Companies Should Review Insider Trading Policies in Light of "Expert Network" Cases

February 11, 2011

The United States Securities and Exchange Commission recently filed civil charges alleging insider trading violations by four consultants and two former employees of an "expert networking" firm.[1] Three of the defendants were employed by technology companies. The SEC alleges that these defendants, in return for consulting fees, improperly provided hedge funds and other investors with material non-public information regarding several publicly held technology companies, including companies other than those that employed them. The Department of Justice has also brought criminal cases against these and other individuals arising out of this type of alleged misconduct.[2]

The defendants' employers in these cases have not been charged, but these lawsuits highlight the reputational and potential legal risks for companies associated with misconduct of the type alleged by the SEC and the Department of Justice. This issue is particularly relevant to the technology industry and other industries where commercial collaboration in product development or supply chain matters is common.

In light of these cases, companies should consider whether their internal policies and compliance programs appropriately address employees' obligations with respect to non-public information that they obtain about other companies in the course of their work for their employer.[3] More specifically, companies whose employees regularly have access to non-public information about other companies in their industry should consider adopting policies that:

- Prohibit employees from disclosing material non-public information about other companies obtained in the course of their employment ("tipping"), except to co-workers within the employer who have a business need to know the information;

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[1] See the SEC's press release of February 3, 2011, available at http://www.sec.gov/news/press/2011/2011-38.htm.

[2] See the December 16, 2010 press release by the United States Attorney for the Southern District of New York, available at http://www.justice.gov/usao/nys/pressreleases/December10/shimoonetalarrestspr.pdf.

[3] Most public companies already have insider trading policies that prohibit employees from disclosing material non-public information about their employer and that permit employees to trade in the securities of their employer only pursuant to special procedures (which may include "black-out" periods and pre-clearance requirements). However, policies vary in whether they explicitly prohibit employees' misuse of non-public information about companies other than their employer. An explicit prohibition of such misuse is common among financial and professional service firms.

- Prohibit employees from trading in the securities of the company's business partners while in possession of material non-public information until such information either has been made public or has become obsolete;

- Prohibit employees from using non-public information about other companies obtained in the course of their employment for personal gain, such as disclosing information to third parties in exchange for a consulting fee, as certain of the SEC defendants are alleged to have done; and

- Remind employees that material non-public information can include anything that investors in the securities of a company would consider important or that could have a substantial effect on the market price of the securities, whether over the short term or the long term.

Employees should be reminded that material non-public information does not just mean financial information. Depending on the circumstances, material non-public information may also include, among other things, information about:

- the status of significant commercial contracts (including cancellations, renewals or entry into new contracts),
- joint ventures and other strategic partnerships,
- events related to R&D and technology,
- communications with regulators,
- product roadmaps and calendars,
- design wins or losses,
- significant pricing changes,
- order backlogs,
- inventory levels,
- other operating metrics, and
- potential personnel changes.

Training about a company's insider trading policy should be part of the initial training provided to all new employees. It is also important to ensure that current employees remain aware of the requirements of the insider trading policy. A useful technique in this regard is to have employees certify on an annual basis that they have read the policy and abided by it.

No written policy by itself can stop misconduct by someone who is resolved to do wrong, but the recommendations set forth above can reduce the risk that employees' carelessness or ignorance will result in unnecessary embarrassment and legal entanglements for their

employer. In addition, in the event of misconduct by employees like that alleged by the SEC and the Department of Justice in the expert network cases, a robust insider trading policy that covers non-public information about other companies will help demonstrate the employer's commitment to a culture of compliance. Among other benefits, this can be helpful in persuading third parties that the employer is not culpable for misconduct by its employees and that sanctioning the employer is unwarranted.

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