

CORPORATE AND SECURITIES LAW

Alert

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The SEC's Expanding Dragnet for Insider Trading

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After just six months in office, Chairman Mary Shapiro appears to be making good on her promise to reinvigorate SEC enforcement. The SEC can boast a dramatic increase in enforcement actions this year to date. In general, the SEC's enforcement agenda tracks the headlines of the financial crisis, with insider trading cases taking a prominent position.

- *Insider Trading: Not Just for Stocks Anymore*

Several recent SEC actions make it clear that stocks are not the only securities being targeted in insider trading actions; both credit default swaps and Treasury bonds are also fair game. In *SEC v. Rorech, et al.* (S.D.N.Y. May 5, 2009), Jon-Paul Rorech, a salesman at Deutsche Bank, is accused of violating Section 10(b) and 10b-5 of the Securities Exchange Act of 1934 by sharing material, nonpublic information about a change in a company's bond structure that would increase the value of its credit default swaps. Allegedly, Rorech unlawfully shared this insider information with a portfolio manager at a hedge fund investment adviser, who in turn used the information to purchase and later sell credit default swaps for a substantial profit. Rorech is the first case in which the SEC has alleged insider trading in credit default swaps.

The question of whether the SEC has jurisdiction over credit default swaps remains to be settled. Regardless, *Rorech* is indicative of the SEC's increased willingness to test the boundaries of insider trading laws.

Like credit default swaps, United States Treasury bonds are seldom associated with insider trading. Nonetheless, a Boston jury recently found that Steven Nothern, a manager of seven fixed income mutual funds, unlawfully traded in U.S. Treasury bonds after receiving material, nonpublic information from a Washington D.C. consultant. The consultant attended the U.S. Treasury Department's quarterly refunding press conference and explicitly agreed to maintain the confidentiality of the information he learned there for 35 minutes after the conference concluded. Despite his agreement, the consultant immediately provided the information to Northern, who was aware of its confidential nature and original source. Northern then proceeded to trade on the information, reaping substantial profits. Remedies against Northern have yet to be set, but *SEC v. Northern* (Mass. Dist. Ct. June 22, 2009) provides a clear example of the broad net the SEC is casting in its insider trading investigations and actions.

- *The “Not Necessarily” Safe Harbor of Rule 10b5-1 Plans*

Another recent SEC action illustrates the perils of relying too heavily on the safe harbor of a Rule 10b5-1 plan. In *SEC v. Mozilo* (C.D. Cal. June 4, 2009), the SEC filed a complaint against Angelo Mozilo, the former CEO of Countrywide Financial, alleging that he engaged in insider trading by selling Countrywide stock based on nonpublic information about the company’s exposure to credit risks. Although Mozilo carried out each of the trades in question pursuant to 10b5-1 plans, he allegedly instituted and implemented the relevant 10b5-1 plans while in possession of material, nonpublic information. He is also alleged to have amended one of the plans to his favor while in possession of such information.

Mozilo highlights the SEC’s readiness to test the integrity of 10b5-1 plans and the need for plans that can withstand such a challenge.

- *Mark Cuban Responsible for a New Standard of Confidentiality Agreements?*

Dallas Mavericks owner Mark Cuban recently challenged the SEC’s aggressive approach to prosecuting insider trading cases. The allegations against Cuban arose in connection with a phone call he received from the CEO of a public company in which Cuban owned a significant stake. After Cuban allegedly agreed to keep information shared during the call confidential, the CEO disclosed the company’s plan to announce a PIPE offering. Displeased with the plan, Cuban liquidated his entire position in the company later the same day, avoiding substantial losses by doing so in advance of the PIPE announcement. In response, the SEC filed *SEC v. Cuban* (N.D. Texas July 17, 2009).

Cuban’s motion to dismiss was granted by a Dallas district court on grounds that could have important consequences for insider trading law, if the decision is upheld on appeal. The court found that Cuban did not misappropriate confidential information in violation of insider trading laws because he did not agree to refrain from trading on the confidential information he received. Since Cuban (a third party) did not owe a fiduciary duty to the company, the court reasoned that a confidentiality agreement would only prohibit insider trading if it explicitly or implicitly included both an agreement not to disclose and an agreement not to trade.

While each of the cases discussed above provides its own lesson, the most important takeaway is that the SEC’s vigorous pursuit of insider trading violations merits heightened sensitivity by those subject to the federal securities laws.

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