, pursuant to a Strategic Alliance Agreement that included several contracts between the same parties.

*Energis* was managed by six “key managers,” who exercised control through their majority ownership of “*Chispas*” shareholding. *Chispas* had

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246. *Id.* art. 60(e).

247. *Id.* art. 60(g).

248. *Id.* art. 60(h).

249. SALAH ABUSLEME, *supra* note 117, at 220.

250. Decree Law No. 3500, art. 159(a), Noviembre 13, 1980, DIARIO OFICIAL [D.O.] (Chile).

251. *Id.* art. 159(b).

252. Juzgado Civil de Santiago (J. Civ.) [Civil Court], 16 julio 2002, “*Mackenna, Luis c. Superintendencia de Valores y Seguros*,” Rol de la causa: C-4641-1997, PODER JUDICIAL No. 600 p.1137, 1310 (Chile), available at [http://www.svs.gob.cl/sitio/mercados/doc/senten\\_5\\_juz\\_chispas\\_130904.pdf](http://www.svs.gob.cl/sitio/mercados/doc/senten_5_juz_chispas_130904.pdf).

253. AGOSIN & PASTÉN, *supra* note 1, at 12.

254. *Id.*



two classes of shares –“A” and “B.” Each key manager owned 20 percent of the “A” shares, allowing them collectively to appoint one of a total of nine directors of each of the Chispas companies. The key managers owned all of the “B” shares, which allowed them to appoint another four of the nine directors of each of the Chispas companies.<sup>255</sup> The Chispas companies, which the key Enersis managers effectively controlled, then held 29.04 percent of Enersis shares,<sup>256</sup> permitting the managers to appoint two of the seven members of the board of directors of Enersis and to participate in the appointment of the directors of Enersis subsidiaries (also very important companies in the electrical services sector).<sup>257</sup> As a result of their stock ownership, and because the key managers gained the confidence of the other members of the Enersis board, the key managers appointed themselves as directors and main corporate officers of Enersis and its subsidiaries. This scheme, in practice, gave the key managers effective and total control of the Chilean electric market.<sup>258</sup>

Through the Strategic Alliance Agreement, Endesa España sought to gain control of Enersis and its subsidiaries. In order to achieve this result, the parties signed several agreements through which Endesa España would acquire the totality of the key managers’ “A” and “B” shares in the Chispas companies.<sup>259</sup> The agreements governing the price and other essential terms of the dealings appointed the key managers as directors of the same companies for a five-year term and awarded a price for “B” shares (which were owned exclusively by the key managers) that was 840 times higher than that of the “A” shares. The key managers also received an option to acquire five percent of Endesa España’s shares at a preferential price.<sup>260</sup> Moreover, under the Management Agreement, the key managers retained the power to administer the holding in a manner that would secure Endesa España’s control over Enersis and its subsidiaries.<sup>261</sup>

At the end of 1997, the SVS imposed multi-million peso fines on each of the key managers for their violation of their duties as directors under the then-governing corporate governance and insider trading rules.<sup>262</sup> The

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255. See Francisco Pfeffer Urquiaga, *El Concepto de Control Societario, La Administración de la Sociedad Anónima, Los Conflictos de Interés y La Potestad Punitiva de La Superintendencia de Valores y Seguros en el Contexto del “Caso Chispas”*, 32 REVISTA CHILENA DE DERECHO 501, 503 (2005) [hereinafter Pfeffer Urquiaga, *Control Societario*] (stating that in one of the companies—Compañía de Inversiones Luz S.A.—key managers had the power to appoint four of the nine directors of the company).

256. *Id.*

257. *Id.* at 504.

258. See *id.*

259. AGOSIN & PASTÉN, *supra* note 1, at 12.

260. *Id.*

261. See Pfeffer Urquiaga, *Control Societario*, *supra* note 255, at 505.

262. *Corte Suprema Confirma Millonaria Multa Contra Ex Ejecutivos de Enersis [Supreme Court Confirms Multimillion Fine Against Former Executives of Enersis]*, ENERNEWS (July 8, 2005), <http://www.enernews.com/nota/181957/corte-suprema-confirma-millonaria-multa-contra-ex-ejecutivos-de-enersis>.

SVS found that: (i) there was a conflict of interest involved in the negotiations between the key managers and Endesa, such that these managers prioritized their personal interests over the interests of the company,<sup>263</sup> and (ii) the key managers did not provide notice of their negotiations with Endesa España to the rest of shareholders, thus violating their duty of loyalty.<sup>264</sup> However, it is imperative to mention that the SVS, in so finding, did not formulate charges for the use of privileged information against the defendants.<sup>265</sup>

With respect to the use of privileged information, the SVS, through Resolution 337 of October 31, 1997, instead imposed a penalty on Elesur S.A. (a subsidiary of Endesa España that acquired 29 percent of Enersis shares) for having illicitly used privileged information.<sup>266</sup> The court opined that Elesur S.A. had violated insider trading law the moment that it acquired the Enersis shares (through a public offering held on September 5, 1997), since Elesur S.A. knew that the Strategic Alliance Agreement signed between Enersis and Endesa España created an obligation on the part of Endesa España to acquire the shares that other Chispas affiliates had in Enersis. The market did not receive this important piece of information until October 17, 1997, implying that during “the whole period of the public offering the market did not learn about the public offering.”<sup>267</sup> This situation caused an “asymmetry in the knowledge of material information [on which] to trade such securities, probably having the [ability] to influence the price of the securities of the Chispas companies.”<sup>268</sup>

