FOCUS ON

INSIDER TRADING

Howard Schiffman, partner at Schulte Roth & Zabel LLP, offers a legal insight into the industry crackdown on insider trading activity

Howard Schiffman is a partner at Schulte Roth & Zabel LLP (SRZ), where he serves as head of the Washington, DC office and co-chair of the firm's Litigation Group. He is a former SEC prosecutor working in white collar criminal defence, securities litigation and government investigations. SRZ is a full-service law firm with offices in New York, Washington, DC and London.

HFMWEEK (HFM): HOW EFFECTIVE DO YOU THINK THE SEC HAS BEEN AT COMBATING ILLEGAL INSIDER TRADING?

HOWARD SCHIFFMAN (HS): We closely monitor SEC developments as we routinely handle matters representing financial and investment management companies and their officers involved in investigations brought by the SEC, as well as other regulatory agencies. From that perspective, I believe last fall's verdict in the Mark Cuban case, and some other recent trial defeats for the SEC, have certainly tarnished the agency's reputation as the insider trading "sheriff", especially when juxtaposed with the Southern District of New York US Attorney's Office's nearly perfect record in its prosecutions under Preet Bharara.

However, the SEC has dozens of insider trading settlements and wins for every one of its losses, and the agency often assists the FBI and US attorneys with their investigations and prosecutions. Therefore, it would be a big mistake to discount the agency's continued willingness and ability to pursue both actual and potential insider trading cases.

HFM: FROM A LEGAL PERSPECTIVE, HOW CHALLENGING IS IT TO PROVE INSIDER TRADING?

HS: Of course, it depends on the case, and the critical point is during the investigation rather than after charges are brought. We have been successful in convincing prosecutors not to file cases by showing that there were benign reasons for the trading and by highlighting the government's lack of proof as to the precise content and timing of the information that was allegedly passed.

If, however, the government has co-operating witnesses (as it often does) who admit to providing tips of confidential information regarding their employers or clients, and to being paid by the tippees for doing so, then it is not terribly difficult to prosecute the direct tippees who traded on that information. But the cases can be quite challenging for the government if the source of the information does not co-operate and there is no wiretap evidence, as it becomes much more difficult to prove that the tippee knew the tipper was breaching a fiduciary duty.

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HFM: WHAT AREAS DOES SCHULTE ROTH & ZABEL LLP COVER IN TERMS OF INSIDER TRADING CASES?

HS: I serve as co-chair of Schulte Roth & Zabel's Litigation Group and we are well known for our strengths in white collar criminal defence and government investigations, including insider trading cases. In fact, I began my career as a trial attorney with the SEC Division of Enforcement, and our team of litigators also includes eight former federal prosecutors and a former regulatory counsel for a major investment banking institution.

We have tremendous experience counselling private fund managers and other clients in three main areas: (1) creating and implementing procedures to reduce the risk of actual and perceived insider trading within their organisations, (2) navigating government insider trading investigations and (3) litigating the relatively rare insider trading cases that wind up being prosecuted.

> ONE OF THE BIGGEST RISKS TO ACTIVIST INVESTORS IS THAT THEIR REPRESENTATIVES ON CORPORATE BOARDS PROVIDE THEM WITH NON-PUBLIC INFORMATION

> THE PACE AND BREADTH OF THE GOVERNMENT'S ASSERTION OF INSIDER TRADING CLAIMS IN THE PAST FEW YEARS HAS BEEN GREATER THAN WE'VE SEEN IN PROBABLY A GENERATION OR MORE

HFM: WITH THE COMPLEXITIES OF INSIDER TRADING LAW, DO YOU FIND SOME FIRMS ARE UNAWARE OF WHAT IS LEGITIMATE/ILLEGITIMATE RESEARCH?

HS: People know the difference. The question is whether they have policies and procedures that help distinguish between expert consultants who provide general industry or country information, which is legal, and those who provide material non-public information about particular companies, which is not. For example, procedures might include tracking and limiting the number of contacts with an expert network. It is easy to understand two contacts per year; it is more difficult to understand why there would be four contacts per year that always occur right before quarterly earnings announcements. Where there are more than just a couple of contacts, additional procedures should be employed.

HFM: A NEW REPORT SHOWS THAT 25% OF PUBLIC DEALS MAY INVOLVE INSIDER TRADING. AT SCHULTE ROTH & ZABEL LLP HAVE YOU SEEN AN INCREASE IN INSIDER TRADING CLAIMS?

HS: The pace and breadth of the government's assertion of insider trading claims in the past few years has been greater than we've seen in probably a generation or more. While I think that's more a reflection of changing enforcement priorities than changing behaviour in the marketplace, the fact that regulators now think they're seeing insider trading around every corner means that even innocent, well-timed trading runs the risk of becoming the subject of an investigation, or worse.

HFM: HOW IS THE ACT OF INSIDER TRADING CHANGING WITH THE PREVALENCE OF ACTIVIST INVESTORS?

HS: One of the biggest risks to activist investors, from an insider trading perspective, is that their representatives on corporate boards or other sources of access provide them with non-public information. That, in turn, prevents them from reducing or increasing their stakes in the companies without disclosing the information, which they usually are prevented from doing by contract or by virtue of fiduciary duties. Meanwhile, the reports from a few months ago of the government investigation involving Carl Icahn and Phil Mickelson raise a separate issue – the possibility that some regulators may view an investor's own trading intentions as material non-public information that he or she cannot privately disclose to others who then trade. That is currently not the law, but if some regulators think it is, that could be troubling.

HFM: HOW ARE NEW TECHNOLOGIES HELPING TO DETECT INSIDER TRADING?

HS: The examinations have become much more aggressive, and the examiners are using greater analytical tools than they were previously. For example, this past March, the SEC began using its new National Exam Analytics Tool (NEAT) which was developed by leading researchers to analyse patterns of trading. It is a more sophisticated tool than is currently available commercially to the industry, and I expect that it will increase the number of well-timed trades that the SEC identifies, and then investigates, for possible insider trading. ■