
Its been almost two and a half years since Galleon's Raj Rajaratnam was arrested, and since then the spotlight on insider trading has not gotten any less bright. What also hasn't changed is the investment community's uncertainty as to just where the lines are being drawn by the government in bringing insider trading cases. In particular, investors and research providers remain worried that what was commonly accepted research might now be viewed as crossing the line.

What has obviously changed are the government's investigative tactics. Wire taps, recorded conversations, and cooperating witnesses are all new to law enforcement in the investment management industry. However, the law of insider trading – be it legislation, administrative rules or judicial decisions – has not changed in any meaningful way in the past two and a half years. Rather, the uncertainty over where the insider trading “lines” are being drawn arises for at least two other reasons. First, the government has brought many of the recent “insider trading” cases as wire fraud and conspiracy cases. These charges are not insider trading charges and have different legal requirements. For example, wire fraud does not require that information be “material” in the insider trading sense of the word and does not even require trading. Conspiracy requires little more than an agreement to try to do something illegal, it does not require anyone to actually engage in illegal insider trading. The media's blurring of the distinctions between these non-insider trading charges and actual insider trading cases is one reason for the uncertainty over changing standards.

Second, the definitions of key aspects of insider trading law have never been well defined and give the government wide discretion to bring colorable claims that in the past were not brought. In particular, the words used to define “materiality” in insider trading law are quite general and arguably open to broad interpretations. In the past the government brought cases in situations where the information was usually quite clearly material (*i.e.*, the stock price moved meaningfully after the specific information in question was publicly released). However, the government might become more aggressive in its view of the “material information” on which it is appropriate to base an insider trading action. Only time will tell if the government goes down this path (and then it will require the courts to decide if the information is actually material for insider trading purposes).

While only one case, the parallel complaints filed by the Justice Department and the Securities and Exchange Commission on January 18, 2012, show the government to be staying within the bounds of traditional notions of insider trading (*SEC v. Adondakis, et al.* and *U.S. v. Newman, et al.*). Although only allegations at this point, the complaints paint a picture of traditional and seemingly clear cut insider trading. It is alleged that company insiders disclosed quarterly revenue and gross margin numbers to traders before the information was publicly available. The traders were alleged to have then profited by trading around the companies' quarterly earnings announcements. It is difficult to argue that actual quarterly revenue and gross margin numbers are not material (although materiality is contextual), and basing an insider trading case on such information is consistent with decades of insider trading cases. Likewise, and although potentially more complicated, it is hardly a stretch for the government to allege that the traders knew the employees were breaching confidentiality obligations or other duties in disclosing this type of information. While it is foolish to read too much into just one case, the recent complaints do not show an effort by the government to stretch the definition of insider trading.

That said, these cases do not mean that traders and research providers should in any way relax their compliance vigilance. The best preventative measures remain a strong compliance program, based on well thought out policies and procedures that are tailored to the firm's actual business practices, substantive education of insider trading issues for employees, and a culture of compliance and ethical behavior.

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