The trial court rejected the penalties on the grounds that “there had not been *access* to the information, but that the information had been *created*; therefore, there was no violation of Article 165 of the SMA.”<sup>269</sup>

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263. See Superintendencia de Valores y Seguros, Resolución No. 351 (1997), available at [http://www.svs.gob.cl/sitio/mercados/doc/res\\_351\\_1997.pdf](http://www.svs.gob.cl/sitio/mercados/doc/res_351_1997.pdf); Superintendencia de Valores y Seguros, Resolución No. 352 (1997), available at [http://www.svs.gob.cl/sitio/mercados/doc/res\\_352\\_1997.pdf](http://www.svs.gob.cl/sitio/mercados/doc/res_352_1997.pdf); Superintendencia de Valores y Seguros, Resolución No. 353 (1997), available at [http://www.svs.gob.cl/sitio/mercados/doc/res\\_353\\_1997.pdf](http://www.svs.gob.cl/sitio/mercados/doc/res_353_1997.pdf); Superintendencia de Valores y Seguros, Resolución No. 371 (1997), available at [http://www.svs.gob.cl/sitio/mercados/doc/res\\_371\\_1997.pdf](http://www.svs.gob.cl/sitio/mercados/doc/res_371_1997.pdf); Superintendencia de Valores y Seguros, Resolución No. 372 (1997), available at [http://www.svs.gob.cl/sitio/mercados/doc/res\\_372\\_1997.pdf](http://www.svs.gob.cl/sitio/mercados/doc/res_372_1997.pdf); Superintendencia de Valores y Seguros, Resolución No. 373 (1997), available at [http://www.svs.gob.cl/sitio/mercados/doc/res\\_373\\_1997.pdf](http://www.svs.gob.cl/sitio/mercados/doc/res_373_1997.pdf).

264. See *supra* note 263.

265. Juzgado Civil de Santiago (J. Civ.) [Civil Court], 16 julio 2002, “Mackenna, Luis c. Superintendencia de Valores y Seguros,” Rol de la causa: C-4641-1997, PODER JUDICIAL No. 600 p. 1137, 1310 (Chile), available at [http://www.svs.gob.cl/sitio/mercados/doc/senten\\_5\\_juz\\_chispas\\_130904.pdf](http://www.svs.gob.cl/sitio/mercados/doc/senten_5_juz_chispas_130904.pdf) (the Court held that the provisions of the SMA and the amendments introduced by Law 19,075—specifically, Articles 164 and 165 regulating the use of privileged information—were not invoked by the SVS as legal foundation of the penalties applied and, for that reason, such provisions may not be considered as violated).

266. GUZMÁN ANRIQUE, *supra* note 110, at 75.

267. PFEFFER URQUIAGA, *supra* note 148, at 2.

268. GUZMÁN ANRIQUE, *supra* note 110, at 75-76.

269. *Id.* at 76.

However, on June 6, 2006, the Appellate Court of Santiago confirmed the fines imposed by the SVS on the Enersis managers, and this holding was later upheld by the Supreme Court.<sup>270</sup>

The Supreme Court's holding in the Chispas case established crucial points for the doctrine of use of privileged information, or insider trading, in Chile. First, it established that both legal entities, as well as individuals, are subject to "the duties of conduct required [of] those who know privileged information."<sup>271</sup> Second, the court explained that privileged information includes information that "ha[s] the potential or [ability] to produce effects on the prices of the securities in the market."<sup>272</sup> The court also held that a change in market prices is not a condition *sine qua non* to punish insider trading violations.<sup>273</sup> Finally, the court held that "the generator or owner of the information is equally obligated by the duties of conduct required by the law [as] those who know privileged information."<sup>274</sup> The rationale for this finding was that the "protected legal interest of the owner of information is subordinated to the public interest[,] in [keeping] with a well-established, orderly, transparent, and competitive market."<sup>275</sup>

Several authors have criticized the case's holding that those who generate inside information are also bound by the prohibitions applicable to insider trading. As one author states, "if the intention is to [impose] the ban [on trading] [on] those who have intervened in the transaction or juridical act generating the information, this situation would lead to the absurdity that such individual could not participate even in that act (since he would be obliged to refrain from acquiring the shares), and in this situation, the *privileged information would not even be born*."<sup>276</sup>

### B. LAN (National Airlines) Case

The LAN case<sup>277</sup> concerns Mr. Sebastián Piñera, the then-President of Chile, who at the time of the case was a presidential candidate. Understandably, the case had not only legal, but also political repercussions.<sup>278</sup> Mr. Piñera and Mr. Juan Cueto, both LAN directors, purchased LAN shares through companies that they controlled, Sociedad Santa Cecilia and

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270. Press Release, Superintendencia de Valores y Seguros, Sentencia en Causa Elesur Con SVS [Decision in Case Elesur v. SVS] (July 27, 2007), No. 3, available at [http://www.svs.cl/sitio/admin/Archivos/com\\_20070727-01.PDF](http://www.svs.cl/sitio/admin/Archivos/com_20070727-01.PDF).

