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SEC V. OBUS: A CASE STUDY ON TAKING THE GOVERNMENT TO TRIAL AND WINNING

After a 13-year battle in which the defendants refused to settle, the SEC finally went to trial in the longest known insider trading case. The theory tried was based on misappropriation of information about an impending acquisition. The government lost, and the authors — counsel for the defendant Obus — explain their litigation strategy, beginning with the SEC's investigation phase and extending through the trial itself.

By Joel M. Cohen, Mary Kay Dunning, Darcy Harris, and Genevieve Quinn *

On May 30, 2014, a 10-person jury in the U.S. District Court for the Southern District of New York returned a unanimous verdict in favor of Nelson Obus, as well as his co-defendants, in an insider trading case involving 13-year-old facts. In contrast to the age of the case, the verdict came after just one day of deliberations following a two-week trial. Legal and media commentators followed the case carefully, partly because the Court of Appeals for the Second Circuit in 2010 reformulated key aspects of insider trading jurisprudence in a pre-trial SEC appeal from the trial judge's grant of summary judgment. As noted below, the Second Circuit's decision continues to befuddle practitioners and courts alike, and figures centrally in many of the most high-profile insider trading criminal and civil cases.[1]

But much of the attention arose from the fact that Mr. Obus's struggle with the SEC represented the longest known insider trading battle ever. For 13 years, the SEC devoted significant resources to investigating, charging,

[1] *See, e.g., United States v. Steinberg*, ___ F. Supp. 2d ___, 2014 WL 2011685 (S.D.N.Y. May 15, 2014); *United States v.* *Newman*, No. 12 Cr. 121 (RJS), 2013 U.S. Dist. LEXIS 70242 (S.D.N.Y. May 7, 2013); *United States v. Whitman*, 904 F. Supp. 2d 363 (S.D.N.Y. 2012); Allison M. Vissichelli, Note, *Intent to Reconcile:* SEC v. Obus*, the Second Circuit's Edification of the Tippee Scienter Standard*, 62 Am. U. L. Rev. 763 (2013); John C. Coffee, Jr., *Introduction: Mapping the Future of Insider Trading Law: Of Boundaries, Gaps, and Strategies*, 2013 Colum. Bus. L. Rev. 281 (2013); Stephen J. Crimmins, *Insider Trading: Where is the Line?*, 2013 Colum. Bus. L. Rev. 330 (2013); Edward Greene & Olivia Schmid, *Duty-Free Insider Trading?* 2013 Colum. Bus. L. Rev. 369 (2013); Donald C. Langevoort, *"Fine Distinctions" in the Contemporary Law of Insider Trading*, 2013 Colum. Bus. L. Rev. 429 (2013).

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∗ *JOEL M. COHEN is a partner and MARY KAY DUNNING, DARCY C. HARRIS, and GENEVIEVE QUINN are associates in the New York office of Gibson, Dunn & Crutcher LLP ("Gibson Dunn"). Their e-mail addresses are jcohen@gibsondunn.com, mkdunning@gibsondunn.com, dharris@gibsondunn.com, and gquinn@gibsondunn.com. They represented Mr. Obus in the SEC v. Obus trial.*

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and litigating the case, involving several teams of counsel and trial attorneys, and different generations of senior enforcement staff who oversaw the effort. Many have asked: how did Mr. Obus and his co-defendants prevail against such a sustained attack for so long?[2] Parties facing this onslaught would have been tempted to cave and settle, regardless of the merits of the allegations.

The jury's verdict marks the end of a long fight by Mr. Obus to clear his name. In 2002, the SEC first subpoenaed Mr. Obus and his co-defendants, as well as his hedge funds. However, the SEC waited to file the complaint until 2006, just one month before the statute of limitations was set to expire. The SEC sued Mr. Obus, the general partner of Wynnefield Capital, Inc. ("Wynnefield"), his analyst Peter Black, and Mr. Black's college friend, Brad Strickland. The SEC alleged that Mr. Black and Mr. Obus traded on inside information in connection with Wynnefield's June 8, 2001 purchase of shares in SunSource, Inc. ("SunSource" or the "Company"), which was two weeks before Allied Capital Corporation ("Allied") announced that it would acquire SunSource. The SEC alleged that Mr. Strickland, who was involved in the Allied-SunSource acquisition, misappropriated information from his employer GE Capital about the acquisition, and then tipped Mr. Black about the pending acquisition; the SEC alleged that Mr. Black in turned tipped Mr. Obus, who then traded. The SEC sought an injunction against Messrs. Black, Obus, and Strickland, disgorgement of over $1.3 million in alleged ill-gotten gains, civil monetary penalties, and an order prohibiting each of them from acting as an officer or director of any issuer of securities.

