



## Jury Verdict in “Spread Bet” Insider Trading Case: A Reminder of U.S. Long-Arm Regulatory Risk

*Posted by Daniel M. Hawke, Arnold & Porter Kaye Scholer LLP, on Wednesday, January 4, 2017*

**Editor’s note:** [Daniel M. Hawke](#) is a partner at Arnold & Porter Kaye Scholer LLP. This post is based on an Arnold & Porter Kaye Scholer publication by Mr. Hawke; the complete publication, including footnotes, is available for download [here](#).

Trading firms in the United Kingdom and elsewhere outside the United States should continue to monitor ongoing efforts by U.S. regulators to assert long-arm jurisdiction over their trading activities. That’s the implication of a jury verdict recently obtained by the U.S. Securities and Exchange Commission (SEC) in [SEC v. Sabrdaran et al.](#) against a U.K.-based trader who used spread bets to engage in insider trading in violation of the U.S. securities laws.

The SEC’s case appears to be the first insider trading case involving the use of spread bets to reach a trial verdict. The case is also significant because the SEC successfully established jurisdiction over spread bets originating in the U.K. as the equivalent of U.S. “domestic transactions” under *Morrison v. National Australia Bank, Ltd.* and because it proved that the spread bets were “in connection with the purchase or sale of [a] security” as required under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder (collectively, the “Exchange Act”).

In October 2014, the SEC [charged](#) Sasan Sabrdaran, a former employee of InterMune, Inc. residing in California, and Farhang Afsarpour, a close friend of Sabrdaran’s residing in Manchester, England, with insider trading. The SEC alleged that Sabrdaran tipped Afsarpour with information that InterMune’s application to market its drug Esbriet in Europe was progressing towards approval. Based on Sabrdaran’s tip, Afsarpour placed multiple spread bets, for himself and some of his friends, anticipating that the price of InterMune stock would go up based on news of the impending approval.

Afsarpour placed his spread bets through IG Index, a London-based firm offering spread bet products. IG Index then hedged Afsarpour’s bets by purchasing InterMune common stock and call options through a U.S.-based broker dealer. When the news of InterMune’s approval to sell its drug in Europe was announced, Afsarpour, on behalf of himself and his friends, realized profits of over \$1 million.

Spread bets are not “securities” but a leveraged derivative product whose value is based on the price of an underlying asset. Where the underlying asset is a security, a spread bet seeks to take advantage of anticipated moves in the price of the stock, up or downward, depending on the nature of the information on which the bet is placed. Spread betting is illegal in the United States. U.S. securities regulators have long worried that U.K. and other non-U.S. based traders seek to

use spread bets to avoid trading in the underlying security and thereby to circumvent the U.S. insider trading laws. The court docket in *Sabrdaran* reflects that the defendants mounted a vigorous legal and factual defense of their conduct, arguing that 1) the spread bet itself is outside the extraterritorial reach of the SEC under *Morrison* because it is not a “domestic transaction,” and 2) Afsarpour’s spread bets were not “in connection with” the purchase or sale of a security as required by the Exchange Act.

## The *Sabrdaran* Court Found *Morrison* Jurisdiction Over Afsarpour’s Spread Bets Because IG Index Hedged Them With InterMune Securities Bought in the United States

In the wake of the Supreme Court’s decision in *Morrison*, the law concerning the extent to which the Exchange Act reaches extraterritorial conduct continues to evolve, particularly as to transactions involving spread bets and Contracts for Difference (CFDs). In considering whether Congress intended the Exchange Act to apply extraterritorially, the *Morrison* Court found that the “focus” should not be “where the deception originated, but upon purchases and sales of securities in the United States.” It adopted a “domestic transactions” test in which courts assessing whether the Exchange Act reaches extraterritorial conduct must determine “whether the purchase or sale is made in the United States, or involves a security listed on a domestic exchange.” Courts applying *Morrison* to spread bets and CFDs have found that where the spread bet or CFD is hedged by a purchase or sale of securities in the United States, the “domestic transactions” test in *Morrison* is satisfied.

For example, in *SEC v. Compania Internacional Financiera S.A.*, an insider trading case in which the SEC alleged that an investor purchased CFDs based on material nonpublic information it received concerning an acquisition of a U.S. publicly traded chemical company, the court concluded that the CFDs were securities because the broker purchased “matching shares of the stock” in the U.S. market. Noting that the broker purchased the stock before pricing the CFD, the court found that “[b]ecause identical matched transactions occur in shares of the actual common stock immediately before the purchase or sale of the CFDs, any influence on the public market price of the underlying securities is also reflected in the price of the CFDs.” Thus, according to the *Compania* court, “the prices for CFDs are the prices for the common stock that is traded on the American exchange, and any profits or damages that holders of the CFDs experience are identical to those experienced by holders of the common stock.” Rejecting the investor’s argument that a defendant itself must transact in the underlying security to satisfy *Morrison*’s “domestic transactions” test, the *Compania* court found that “[t]his interpretation misreads *Morrison*, which never states that a defendant must itself trade in securities listed on domestic exchanges or engage in other domestic transactions.”