271. *Id.*

272. *Id.*

273. *Id.*

274. *Id.*

275. *Id.*

276. GUZMÁN ANRIQUE, *supra* note 110, at 78; see also Vásquez Palma, *supra* note 115, at 273.

277. Corte Suprema de Justicia [C.S.J.] [Supreme Court], 8 Marzo 2010, "Superintendencia de Valores y Seguros v. Cueto Plaza, Juan," Rol de la causa: 1044-2009 (Chile),

278. See generally Amar, *supra* note 15.

Sociedad Cantábrico, respectively.<sup>279</sup> The director-authorized share purchases were finalized a mere twenty-nine minutes after the LAN board of directors meeting concluded on July 24, 2006, during which the financial statements of the company were approved.<sup>280</sup> Yet, LAN's financial statements were not made public until after the market had closed on the following day. In other words, LAN's financial information did not become public until July 26, 2006, when notice of the purchase of shares was communicated to the SVS.<sup>281</sup>

On July 6, 2007, the SVS fined Mr. Piñera and Mr. Cueto for violating their duty of abstention owed under Article 165, Paragraph 1, of the SMA.<sup>282</sup> Mr. Piñera paid the fine imposed by the SVS; Mr. Cueto appealed the SVS decision to the courts.<sup>283</sup> In defense of the share acquisition, Mr. Cueto asserted that the information contained in the financial statements did not have the ability to influence the price of LAN securities, and that the financial statements by themselves—without that ability to affect price—did not constitute privileged information. He further contended that the obligation not to purchase securities, derived from Article 165, may not be interpreted independently of whether the purchase decision is motivated by the use of privileged information.<sup>284</sup> Finally, Mr. Cueto insisted that the SVS had already declared that there was no use of privileged information in the case.<sup>285</sup>

Both claimants insisted that their knowledge of the company's financial information was not what led them to acquire the shares; instead, they argued that they had purchased the shares under “a purchase model consistent with the historical policy for the purchase of shares in that company.”<sup>286</sup> Notably, in a press release dated July 6, 2007, the SVS did indeed recognize that the claimants had demonstrated that their purchases were *not* motivated by the knowledge of the financial statements. Yet, despite this acknowledgment, the SVS concluded that “one of the obligations established in Article 165 of the SMA, paragraph one, [was] [the] legal prohibition [of] acquir[ing] securities [for] which privileged information exist[ed].”<sup>287</sup>

The trial and the appellate courts confirmed the fines imposed by the SVS,<sup>288</sup> and their decisions provided responses to issues raised by Mr. Cueto's defense theories: (i) whether the financial statements by them-

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279. Vázquez Palma, *Caso LAN*, *supra* note 139, at 462.

280. *See id.*

281. *Id.*

282. *Id.* at 462-63.

283. *Id.* at 463.

284. *Id.* at 463-64.

285. Vázquez Palma, *Caso LAN*, *supra* note 139, at 464.

286. GUZMÁN ANRIQUE, *supra* note 110, at 72-73.

287. *Id.* at 72.

288. Vázquez Palma, *Caso LAN*, *supra* note 139, at 466-67.

selves – absent a consideration of their content – can influence the price of a company’s securities, and (ii) if directors are under an absolute duty to abstain from purchasing and selling shares based on information obtained during a board meeting and unknown to the market, even when such transactions were not motivated by that information. With respect to the first question, the trial court held that the financial statements of LAN, as well as “those of any other company regulated under the SMA, contain and represent privileged information, as long as they are not disclosed to the market and [in this case] had sufficient force to influence the price of the securities issued independently of whether this result is obtained or not.”<sup>289</sup> Concerning the second question, while confirming the fines imposed by the SVS, the trial court also confirmed the existence of a duty of absolute abstention from trading in shares for which privileged information exists, while such information is non-public.<sup>290</sup>

The appellate court’s dissenting opinion questioned the notion of an absolute prohibition on trading company shares while possessing non-public information. To bolster its proposition, the dissent raised, as an example, a director’s right to obtain information on the state of the corporation’s business, per Article 39 of the SCA. An individual possessing this right, but also subject to a prohibition on trading on inside information, would never be able to trade shares of the company for which he or she is a director. Such a result would impinge the constitutional rights of the claimants, such as the right to economic freedom and the director’s right of property over his shares.<sup>291</sup> This position was challenged with the counter-argument that, once the information is no longer privileged, the director may freely dispose of his shares, and that “the limitation imposed in the [SMA] to contractual freedom, in particular, and to free will, in general, operate[s] [on] the basis of a higher good, which is the protection of the public economic order.”<sup>292</sup>

## VII. POTENTIAL LEGISLATIVE CHANGES REGARDING INSIDER TRADING REGULATION IN CHILE: A COMPARATIVE PERSPECTIVE

Based on the previous discussion of the current insider trading regime, the Chilean securities market could benefit from several legal amendments to its regulatory system for insider trading.

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289. *Id.* at 466.

290. Corte Suprema de Justicia [C.S.J.] [Supreme Court], 8 Marzo 2010, “Superintendencia de Valores y Seguros v. Cueto Plaza, Juan,” Rol de la causa: 1044-2009 (Chile); Vásquez Palma, *Caso LAN*, *supra* note 139, at 481.

291. *Id.* at 468.

292. *Id.* at 477.

A. *A More Precise Determination of Covered Subjects*

SVS rule NCG No. 270 of 2009,<sup>293</sup> which contains the “Manual for the Management of Information of Interest for the Market”<sup>294</sup> (the “Manual”), designates those who “may acquire or sell company securities or securities whose price . . . is conditioned, in whole or significant part, [on] the variation of the price of such securities.”<sup>295</sup> This mandatory norm gives regulated entities broad latitude to determine the precise individuals subject to the insider trading restrictions mentioned in NCG No. 270.<sup>296</sup> This norm may be contrasted with Section 20A(a) of Exchange Act, which refers to “*any person* that violates any provision of this title or the rules or regulations enacted under it through the purchase or sale of a security while in possession of material non public information.”<sup>297</sup> Similarly, Rule 10b-5 refers to “*any person . . .*”<sup>298</sup>

Similarly, NCG No. 270 also indicates that the board of directors is obligated to ensure that information pertaining to the legal, economic, and financial situation of the company not be disclosed to individuals beyond those whose position or relationship to the company necessitates such disclosure, before the information is made public.<sup>299</sup> This “big brother” requirement borne on the board of directors seems to dilute the duty not to engage in insider trading that is, or ought to be, applicable to *any person* associated with the company, in any capacity.