Defendants moved for summary judgment in July 2009, which Judge George B. Daniels of the Southern District of New York granted in September 2010. After the SEC appealed that decision, the Second Circuit reversed the district court two years later, and the May 2014 trial followed.

Through a well-crafted defense strategy that began in 2002, Mr. Obus and his co-defendants emerged victorious. For anyone facing an SEC investigation, regardless whether it ripens into a contested matter at trial, *SEC v. Obus* offers an instructive case study, elucidating how critical early steps and later adjustments shaped a successful defense strategy that exonerated Mr. Obus and his co-defendants. The case also offers a view into the aggressive tactics mustered by the SEC when it is forced to prove a case rather than settle it. Not all clients can bear the financial cost and reputational risks that fighting the SEC through trial entails, but for those who can, the trial in *SEC v. Obus* offers a blueprint of useful steps to battle and succeed. As explained below, the following defense strategies were instrumental in securing this hard-fought victory:

- developing offensive themes at the outset, and continuing to pursue and develop them throughout the investigation and litigation;
- building a full factual record in response to both SEC investigative requests and traditional discovery;
- pursuing every possible lead during discovery and running issues to ground;
- anticipating and neutralizing expected juror bias;
- anticipating and countering SEC trial tactics;
- preparing for the use of SEC investigative testimony;
- assessing and recognizing both the benefits and challenges of old evidence; and
- emphasizing and being prepared to defend the credibility of defense witnesses.

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[2] *See, e.g.*, Rachel Abrams, *After Fighting Insider Trading Charges for 10 Years, a Fund Manager Is Cleared*, N.Y. TIMES, May 30, 2014; Bob Van Voris, *SEC's Insider-Trading Case Against Obus Revived on Appeal*, Bloomberg, May 20, 2014; Joe Palazzolo, *Insider-Trading Case Involving GE Capital Tip Heads for Trial*, WALL ST. J., May 18, 2014; Nate Raymond, *Long-Running SEC Insider Trading Case Heads to Trial*, REUTERS, May 15, 2014; Susanne Craig, *The Curious Case of Nelson Obus*, N.Y. TIMES, June 4, 2011.

SEC v. Obus demonstrates that these cases can be challenged, whittled down, and won, even in a poisonous environment where financial institutions, funds, and investors are vilified. To do so, it takes an awareness of both the tactics the SEC will use and the mistakes it will make as it continues to rely on settlement as the means to paper over deficiencies in its cases, especially when those cases are based entirely on circumstantial evidence.

INVESTIGATIVE STAGE

On October 17, 2001, just four months after the announcement that Allied would acquire SunSource, the NASD sent to the SEC's Office of Market Surveillance an Insider Trading Referral Report regarding SunSource. The NASD identified four accounts involved in "suspicious" trading in the weeks leading up to the announcement, one of which was Wynnefield's. Wynnefield managed three funds (the "Wynnefield Funds") that purchased SunSource stock prior to the announcement. On July 2, 2002, enforcement officials in the SEC's home office in Washington, D.C. opened an investigation into trading in the securities of SunSource.

Document Requests: Produce to Defend

The SEC issued subpoenas to Wynnefield, Mr. Obus, and Mr. Black in July and August of 2002. Predictably, the subpoenas included requests for documents regarding SunSource. Although it was not clear where the SEC's investigation would lead, Wynnefield's long history of investing in SunSource plainly would figure later in defending against insider trading allegations. Wynnefield's production to the SEC at this early stage of the investigation proved to include some of the most important evidence admitted at the trial 12 years later, namely, Wynnefield's history of (1) researching SunSource and its management and (2) purchasing shares of SunSource over a four-year period. Because of Wynnefield's practice of keeping records of companies it followed, Wynnefield still had in its possession during the summer of 2002 — just one year after the announcement — nearly 4,000 pages of documents relating to its research on SunSource. Had Wynnefield disposed of its research files from prior years — as many investment advisers are advised to do — this in-depth research record would no longer have existed.

