SEC Charges Hao He with Insider Trading, for Some Reason or Another

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Here are two things about insider trading law: First, it's hard to know exactly what the parameters are. The United States doesn't have a specific statute prohibiting it. It grows out of the general anti-fraud provisions of the Exchange Act and the Securities Act, but the SEC and the courts over the years have outlined what insider trading is and how far one can go in that sphere. Second, it's not impossible to know what the parameters are. Clues are out there in the form of court cases and, for settled matters, complaints filed by the SEC in federal courts.

One such complaint was filed last Thursday in the Northern District of Georgia. In the litigation release for that complaint, we learn that on November 13 and 14, 2012, Hao He bought $162,000 of short-term put options in Sina Corporation. On November 15, Sina announced it had beaten analyst forecasts for third quarter earnings, but also announced unexpected negative guidance for the fourth quarter of 2012. As a result of this negative guidance, Sina's stock price declined approximately 8.5%, opening at $48.60 compared to the previous day's close of $53.10. The next day, He sold all of his put options for $331,530, generating illicit profits of $169,819. Okay, fine. But why was this illegal?

FACTS ACCORDING TO THE LITIGATION RELEASE

According to the litigation release, He "obtained material nonpublic information concerning Sina's upcoming, negative, future earnings guidance while visiting China and/or through phone calls to China." That's all we know. It may be worth noting here that it is perfectly legal both to visit and to make phone calls to China. Is He a Sina insider? An accountant or lawyer for the company? Is this a misappropriation case? You're not going to learn from the litigation release. The SEC hasn't posted the complaint along with the release, which is its usual practice. Strong forces encouraged me to stop there, but . . .

FACTS ACCORDING TO THE COMPLAINT

My curiosity overcame my laziness, and I pulled the complaint from PACER. In the complaint we learn:

"12. Between on or about October 10, 2012 and November 5, 2012, He traveled to Shanghai, China, the headquarters of Sina. On or about November 5, 2012, He returned to the United States, shortly after which he had several telephone conversations with an unknown person or persons in China.
13. During his visit to China and/or during those subsequent phone calls, He obtained material, nonpublic information concerning Sina's upcoming future guidance, directly or indirectly, from a Sina officer, director, corporate insider or other person with a duty of trust and confidentiality to Sina's shareholders. Such information was provided by the tipper to He with an expectation of personal benefit from the disclosure.
14. Alternatively, during his visit to China and/or during those subsequent phone calls, He misappropriated material, nonpublic information concerning Sina's upcoming future guidance from a person with knowledge of such information and to whom He owed a duty of trust and confidence."

MY TAKE

This is fairly baffling. The litigation release declines to discuss how the insider acquired this material, nonpublic information. The complaint, meanwhile, says, well, it could have been a tipping situation or it could have been a misappropriation. In failing to specify which, the SEC has missed an opportunity to educate the market on what it views as insider trading under Section 10(b) of the Exchange Act and Rule 10(b)(5). I think it has also given up some credibility when it didn't need to. This is a settled case, so at some level I suppose it doesn't matter. But what happened here? What was the discussion at the closed Commission meeting where the case was approved? Were the Commissioners aware the complaint would be this ambiguous?

Given the fairly intense doubts about the insider trading prohibition in some circles, and some thoughts that insider trading law is inappropriately vague, the Commission would be smart to make the facts about its cases clear.
Attachments:

Attachment	Size
news_178.pdf	20.28 KB
Hao He complaint.pdf	72.2 KB