To this end, greater precision should be added to the pertinent Chilean regulations, in similar fashion to the precision exhibited by Section 20A(c) of ITSFEA, which imposes on “*any person* that violates insider trading rules through the communication of material non-public information, joint and several liability with the person to whom the communication was directed.”<sup>300</sup> A measure like this would clarify and extend the universal duty of abstention currently applicable only to directors of stock corporations in Chile.

The recent U.S. legislative and jurisprudential evolution has also greatly expanded the categorization of persons that may be considered *insiders* for all legal purposes. Thus, for example, accountants, consultants,

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293. Superintendencia Valores y Seguros, Normal de Carácter General No. 270, *Establece Normas para la Publicidad de Políticas y Procedimientos Relativos a la Adquisición o Enajenación de Valores de la Entidad y al Manejo y Divulgación de Información para el Mercado* [Establishes Provisions for the Publicity of Policies and Procedures Related to the Acquisition and Transference of Securities of the Entity and the Management of Information for the Market] (Diciembre 31, 2009) [hereinafter NCG No. 270], available at [http://www.svs.gob.cl/normativa/ngc\\_270\\_2009.pdf](http://www.svs.gob.cl/normativa/ngc_270_2009.pdf).

294. *Id.* at 2.

295. *Id.*

296. *Id.* at 3.

297. 15 U.S.C. § 78t-1(a) (2012) (emphasis added).

298. 17 C.F.R. § 240.10b-5 (2014) (emphasis added).

299. See NCG No. 270, *supra* note 293, at ¶ 7 para. 2.

300. LANGEVOORT, *supra* note 34, § 9:3.

market advisors, lawyers, brokers, and lenders are deemed insiders.<sup>301</sup> The origin of this expansion in the categories of traditional insiders<sup>302</sup> is found within the Supreme Court decision of *United States v. O'Hagan*,<sup>303</sup> in which the Court expanded liability to those not explicitly bound by a fiduciary duty to the company or to its shareholders.<sup>304</sup> This greater specter of liability came to replace the traditional doctrine "that required the presence of a fiduciary relationship between the insider and the shareholders."<sup>305</sup>

In the Chilean context, NCG No. 278<sup>306</sup> goes in the right direction by requiring the Manual to spell out norms and procedures that are to be applicable to a broad swath of people, whether independent of the securities issuer or not. However, despite this step forward, the approach used by NCG No. 278 of specifically listing the individuals subject to the Manual may have already been overcome by the realities of the securities market, in which new (non-listed) stakeholders have emerged. In that sense, SEC Rule 17j-1's use of the notion of "access persons"<sup>307</sup> as individuals that "ha[ve] access to information regarding any clients' purchase or sale of securities . . ." <sup>308</sup> could also serve as a useful guide to Chilean legislators, because it has the benefit of providing a conceptual definition, rather than a strict enumeration.

#### B. *A More Rational Description of the Prohibited Conducts and Applicable Penalties*

Sanctions indicated in the Manual include, besides those prohibiting certain future conduct, a fine payable to the SVS equivalent to a percentage of the operation or equal to the "total amount of the profit obtained or the loss avoided."<sup>309</sup> Comparatively, the U.S. system of civil penalties for insider trading demands not only the disgorgement of the total amount involved in the relevant transaction, whether undue profits or avoided losses, but also the payment of up to treble damages.<sup>310</sup>

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301. Sapp, *supra* note 32, at 3.

302. Gorman, *supra* note 34, at 478.

303. *United States v. O'Hagan*, 521 U.S. 642 (1997).

304. Sapp, *supra* note 32, at 6.

305. Gorman, *supra* note 34, at 479.

306. Superintendencia Valores y Seguros, Normal de Carácter General No. 278, *Establece Obligación de Contar con Manual de Manejo de Información [Establishes the Obligation to Approve an Information Management Manual]* (Jan. 19, 2010) [hereinafter NGC No. 278], available at [http://www.svs.cl/normativa/ngc\\_278\\_2010.php](http://www.svs.cl/normativa/ngc_278_2010.php).

307. 17 C.F.R. § 275.204A-1 (2012).

308. *Id.* § 275.204A-1(e)(1)(i)(A).

309. See NGC No. 270, *supra* note 293, at 3.

310. See Sapp, *supra* note 32, at 16.

### C. *The Need for a Mandatory Code of Ethics to Prevent Insider Trading*

Although the SVS's current regulatory framework requires the preparation of a "Manual for the Management of Information of Interest for the Market" citing the important aspects of confidentiality and disclosure of internal corporate information,<sup>311</sup> the obligation to approve a written Code of Ethics within the regulated entity – as is the case in the U.S. – is missing from the Chilean regulatory framework.<sup>312</sup> The addition of such a measure could promote an active self-regulatory approach in the Chilean corporate world through the development of "codes of conduct" or "codes of good practices"<sup>313</sup> for corporate governance.