In *Sabrdaran*, defendant Sabrdaran moved to dismiss the SEC’s complaint on the grounds that Afsarpour’s spread bets were distinguishable from the CFDs in *Compania*. At the time Afsarpour opened his spread betting account, I.G. Index stated in its customer disclosures that “We may hedge our liability to you by opening analogous positions ... in the Underlying Market.” According to the SEC, “[w]hen hedging its risk by buying InterMune call options or common stock, IG index would not post the spread bet to Afsarpour’s account until after the firm had purchased the underlying securities in the U.S. market.” Sabrdaran replied that the SEC’s complaint was too “speculative” because it did not allege “whether IG Index hedged all of the bets, when IG Index hedges the spread bets and whether the spread bets were hedged after InterMune publicly

disclosed the Esbriet approval.” Differentiating these facts from *Compania*, Sabrdaran argued that “[t]he difference between this case and *Compania* is made more evident by the fact that the CFDs in *Compania* involved *identical matched transactions* in shares of the actual common stock *immediately before* the purchase or sale of the CFDs.”

Ordering the SEC to amend its complaint to add information concerning the timing of the hedging transactions relative to Afsarpour’s spread bets, the court nevertheless rejected Sabrdaran’s argument that the hedging transactions must identically match the placement of the spread bets. Rather, according to the court, the SEC “sufficiently alleged that Afsarpour’s spread bets ‘involved’ a security traded on domestic exchanges because IG Index actually bought call options in the underlying security before posting any of [Afsarpour’s] spread bets to his account.” Thus it appears that as long as a spread bet or CFD transaction “involves” a hedging position in the underlying security made through a U.S. exchange, the “domestic transactions” test in *Morrison* is satisfied.

### The Jury Found That Afsarpour’s Spread Bets Were “In Connection With” the Purchase or Sale of a Security

Prior to trial, the SEC moved for partial summary judgment on the issue of whether Afsarpour’s spread bets satisfied the “in connection with” requirements of the Exchange Act. At issue was whether the timing, sequence and circumstances of IG Index’s hedge transactions were sufficiently connected to Afsarpour’s spread bets themselves to meet the “in connection with” requirement.

The *Sabrdaran* court evaluated the case against the holding in *SEC v. Suterwalla*, a similar insider trading case involving spread bets in the U.K. In *Suterwalla*, the SEC charged a British stockbroker with insider trading based on spread bets placed through U.K.-based brokerage firms. The brokers hedged their risk by timely purchasing a corresponding amount of the underlying security when the spread bet was made and selling that position when the spread bet was sold. At issue in *Suterwalla* was whether the relationship between the defendant’s spread bets and the brokerage firms’ purchase of the underlying securities was “too attenuated” to satisfy Section 10(b)’s “in connection with” requirement.

Suterwalla argued that “the spread bet itself is complete and effective at the time the broker accepts payment for the bet [and that if] the broker independently and for its own benefit [buys the underlying stock], Suterwalla has no control over that separate transaction.” The SEC argued that the spread bets at issue “triggered the virtually contemporaneous purchase of a corresponding amount of [ ] securities by [the brokerage firms] to protect themselves from the significant financial risk” of the bets. The *Suterwalla* court compared the timing and value of the defendant’s spread bet transaction and the broker’s corresponding hedge position and found a “close connection” between the two. According to the court, “the connection between the insider trading and the spread bets is not so attenuated as to deprive the SEC of its’ enforcement authority over an individual in Britain.”

Consistent with *Suterwalla*, the *Sabrdaran* court found that the “SEC must prove that there was some nexus or relationship between the spread bets on InterMune stocks and the purchase of InterMune stocks themselves.” The court, however, denied the SEC’s motion for partial summary judgment on the “in connection with” issue because IG Index’s hedge positions did not appear as

closely correlated to Afsarpour's spread bets as the court in *Suterwalla* had found concerning the spread bets and hedge transactions in that case. For example, the *Sabrdaran* court observed that there were delays between the time Afsarpour placed his bets and IG Index purchased the InterMune securities; there was evidence that IG Index stated only that it "may" hedge Afsarpour's spread bets; and that IG Index did not always hedge Afsarpour's bets. As a result, at the summary judgment stage, the Court could not conclude that "every reasonable trier of fact would have to find Afsarpour's spread bets were made 'in connection with the purchase or sale of any security.'"

While defendants in *Sabrdaran* were successful in raising a triable issue of material fact concerning the sequence, timing and circumstances of Afsarpour's spread bets relative to IG Index's hedging transactions, the jury in *Sabrdaran* found that Afsarpour used material nonpublic information disclosed to him by Sabrdaran to "engage in [ ] transactions that were in connection with a purchase or sale of a security."

## Conclusion

U.K. and other European-based trading firms should continue to monitor efforts by U.S. regulators to assert jurisdiction over their trading activities. Given a favorable jury verdict in *Sabrdaran*, the SEC will likely continue to view spread bets and CFDs as extraterritorial activity well within its enforcement purview. Where a hedge position is established in the underlying U.S. security, extraterritorial challenges under *Morrison* appear to be unavailing. Challenges to the Exchange Act's "in connection with" requirement, however, may be more fruitful, if only to put the SEC to its burden of proving a relationship between the spread bet and hedge position and to otherwise disrupt the SEC's ability to tell a coherent story of tipping and trading at trial. Ultimately, however, the message of *Sabrdaran* is that individuals and firms entering into spread bets and CFDs should consider their exposure to the U.S. insider trading laws as having roughly the same degree of regulatory risk as if they had transacted directly in the underlying securities themselves.

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The complete publication, including footnotes, is available for download [here](#).