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Court Rules Internal Affairs Doctrine Bars California Insider Trading Claim

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California, unlike the federal government, has codified its prohibition on insider trading. Corporations Code Section 25402 provides:

"It is unlawful for an issuer or any person who is an officer, director or controlling person of an issuer or any other person whose relationship to the issuer gives him access, directly or indirectly, to material information about the issuer not generally available to the public, to purchase or sell any security of the issuer in this state at a time when he knows material information about the issuer gained from such relationship which would significantly affect the market price of that security and which is not generally available to the public, and which he knows is not intended to be so available, unless he has reason to believe that the person selling to or buying from him is also in possession of the information."

The courts, however, have been divided on whether Section 25402 applies to issuers organized under the law of another jurisdiction. Two U.S. District Court Judges have concluded that the internal affairs doctrine bars claims under Section 25402. *In re Sagent Technology, Inc. Derivative Litigation*, 278 F. Supp. 2d 1079 (N.D. Cal. 2003) and *In re Wells Fargo & Co. S'holder Deriv. Litig.*, 282 F. Supp. 3d 1074 (N.D. Cal. 2017). However, a California Court of Appeal reached the opposite conclusion and at least two other District Court rulings are in agreement. *Friese v. Superior Court of San Diego County*, 134 Cal. App. 4th 693 (2005); *In re VeriSign, Inc., Derivative Litig.*, 531 F. Supp. 2d 1173 (N.D. Cal. 2007) and *In re Maxim Integrated Prods.*, 574 F. Supp. 2d 1046 (N.D. 2008).

Most recently, Judge Haywood S. Gilliam Jr. ruled that the internal affairs doctrine does bar derivative claims under Section 25402 when the corporation is not incorporated in California. *In re Facebook, Inc. S'holder Derivative Privacy Litig.*, 2019 U.S. Dist. LEXIS 48334 (N.D. Cal. 2019). Judge Gilliam's ruling cites *Sagent* and *Wells Fargo* but makes no mention of the contrary rulings in *Friese*, *Verisign* or *Maxim*.

For more on California's insider trading law, see my article, *California's Unique Approach to Insider Trading Regulation*, 17 Insights 21 (July 2003).

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