### D. *Insider Trading in the Context of Public Offerings*

Despite the fact that Article 166 of the SMA creates a presumption that a wide range of individuals possesses privileged information by virtue of their position or relationship to a given company, the presumption still lacks the breadth possessed by Rule 14e-3 of the 1934 Act. In fact, Article 166 of the SMA takes the same approach as NGC No. 278 of the SVS, which requires regulated entities to enumerate the people who will be responsible for establishing and enforcing purchases or transfers, in their Manual.<sup>314</sup>

By contrast, SEC Rule 14e-3 bans any person that is in possession of material non-public information regarding the commencement of a tender offer, whether acquired directly or indirectly, from trading in such companies' securities. Unlike in Chile, prohibition in the U.S. centers on the issue of *access* to material non-public information. In other words, the rebuttable presumption of access that exists in Chilean law is treated as a non-rebuttable presumption in the U.S. In addition, it is not necessary in the U.S. that there be a violation of a fiduciary duty to invoke the rule;<sup>315</sup> there need only have been substantial steps made towards a tender offer. Furthermore, Rule 14e-3 is also an anti-*tipping* provision, banning certain persons from communicating material non-public information regarding a tender offer to any person under circumstances in which it is reasonably

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311. NGC No. 278, *supra* note 306, at 1-2 (mentioning the following points that must be incorporated in the Manual: (i) staff responsible for establishing and enforcing its provisions; (ii) criteria and procedures applicable to the protection of information; (iii) prohibitions or restrictions; (iv) mechanisms to resolve conflicts of interest; (v) disciplinary framework in case of infractions; and (vi) mechanisms for the disclosure of the Manual to the public).

312. 17 C.F.R. § 275.204A-1(a) (2012).

313. Wigodski & Zúñiga, *supra* note 7, at 1.

314. NGC No. 278, *supra* note 306, at ¶ 4.

315. *See, e.g., SEC v. Bakrie*, Lit. Rel. No. 15834, 1998 WL 449686 (Aug. 6, 1998) (describing a circumstance in which an insider revealed the existence of discussions surrounding the acquisition of another company to his friend, before the information became public, prompting the friend to acquire shares in the target company. Ultimately, the acquisition was not successful, but the insider was discovered, arrested, and paid a civil penalty before returning to his country of origin).



foreseeable that such communication will likely result in a violation of insider trading rules. The anti-tipping provision applies to any insider of the offeror and to any tipped individual.<sup>316</sup> Specifically, the Rule pertains to intentional tipping, not *lapsus linguae*.<sup>317</sup> In Chile, by contrast, NCG No. 270 of 2009 requires the board of directors to “adopt appropriate measures to prevent . . . [confidential information] . . . from being disclosed to persons other than those who, by reason of their office, position or activities within the corporation, must know such information, before the information is communicated to the shareholders or the public.”<sup>318</sup> It would be highly advisable for Chile to remove the power to regulate *tipping* from the board of directors and to directly empower the SVS to issue mandatory rules in this regard.

Finally, U.S. mergers and acquisitions are often plagued by insider trading abuses during the pre-announcement period.<sup>319</sup> A 2006 comprehensive independent study<sup>320</sup> found that 41 percent of companies that received tenders for 100 percent takeovers exhibited abnormal and suspect transactions in the days prior to the date when those transactions became public. The study concluded that these unusual activities very likely involved unlawful insider trading in transactions worth substantial amounts of money, sometimes billions of dollars.<sup>321</sup> This data—and the idea that similar abuses could exist in Chile—present all the more motivation for Chile to more aggressively regulate tipping practices.

#### E. *Mandatory Black-Out Periods*

SVS’s NCG No. 270 of 2009<sup>322</sup> provides that each regulated entity must specify in its respective “Manual for the Management of Information of Interest for the Market”: (a) the corporate organ(s) that create and apply the manual, (b) instructions related to the disclosure of transactions performed by related entities and their security holdings, and (c) the *existence of black-out or prohibition periods* affecting “directors, managers, administrators and main corporate officers, as well as entities directly controlled by them or through third parties.”<sup>323</sup> NCG No. 270 further estab-

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316. See LANGEVOORT, *supra* note 34, § 4:3

317. See *id.* “Lapsus linguae” is defined as a “slip of the tongue” by the Merriam-Webster Dictionary. *Lapsus Linguae*, MERRIAM-WEBSTER, <http://www.merriam-webster.com/dictionary/lapsus%20linguae> (last visited June 19, 2014).

318. NCG No. 270, *supra* note 293, at 3.

319. *Illegal Insider Trading*, *supra* note 17, at 1 (statement of James D. Cox, Brainerd Currie Professor of Law, Duke University School of Law).

320. Gretchen Morgenson, *Signs of Insider Trading Match Surge in Mergers*, N.Y. TIMES (Aug. 27, 2006), [http://www.nytimes.com/2006/08/27/your-money/27iht-mergers.2609879.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2006/08/27/your-money/27iht-mergers.2609879.html?pagewanted=all&_r=0).

321. *Illegal Insider Trading*, *supra* note 17, at 1 (statement of Sen. Arlen Specter, Chairman, S. Comm. on the Judiciary).

322. NCG No. 270, *supra* note 293.

323. *Id.* at 3.

lishes that such limitations may consist of a total and permanent prohibition of operations, a temporary prohibition for a period defined by the board of directors, or a permanent trading prohibition for a determined period between the respective transactions.<sup>324</sup> However, though the SVS rule provides guidelines regarding the parameters of black-out or prohibition periods, their implementation is merely optional for regulated entities. Hence, there is a need to more strongly mandate this matter in order to ensure actual, rather than aspirational, compliance with insider trading rules in Chile.

