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Insider Trading Case Highlights Government Focus on Hedge Fund Activities

A recent insider trading case against a doctor who was involved in clinical trials of a drug to treat hepatitis and allegedly tipped material, non-public information relating to those trials to a hedge fund manager, is another example of the government's renewed focus on insider trading and hedge funds.¹ This case is noteworthy because it highlights the potential areas of abuse of sensitive clinical trial information in the pharmaceutical and life sciences areas. Given the recent government inquiries issued to pharmaceutical and life sciences companies relating to the Foreign Corrupt Practices Act, this action highlights another area of concern for public companies in those industries. Further, it brings into focus the potential areas of abuse in hedge fund relationships with consultants who have known connections with the publicly traded pharmaceutical and life sciences companies they trade.

Background

A French doctor served on a steering committee for a pharmaceutical company that oversaw the clinical trials of an experimental drug related to hepatitis. The government alleges that the doctor, as a member of that steering committee, possessed sensitive inside information regarding the results of the clinical trials and the drug's effectiveness. The government also alleges that while serving on the steering committee, the doctor had consulting arrangements with hedge funds and other investors that purchased and sold healthcare-related securities. Pursuant to his contractual relationship with the pharmaceutical company, the doctor owed a duty to hold information learned regarding the clinical trials in strict confidence. Further, pursuant to the consulting agreements with hedge funds, the doctor was prohibited from disclosing confidential information to his consulting clients. The government's complaints allege that based on negative information regarding the clinical trials received from the doctor, the portfolio manager caused six hedge funds that he co-managed to sell their shares of stock in the pharmaceutical company just prior to the public release of negative information regarding the clinical trials. By doing so, the hedge funds are alleged to have averted \$30 million in losses.

On the criminal securities fraud charges, the doctor faces a maximum combined sentence of 25 years in prison. On the civil side, the doctor could be held liable for \$30 million, representing the losses averted by the portfolio manager/co-conspirator. The SEC is seeking disgorgement of ill-gotten gains, along with prejudgment interest and a financial penalty. Although the government has not brought any formal charges against the hedge fund manager, the manager is described by the criminal authorities in the criminal complaint against the doctor as a co-conspirator.

Impact

As mentioned above, this case highlights the government's renewed focus on insider trading and its focus on the trading activities of hedge funds. It is also another area of concern for public companies in the pharmaceutical and life sciences industry. The relevance of this case, however, is not limited to those industries, but to any industry in which sensitive trial or testing information is available, such as technology and energy companies. Public companies in these areas should be mindful of the potential for the abuse of sensitive testing data and should review their insider trading policies as well as review their relationships and agreements with experts involved in such testing.

Additionally, hedge funds should be aware of the serious risks in obtaining and trading on information from consultants with known ties to the public companies that the hedge fund may trade. As highlighted in recent press reports, the government is conducting a wide-ranging insider trading investigation of Wall Street that has included FBI raids of a number of hedge funds and inquiries to other hedge funds for information.² According to those press reports, as part of the government's probe, the government is investigating whether independent analysts and consultants who work for companies that provide services to hedge funds and mutual funds have passed along inside information. Hedge funds should review their relationships with consultants and analyze their policies and procedures to ensure that their employees, as well as their consultants, understand the types of information they can and cannot share.

For more information concerning this article or to ask specific questions regarding your own matter, please contact Venable and the authors of this article. Venable's [SEC/White Collar Group](#) has significant expertise regarding insider trading issues, and is well-positioned to help companies and individuals preemptively avoid or, if necessary, prepare for and comply with such investigations.

[1] See *U.S. v. Benhamou* (S.D.N.Y. Filed Nov. 1, 2010); *SEC v. Benhamou*, Civil Action No. 10-CV-8266 (S.D.N.Y. Filed Nov. 2, 2010).

[2] Susan Pulliam, Michael Rothfeld, Jenny Strasburg and Gregory Zuckerman, *U.S. In Vast Insider Trading Probe*, Wall St. J, Nov. 20, 2010; Susan Pulliam, Michael Rothfeld, and Jenny Strasburg, *FBI Raids Hedge Funds*, Wall St. J., November 22, 2010; Aparajita Saha-Bubna and Michael Rothfeld, *SAC, Janus, Wellington Receive Inquiries on Insider Trading*, Wall St. J., Nov. 23, 2010.

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