

**JURY VERDICT IN SEC “SPREAD BET” INSIDER TRADING CASE REMINDS U.K.
AND OTHER FOREIGN TRADING FIRMS OF U.S. LONG-ARM REGULATORY RISK**

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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 bets¹ 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.² 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.](#)³ 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)⁴ of the Securities Exchange Act of 1934 and Rule 10b-5⁵ 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.⁶ The SEC alleged that Sabrdaran tipped Afsarpour with information that InterMune’s application to market its drug Esbriet in Europe was progressing towards approval.⁷ Based on

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¹ A spread bet is an agreement in which the purchaser purchases from a counterparty the opportunity to profit from changes in the price of an underlying asset, such as an equity security or option.

² The SEC has brought other cases charging violations of the U.S. securities laws based on spread bets but those cases appear to have settled before reaching a contested adjudicated outcome. See [SEC v. One or More Unknown Purchasers of Call Options for the Common Stock of Petco Animal Supplies, Inc. and Taher Suterwalla](#), Case No. 06-CV1446 DMS (LSP) (S.D. Cal.), Lit. Rel. No. 20224 (Aug. 3, 2007) ([settled](#) September 15, 2008); [SEC v. Arnold McClellan and Annabel McClellan](#), Case No. CV-105412 (JCS)(N.D. Cal.); Lit. Rel. No. 21758 (Nov. 30, 2010) ([settled](#) October 25, 2011).

³ 561 U.S. 247, 130 S. Ct. 2869, 177 L. Ed. 2d 535 (2010) (“[Morrison](#)”).

⁴ 15 U.S.C. § 78j(b).

⁵ 17 C.F.R. § 240.10b-5.

⁶ [Securities and Exchange Commission v. Sasan Sabrdaran and Farhang Afsarpour](#), Civil Action No. 3:14-cv-4825 (JSC) (N.D. Ca., Oct. 30, 2014) (“[Sabrdaran](#)”).

⁷ [Sabrdaran](#), SEC Complaint, ¶¶ 25-33.

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.⁸

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.⁹ 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.¹⁰

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).¹¹ 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."¹² 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."¹³ Courts applying Morrison to

⁸ Id., ¶¶ 34-46.

⁹ Id., ¶ 35. The nature and timing of IG Index's hedge transactions became a central issue in the litigation. Afsarpour himself also directly placed a small order for InterMune stock through a brokerage account he opened in the United States. Id.

¹⁰ Id., ¶¶ 39, 46.

¹¹ Similar - though, not identical - to a spread bet, a CFD is a "security" where the purchaser acquires "the future price movement of the underlying company's common stock (positive or negative) without taking formal ownership of the underlying shares." Freudenberg v. E*Trade Financial Corp., No. 07 Civ. 8538 (RWS), 2008 WL 2876373 (S.D.N.Y. July 16, 2008) at 7.

¹² Morrison, 561 U.S. at 266.

¹³ Id. at 269-270; see J. Koury, Extraterritoriality For Securities Fraud Post-Morrison, 1 Emory Corp. Governance & Accountability Rev. 63 (2014)

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.¹⁴

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.¹⁵ 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.”¹⁶ 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.”¹⁷ 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.”¹⁸

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.¹⁹ 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.”²⁰ 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.”²¹ 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

¹⁴ SEC v. Compania Internacional Financiera S.A., No. 11 Civ. 4904 (DLC), 2011 WL 3251813 (S.D.N.Y. July 29, 2011)(“Compania”); SEC v. Maillard, No. 13-cv-4299 (VEC), 2014 WL 1660024 (S.D.N.Y. Apr. 23, 2014). In Maillard, the court suggested the theoretical possibility of a different outcome in “a case in which a CFD was purchased and the seller decided not to hedge the transaction by purchasing the underlying security. . . .” Maillard, at 2 (emphasis added).

¹⁵ Compania at 3 citing Freudenberg, *supra*.

¹⁶ Id. at 3 (citation omitted).

¹⁷ Id. (citation omitted).

¹⁸ Compania, at 6.

¹⁹ See Sabrdaran, Court Docket Entry # 21, Sabrdaran’s Motion to Dismiss, filed 01/12/2015.

²⁰ Sabrdaran, SEC Complaint, ¶ 37.

²¹ Id., ¶ 38.

bets were hedged after InterMune publicly disclosed the Esbriet approval.”²² 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.”²³

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.²⁴ 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.”²⁵ 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.²⁶ 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.²⁷

The Sabrdaran court evaluated the case against the holding in SEC v. Suterwalla,²⁸ 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

²² Sabrdaran, Court Docket Entry # 32, Sabrdaran’s Reply Memorandum in Support of its Motion to Dismiss, at 10.

²³ Id. (Emphasis in original)

²⁴ See Sabrdaran, Court Docket Entry # 36 filed 03/02/15 (Order Granting In Part Motion to Dismiss and Denying Motion to Strike)(hereinafter “Sabrdaran Order”) at 20 (citing Morrison).

²⁵ Sabrdaran Order at 24 citing Morrison, 561 U.S. at 269-70.

²⁶ Sabrdaran, Court Docket Entry # 66 filed 07/21/16 (SEC’s Motion for Partial Summary Judgment).

²⁷ On the SEC’s motion for partial summary judgment, the parties also litigated the question of whether knowledge is an element of the “in connection with” requirement. The court found that “Afsarpour’s knowledge of the . . . [spread bet’s] connection to the purchase or sale of a security [] while certainly potentially relevant, is not an element of the ‘in connection with’ requirement.” Sabrdaran, Court Docket Entry # 99 filed 09/14/16 (Order Denying Plaintiff’s Motion for Partial Summary Judgment (2016 WL 4791771))(“Sabrdaran Summary Judgment Denial Order”) at 2.

²⁸ No. 06-CV1446 DMS (LSP), 2008 WL 9371764 (S.D. Cal. Feb. 4, 2008)(Suterwalla).

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.²⁹

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."³⁰ 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.³¹ 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.³² 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."³³

Consistent with Suterwalla, the Sabrbaran 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."³⁴ 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.³⁵ For example, the Sabrbaran 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.³⁶ 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.'" ³⁷

While defendants in Sabrbaran 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 Sabrbaran found that Afsarpour used material nonpublic information disclosed

²⁹ Suterwalla, at 3.

³⁰ Id.

³¹ Id.

³² Id.

³³ Id.

³⁴ Sabrbaran Summary Judgment Denial Order at 2.

³⁵ Id. at 3.

³⁶ Id.

³⁷ Id.

to him by Sabrdaran to “engage in [] transactions that were in connection with a purchase or sale of a security.”³⁸

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.

³⁸ Sabrdaran, Court Docket Entry # 165 filed 11/14/16 (Verdict Form) at ¶ 5.