U.S. law defines a blackout period as:

[A]ny period of more than 3 consecutive business days during which the ability of not fewer than 50 percent of the participants or beneficiaries under all individual account plans maintained by the issuer to purchase, sell, or otherwise acquire or transfer an interest in any equity of such issuer held in such an individual account plan is temporarily suspended by the issuer or by a fiduciary of the plan.<sup>325</sup>

If a valid corporate purpose is in fact served by the withholding of a material fact, then persons who are “in the corporate trust” must not deal personally in the corporation’s securities during a period of non-disclosure.<sup>326</sup> Such a restriction frequently applies with respect to retirement funds.<sup>327</sup>

Section 306 of the Sarbanes-Oxley Act<sup>328</sup> prohibits insider securities transactions during pension fund blackout periods. The introduction of this section was intended, in part, to prevent corporate officers and directors from selling off company stock during a time when employees were prevented from selling company stock in their 401(k) retirement plans.<sup>329</sup> A former SEC chairman described the situation more colorfully, stating that investors were revolted by “[t]he spectacle of corporate insiders plundering their own companies or selling their stock quietly in advance of a looming collapse . . . .”<sup>330</sup>

When, as is the case of Chile, the regulatory framework rests on voluntary rather than mandated compliance, a real disincentive against insider trading does not exist truly exist.

#### F. *Compliance Programs*

U.S. self-regulatory organizations (SROs) have internal regulatory insider trading frameworks and are required to enforce member compli-

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324. *Id.* at 3.

325. Sarbanes-Oxley Act of 2002 § 306(a)(4)(A), 15 U.S.C. § 7201(a)(4)(A) (2012).

326. GOLDBERG, *supra* note 12, at 69-70 (citing SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968)).

327. See WANG & STEINBERG, *supra* note 20, §§ 12.1-2.

328. Sarbanes-Oxley § 306, 15 U.S.C. § 7201.

329. § 306(a)(1), *id.* § 7201(a)(1).

330. WANG & STEINBERG, *supra* note 20, § 12.2 (quoting S. REP. NO. 107-205, at 27 (2002)).

ance.<sup>331</sup> Individual SROs have the authority to impose fines, censure and expel members, and assess costs, subject to the right to appeal to the SEC.<sup>332</sup> In the wake of the 1988 ITSFEA and its imposition of substantial penalties, SROs and corporations developed even more robust internal compliance programs.<sup>333</sup>

Professional firms, such as accounting and law firms, financial intermediaries, such as advisers and banks, and publicly held companies should *all* focus on educating their employees of the rules and risks regarding insider trading, on implementing procedures to help prevent and detect abuses, and on adopting mechanisms to limit access to confidential information.<sup>334</sup> Furthermore, as previously discussed in Part II.A and II.C, so-called “Chinese Walls” are designed to control the flow of material, non-public information within firms. The SEC has taken positions on the efficacy of particular companies’ Chinese Walls in a number of cases and generally endorses their use in settlements.<sup>335</sup> A more widespread introduction of these walls would aid in containing the locus of inside information.

### G. Legislative Incorporation of Tipping

Some Chilean authors have criticized the SMA’s technique of punishing insider trading.<sup>336</sup> In their belief, the law hinges on a complex set of conduct requirements, which, in certain circumstances, can create generic and overbroad obligations such as the duties of abstention, custody, or control (i.e., ensuring that employees or third parties did not engage in banned conduct).<sup>337</sup> Criticisms also point towards the absence of general limitations on disclosure and non-recommendation or communication of information,<sup>338</sup> known in the United States as “tipping.”<sup>339</sup>

Some courts have determined that a tippee (the person receiving the tip), in trading upon the information received, may breach his duty to the investing public, though he has no legal duty or responsibility to the company in whose securities he is trading.<sup>340</sup> Other courts have taken the al-

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331. Press Release, U.S. Sec. & Exch. Comm’n, SEC Approves New Rule Requiring Consolidated Audit Trail to Monitor and Analyze Trading Activity (July 11, 2012), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171483188>.

332. WANG & STEINBERG, *supra* note 20, § 7.1.4.

333. See, e.g., Carlo V. di Florio, Dir., Office of Compliance Inspections and Examinations, U.S. Sec & Exch. Comm’n, The Role of Compliance and Ethics in Risk Management (Oct, 17, 2011), <http://www.sec.gov/news/speech/2011/spch101711cvd.htm> (referring to efforts to consolidate “a culture of ongoing improvement.”).

334. See generally WANG & STEINBERG, *supra* note 20, §§ 13.4-.7.

335. *Id.* § 13.5.2.

336. Vásquez Palma, *Caso LAN*, *supra* note 139, at 472.

337. *Id.*

338. *Id.*

339. See Prado Puga, *supra* note 112, at 248.

340. *Id.* at 59.

ternative view that a tipper (the person giving the tip) must breach a duty to the information source (e.g., an employer) in order to be liable.<sup>341</sup> That is, while some courts rely on the breach of a fiduciary duty between the tipper and the corporation, others do not establish this requirement and, thus, propose an expansive concept of tipping.

Given these considerations, the institution of tipping might become a genuine contribution for the study of eventual legislative amendments to the Chilean securities market. Crucial aspects in this regard would pivot around the following ideas:

(a) Tipping should occur not only be deemed to have occurred in the context of a “special relationship” between the inside trader (or tipper), the innocent party, and the issuer, but also when there is “misappropriation” of information. In this latter case, liability should arise when a person trades on or tips material nonpublic information in breach of a fiduciary duty to the information source. As a result, and in contrast to the “special relationship” situation, the party on the other side of the trade should be largely irrelevant to the question of liability, and the party harmed should be the source who had a justifiable expectation of confidence and loyalty.

