

DISCUSSING THE TRENDS

Q&A with Christopher Clark and Matthew Salerno

Insider Trading Investigations: What To Watch for in 2014

March 3, 2014

Christopher Clark is a partner at Latham & Watkins where he represents public companies, alternative investment entities such as hedge funds, and individuals in both criminal and civil investigations involving state and federal law enforcement authorities. Matthew Salerno is an associate at Latham and a member of the firm's Litigation Department.

Clark and Salerno successfully defended entrepreneur and Dallas Mavericks owner Mark Cuban at trial against insider trading allegations brought by the U.S. Securities and Exchange Commission (SEC).

In this interview Clark and Salerno talk about what developments to watch for in 2014 related to insider trading-related enforcement actions.

Do you anticipate more SEC administrative adjudications of insider trading in 2014?

Clark: Yes. The SEC has had a number of highly publicized failures in federal district court trials. There is a substantially different process in an administrative proceeding, which provides the SEC with a lot of advantages. The first advantage of an administrative proceeding is that the facts are not found by a jury, they are found by an SEC administrative law judge — who is an SEC employee. You can imagine that the SEC does better under this circumstance than they might do with a jury of American citizens.

Administrative proceedings provide the SEC with other advantages, including limiting the discovery available to the opposing party, speeding up the pace of the litigation, and having the backstop of de novo review by the Commission if the SEC staff doesn't like the administrative law judge's decision. Finally, recent legislative changes now give the SEC greater flexibility to pursue remedies in administrative proceedings that it historically could only obtain in federal district court. As a result, there is very little downside to the SEC bringing such cases as administrative proceedings.

We started seeing the SEC's strategic shift toward more administrative proceedings in 2011, around the time when the SEC attempted to bring an insider trading case against Rajat Gupta as an administrative action rather than through the federal courts. More recently, the SEC chose to bring its case against SAC Capital founder Steve Cohen for failure to supervise as an administrative proceeding as well. Given both the advantages of administrative proceedings and some of the SEC's more recent strategic choices, we expect to see a continued shift toward SEC administrative proceedings in 2014.

What impact has Operation Perfect Hedge had during the past six or seven years?

Salerno: Operation Perfect Hedge was a sting set up by the federal government beginning in 2007-2008. The investigation was prompted by observations that profits at many hedge funds dramatically outpaced those in the broader market. Investigators had suspicions that these disproportionate profits could be the result of insider trading, and they began to dig deeper.

Through one of the first uses of wire-tapping targeting insider trading, investigators began to uncover a series of networks and channels through which information flowed from insiders to various financial institutions. The sting branched out into the largest insider trading investigation in about 25 years, and the largest ever focused on hedge funds. Arrests began in 2009 but the operation was not publicly acknowledged until nearly 50 individuals had been arrested in 2011. The large network of informants and wiretaps amassed between 2007 and 2011 has so far resulted in insider trading charges against 83 individuals and four entities.

The success rate of the operation has been pretty staggering. The Southern District of New York (SDNY), which has taken charge of prosecuting most of these cases, remains undefeated since August 2009 with 79 guilty pleas or convictions.

Do you expect to see continued activity related to Operation Perfect Hedge in 2014?

Salerno: There are a number of things to watch for throughout 2014 related to Operation Perfect Hedge. The government has said it intends to bring a number of other cases this year based off the evidence it has collected, and many questions remain about who the government is looking to charge next. At the end of 2013, one of the nation's largest hedge funds, SAC Capital, plead guilty to insider trading. Separately, eight current and former SAC employees have been convicted or pled guilty to insider trading. The big question that will be answered in 2014 is whether SAC's founder, Steven Cohen, will be the next person to face insider trading charges as a result of Operation Perfect Hedge.

In addition to charging decisions, a number of pending appeals in the Second Circuit are expected to be resolved in 2014. Those appeals address a broad range of issues raised by Operation Perfect Hedge, from the propriety of the tactics used to investigate insider trading to the very definition of insider trading itself.

What activities can we expect to see related to Insider Trading 2.0?

Salerno: Insider Trading 2.0 is a term coined by New York Attorney General Eric Schneiderman in 2013 to broadly describe a number of activities that could allow individuals or institutions to obtain an advanced look at market moving information. Thus far, Mr. Schneiderman has sought to prohibit the early release of consumer sentiment reports to high-frequency traders, even where such early release was as little as two seconds. He has also sought an end to advanced surveying of analysts to measure changes in analyst sentiment because such surveys could lead to information related to broader market shifts. From a legal perspective, there is a serious debate as to whether such conduct even falls under the traditional definitions of insider trading. This debate notwithstanding, the Attorney General has already achieved some success in curtailing these practices and 2014 will likely see additional activity on this front.

Clark: All companies should have a strong awareness of the associated issues stemming from insider trading and have insider trading policies in place to address them. Those institutions that don't should be talking to an experienced advisor immediately.

CONTACTS

Christopher J. Clark
New York
T +1.212.906.1350
christopher.clark2@lw.com

Matthew S. Salerno
New York
T +1.212.906.4738
matthew.salerno@lw.com

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