



# The Ins and Outs of Insider Trading Compliance



**Ara B. Gershengorn**  
**Foley Hoag LLP**  
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# The Government on Insider Trading

- “We have witnessed the most educated, successful, and monied professionals in the country put their companies — not to mention their own liberty — at risk by engaging in flagrant and foolhardy illegal conduct.”  
--- Preet Bharara (US Atty SDNY) (7/23/2012)
- “When [these defendants] chose to traffic in inside information involving high-tech companies, they embarked on a high-stakes game that has repeatedly proven to be unwinnable.”  
--- Preet Bharara (3/29/ 2013)
- “The FBI is committed to investigating allegations of insider trading and holding its beneficiaries accountable.”  
--- Bill L. Lewis  
(Ass’t Dir. In Charge, FBI Los Angeles Field Office) (4/11/2013)
- “Insider trading undermines ordinary investors’ faith in our financial markets, and the Justice Department has zero tolerance for it.”  
--- Mythili Raman  
(Acting Assistant Attorney General, Criminal Division)  
(4/16/2013)

# Insider Trading Basics

- Basic Definition: Trading on the basis of material, non-public information (“MNPI”) that was acquired in breach of a fiduciary relationship or other position of trust and confidence, in exchange for a personal benefit
  - Trading = buying, selling, taking a short position, etc.
  - Material = substantial likelihood a reasonable investor would want to know before buying or selling
  - Non-Public = not in the public domain

# Insider Trading Basics (cont.)

- Fiduciary Relationship = wide range, including lawyers, consultants, investment bankers and even an electrician
- Personal Benefit = includes intangibles, even a tipper perceiving advancement in relationship with the tippee
- Liable Individuals = the “tipper” (the person involved in “tipping” information to others), and the “tippee” (the person who receives the information)

## Insider Trading Basics (cont.)

- Classical Theory: Use of confidential information by a “Corporate Insider” or “Temporary Insider”
- Misappropriation Theory: Misappropriation of confidential information by an “outsider” in breach of a duty owed to the information source
- Civil prosecution by the SEC: Penalties may include substantial monetary payments and bars from certain positions at a broker-dealer or public company
- Criminal prosecution by the Department of Justice: Penalties may include substantial monetary payments and jail or probation
- There are significant differences between civil and criminal cases

- “material” and “non-public” information
  - Materiality:
    - a judgment call with many shades of grey – there is no bright line test
    - often judged in hindsight – if the stock price moves when the information is disclosed, it is an uphill battle to argue it is not material
    - may include information that seems immaterial but is pieced together to make it material (*Moore*)
  - “Non-public”:
    - Assume information is “non-public” unless you know it has been widely disseminated to investors and investors have had time to absorb the news

# Examples from Recent Cases

## ■ Material, Non-Public Information

- CFO receives reports stating that revenue and sales were down and behind prior year's performance. CFO tips friend that company had "worse-than-expected performance" and friend shorts company's stock. (*Chellam* Complaint)
- Before Marvell announcement: "Marvell's revenues for the quarter would be approximately \$805 million and that its gross margins would be 53%" (*Jiau* Complaint)
- Before AMD announcement, "we're goin' be about 1.8 [billion in the second quarter.]" "I've got a buddy that works in, in finance, that ... gives ... nitty gritty details...." (*Longoria* Complaint)
- Email message: "ATHR: Q2 better than expected, over 105M. GM ok. Q3 internal target at 123M, guidance pending ?115 or so? ... Have fun!" (*Chu* Complaint)

## Examples from Recent Cases (cont.)

- Breach of Duty by Outsider
  - “Flextronics and certain Flextronics employees were provided with information and forecasts regarding Apple purchase or shipping orders regarding Flextronics components, as well as information regarding alternative suppliers for Apple products. The disclosure of this kind of information was governed by non-disclosure agreements executed between Flextronics and Apple.”
  - “Apple often shared information with Flextronics about future Apple products under development. The disclosure of this information was also governed by a separate non-disclosure agreement ....”  
(*Shimoon* Complaint)



# But will anyone know?

## ■ Yes

- Regulators use computer programs to track unusual trading surrounding any market-moving event
- Regulators request companies to disclose the names of all individuals who were in possession of the key information, and these people get a call from an investigator and are asked who they spoke to. Then the next round of people get a call from an investigator and are asked who they spoke to ....
- More expansive examinations of newly registered hedge funds
- Expanded use of wiretaps and other investigatory techniques
- Defendants caught “dead to rights” seek to reduce their penalties by cooperating against anyone they know
- Prosecutors are focused on insider trading; it is a felony

# What is catching the government's eye?

- 10b5-1 Plans
  - Initially designed to allow executives to schedule in advance when to buy or sell securities, how much and at what price
    - Has to be entered into before possessing material, nonpublic information
    - Does not have to be disclosed to the SEC
    - Details are generally not known to the public
  - Historically served as an affirmative defense to insider trading
  - **BUT...**
  - DOJ is “reviewing these practices further” and directors can expect to see enforcement actions relating to these plans “coming down the pipe.” – (Patrick Sinclair, U.S. Attorney EDNY, April 2013)
  - Subpoenas sent to three companies and three investment funds in the past two months

## ■ Expert Networks

- Firms link investors up with paid industry/company experts
- “Professionals need to consult with other professionals to learn and make better decisions, especially as the business environment becomes more not less complex. That’s true for all of our clients — investors, corporations, law firms, nonprofits.” (Gerson Lehman CEO, Alexander Saint-Amand)

## ■ **BUT...**

- Provides an opportunity for the sharing of inside information
- Conversations are often with technical/scientific personnel
- *United States v. Martoma; SEC v. CR Intrinsic Investors, LLC et al.*

**Ara B. Gershengorn, Partner  
Foley Hoag LLP  
Seaport West  
155 Seaport Boulevard  
Boston, MA 02210  
(617) 832-1260  
[agershengorn@foleyhoag.com](mailto:agershengorn@foleyhoag.com)**