(b) The concept of “insider” should cover not only an issuer, but also a corporation’s employees, officers, directors, shareholders, and even a individual shareholder, independent of amount of ownership.

(c) Formal collaboration or a conspiracy between the tipper and tippee should not be required. For example, a tippee could merely be eavesdropping on the tipper.

#### H. “Short-Swing Trading”

In the U.S., Section 16(b) of the 1934 Act is a technical provision that authorizes the recapture by a company of profits arising from short-swing trading in equity securities of the company by certain insiders.<sup>342</sup> The provision gives publicly held companies the right to recover any profit made by an officer, director or controlling shareholder<sup>343</sup> from purchase and sales that occur within six months of each other.<sup>344</sup> This Rule applies regardless of whether the trader possessed any material nonpublic information.<sup>345</sup> Section 16(b) liability runs to the corporation, meaning that any shareholder may file a derivative action on the corporation’s behalf if the corporation itself does not bring a suit.<sup>346</sup> This short swing trading provision was intended to protect the interests of the public against predatory

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341. See WANG & STEINBERG, *supra* note 20, § 4.5.2.

342. GOLDBERG, *supra* note 12, at 13 (describing a controlling shareholder as a beneficial owner of more than ten percent of any class of equity security of the corporation).

343. WILLIAM H. PAINTER, FEDERAL REGULATION OF INSIDER TRADING 24 (1968).

344. See LANGEVOORT, *supra* note 34, § 10:2.

345. *Id.*

346. PAINTER, *supra* note 343, at 15.

activities of directors, officers, and principal stockholders of corporations by preventing them from speculating in the stock of the corporations to which they owe a fiduciary duty. It is a prophylactic measure – intent is irrelevant, as is whether there was unfair use.<sup>347</sup>

Courts use the “lowest-in, highest-out” formula in these types of cases, matching the lowest price of securities purchase with the highest price at which they were sold to assure that the rule’s sting will be sufficient to deter short-swing trading by insiders.<sup>348</sup> Recoveries are, therefore, maximized under the statute, which is why Section 16(b) has acquired “quasi-penal” overtones.<sup>349</sup> Section 16(b) is similar in purpose to Rule 10b-5, since it addresses the informational advantage of insider status. However, Rule 10b-5 affixes liability only where actual misuse of material inside information is proven, whereas Section 16(b) is applied mechanically, irrespective of whether misuse of material inside information is shown.<sup>350</sup> In sum, the “*Short-Swing Trading*” formula could be a point of reference for future legislative amendments directed at curbing insider trading in Chile. The most important benefit that Chile could derive from the “*Short-Swing Trading*” formula lies in the introduction of the “lowest-in, highest-out” metric. In fact, use of this model to calculate damages in insider trading transactions would result in an improvement to the current situation, in which a judge relies primarily on formulas based in tort law that are ill-suited to the peculiarities of financial markets and financial transactions.

### I. *Inclusion of SEC’s Bounty Program*

The SEC’s arsenal of investigative mechanisms is vast and includes such measures as the oversight of securities markets through sophisticated computer programs and investigations of regulated entities of their own volition, upon a citizen’s request, and in cooperation with other government agencies.<sup>351</sup> The SEC also utilizes such tools as anonymous tips, press information, and the “bounty program.”<sup>352</sup> The bounty program permits the SEC to allocate up to 10 percent of the fines collected for the benefit of those who provided information conducive to the application of penalties. The rewards provided under the bounty program are completely discretionary and not subject to judicial review.<sup>353</sup>

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347. *Id.* at 25.

348. GOLDBERG, *supra* note 12, at 14, 18.

349. PAINTER, *supra* note 343, at 26.

350. GOLDBERG, *supra* note 12, at 14.

351. See generally *SEC Enforcement Actions Insider Trading Cases*, U.S. SEC. & EXCH. COMM’N, <http://www.sec.gov/spotlight/insidertrading/cases.shtml> (last visited June 19, 2014) (referencing examples of insider trading enforcement actions recently taken).

352. See *Office of the Whistleblower Final Orders of the Commission*, U.S. SEC. & EXCH. COMM’N, <http://www.sec.gov/whistleblower> (last visited June 19, 2014) (listing recent bounty payments made pursuant to SEC enforcement actions).

353. Sapp, *supra* note 32, at 18.

This reward system could be a useful means of increasing insider trading enforcement, or simply decreasing incidence of insider trading, in Chile. However, considering that the philosophical-judicial foundation of this type of program is intimately tied to the Anglo-Saxon notion of citizen enforcement for the compliance of law, the incorporation of such a program into the Chilean civil law system might be a tough pill to swallow and would require a thorough review and study of its feasibility and potential benefits, particularly in light of the fact that civil jurisdictions do not approve of punitive damages, contingent fees, or other similar methods of compensation.<sup>354</sup>

#### J. Reinforced Preventative Measures

A fast and easily implementable proposal would be to broaden the scope and application of precautionary measures, focusing primarily on access to corporate non-public information by unauthorized employees, in order to avoid additional incidence of insider trading in conjunction with the advent and increased implementation of new information technology (e.g., websites, electronic mail, and social media).<sup>355</sup>

#### K. “No Fault” Prosecutions

Finally, Chile might benefit from a serious consideration of the “*no fault*” agreements used by prosecutors in the US. Under these agreements, the investigated party accepts, without the admission or denial of the allegations made against the investigated person, certain administrative, civil and/or criminal penalties that might arise from the facts under investigation.<sup>356</sup> The SEC and Department of Justice rarely skimp on resources to carry out their securities investigations and legal prosecutions, prompting investigated parties’ eagerness to engage in these “no fault” prosecutorial agreements. Because the SEC and DOJ preserve their legal powers to obtain the defendants’ frozen assets, whatever their nature or location,<sup>357</sup> investigated parties have an even further incentive to agree to such an agreement. The U.S. “no fault” prosecutorial system seems to provide ad-

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354. See Dante Figueroa, *Conflicts of Jurisdiction Between the United States and Latin America in the Context of Forum Non Conveniens Dismissals*, 37 U. MIAMI INTER-AM. L. REV. 119, 148 (2005) (referring to the lack of acceptance of punitive damages and contingent fees in Latin America).

355. See *id.* at 7-9, 14-15.

356. See, e.g., SEC v. Hirsch, Lit. Rel. No. 15176, 1996 WL 693855 (Dec. 4, 1996).

357. See, e.g., SEC v. Certain Purchasers of Call Options of Duracell International, Inc., Lit. Rel. No. 15045, 1996 WL 546472 (Sept. 16, 1996); Lit. Rel. No. 15250, 1997 WL 54807 (Feb. 10, 1997). In this case, based on SEC’s request and on the same day when SEC’s action was presented, the court ordered the temporal freezing of the defendant’s assets. Unsurprisingly, this action motivated the defendant to reach a prompt agreement with the SEC, accepting multimillion civil penalties for its insider trading actions. The same outcome took place in the case SEC v. Certain Purchasers of the Common Stock of CBI Industries, Inc., Lit. Rel. No. 15020, 1996 WL 492277 (Aug. 22, 1996).

vantages for all parties involved and is a system which could be replicated in Chile, to the benefit of the Chilean securities market.

In sum, Chile's securities regulatory framework could derive important benefits from exploring and potentially adding the types of agreements, procedures, and statutory provisions explored in Section VI to its menu of insider trading enforcement mechanisms.

#### VIII. CONCLUSION

The regulation of the use of privileged information in Chile has undergone important transformations over the last twenty years due to a variety of factors. Chief among them are judicial cases of high public notoriety, as well as an increase in the corporate governance standards required of the country by the OECD.<sup>358</sup> The concept of insider trading has similarly expanded, but, more importantly, so has the acknowledgment that prosecuting wrongful insider trading is fundamental to the creation of a transparent and equal securities market for all participants.<sup>359</sup> In keeping with this trend, the Chilean Supreme Court has gradually lowered the threshold for the determination of whether insider trading exists in a particular case. For example, proof of actual damages is no longer necessary. The same court has decided that actual intent to use privileged information is no longer required to ascertain a wrongful use of insider trading.<sup>360</sup> The Chilean Supreme Court has quite clearly taken a huge step towards establishing a modified form of strict liability in insider trading cases, well beyond the explicit text of the current legislative framework.

However, further reform must occur. In the context of progressive regulation of insider trading in Chile, the courts, particularly, the Chilean Supreme Court, have played a pioneering and expansive role. Yet, in a democracy, such reform should be left to the legislature, not the judiciary, well-informed and well-intentioned as it may be. Accordingly, several key obligations or restrictions identified by the SVS should be upgraded from being voluntary to mandatory (e.g. black-out periods).

In the case of the United States, the prosecution of insider trading has increased during the last several decades. This evolution is evidenced by the expansion of insider trading liability to persons with a "derivate fiduciary duty"<sup>361</sup> and to individuals that may be remotely or unrelated to the

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358. *Reforma a Gobiernos Corporativos en Empresas Privadas [Reform to Corporate Governance in Private Companies]*, LA TERCERA (Apr. 13, 2009), [http://www.latercera.com/contenido/894\\_118457\\_9.shtml](http://www.latercera.com/contenido/894_118457_9.shtml); Jorge Barrera, *Reforma al Sistema de Empresas Públicas*, LA TERCERA (Sept. 10, 2013), <http://www.latercera.com/noticia/opinion/ideas-y-debates/2013/09/895-541879-9-reforma-al-sistema-de-empresas-publicas.shtml>.

359. See PFEFFER URQUIAGA, *supra* note 148, at 12.

360. Vásquez Palma, *supra* note 115, at 288 (citing Corte Suprema de Justicia [C.S.J.] [Supreme Court], 8 Marzo 2010, "Superintendencia de Valores y Seguros v. Cueto Plaza, Juan," Rol de la causa: 1044-2009 (Chile)).

361. Vásquez Palma, *supra* note 115, at 278.

company<sup>362</sup>—a clear divergence from the former requirement of a fiduciary relationship.

Chile would benefit most from avoiding crippling government intervention, as may be present in the United States. Chile should resist segregating certain activities related to the trading of securities (investment banking, commercial banking, financial intermediation, financial services, consumer services, etc.). A segregation of such activities would be analogous to using topical medicines to treat an addiction, rather than adopting a comprehensive therapy aimed at changing harmful practices.

Financial markets that function correctly are vital for a prosperous society to exist. Hence, there is a need to protect financial markets from both internal and external threats. When market agents behave in an irregular manner, they end up contaminating the rest of the market, leaving the door open for more stifling government intervention. The government and the entrepreneurial sector have a key role in protecting financial markets, and this is true for both Chile and the United States. To this end, the thriving Chilean financial market would benefit from some of the proposals to combat insider trading outlined in this paper.

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362. *See, e.g.,* United States v. Falcone, 257 F.3d 226 (2d Cir. 2001) (involving a night watchman who passed privileged information to a friend who later used it for his benefit).