During the trial in 2014, Mr. Obus and Mr. Black testified extensively about dozens of the documents contained in its SunSource research file, explaining why Wynnefield invested in SunSource at different points in time over the years and what Wynnefield thought about SunSource's management. This testimony and the documents from the SunSource research file admitted into evidence during the trial helped convince the jury that Wynnefield's June 8, 2001 purchase of SunSource stock was not based on material, non-public information, but rather on Wynnefield's long history of researching and investing in SunSource. In fact, during jury deliberations, the jury requested an exhibit detailing Wynnefield's four-year investment history in SunSource. Clearly, the jury took into consideration evidence about Wynnefield's long relationship with SunSource and its management.

Although common wisdom suggests otherwise, in responding to document requests early in an SEC investigation, or even when doing so on a voluntary basis in response to an informal inquiry by the SEC, counsel should consider proactively producing documents that could ultimately aid in the defense of clients who are prospective defendants. The knee-jerk response to receiving a document subpoena in an SEC investigation may be to provide the SEC with as little information as possible, especially when it is unclear whether the client is a target of the investigation, or simply a witness. However, as counterintuitive as it may seem to take an offensive approach to responding to an SEC subpoena instead of just playing defense, counsel should begin to develop a theory of the case as soon as possible by working with the client to identify potentially exculpatory evidence and using it to prepare the client for on-the-record testimony.

Testimony under Subpoena

The SEC's subpoenas of Wynnefield and its employees also included early requests for testimony. Within weeks of receiving the requests, Mr. Obus (as well as his analyst, Mr. Black, and Wynnefield's trader, who was not ultimately named as a defendant) testified on-the-record, under oath, at the SEC's headquarters in Washington, D.C. (hereinafter "OTR" or "on-the-record" testimony). Consistent with its longstanding practice, the SEC did not provide any guidance about its investigation and declined to identify its targets. Not knowing whether they are targets, individuals frequently are forced to testify on short notice without the benefit of understanding the focus of the SEC's often-vague questions posed during OTR testimony.[3] The SEC, like

[3] Of course, the SEC's stated position is that no one is a target of an investigation, but the SEC attorneys who investigated Mr. Obus certainly made clear that he was a target. *See* SEC, Division of Enforcement, Enforcement Manual § 3.3.2 (Oct. 9, 2013)], *available at* http://www.sec.gov/divisions/enforce/

many regulators, prefers to capitalize on the confusion and anxiety caused by refusing to share even the general contours of its investigation.

The aggressive tactics employed by the SEC investigative attorneys during the OTR interview of Mr. Obus — which spanned two full days, twice the amount of time permitted under the Federal Rules of Civil Procedure for a deposition in a civil matter[4] — created an intimidating atmosphere of interrogation and hostility. The process did not seem designed to dispassionately discover the truth. Rather, the SEC's questions frequently were overly complex and compound in form. The atmosphere in the interview was openly hostile, with the SEC staff attorneys frequently raising their voices and pointing fingers.

SEC OTR testimony is a dangerous hybrid between recorded deposition testimony and law enforcement interrogation. The protections afforded to a defendant in a deposition taken pursuant to the Federal Rules of Civil Procedure are absent during OTR testimony.[5] The SEC controls the record during the testimony.[6] As such, if the witness wants to go off the record for any reason, it is within the SEC attorney's discretion to deny such a request. The reporter will go off the record only at the SEC's request. One example of how the SEC seeks to control the record to its benefit: during Mr. Obus's OTR testimony, the SEC examiners purported to instruct his counsel not to take notes, arguing that identities of individuals it was asking about were "confidential."[7]

In addition, although a witness who testifies during a formal investigative proceeding is entitled to purchase a copy of the transcript of his or her OTR testimony, the SEC may for good cause deny such a request.[8] Further, whereas a deponent in a civil case is afforded the opportunity to review the transcript and submit an errata sheet containing any transcription errors,[9] no such opportunity is afforded a witness who provides SEC OTR testimony; only the SEC may review the transcript for errors and submit an errata sheet with any necessary changes to the reporter.[10] Months or years later, the witness-turned-defendant may be confronted with the SEC's selected snippets of his words without ever having had an opportunity to review whether they were transcribed accurately.

Finally, and most frustratingly, although a witness has the right to counsel during the testimony, counsel is not permitted to object to questions as she would be permitted to do during a deposition.[11] The most that counsel is permitted to do is to advise a witness during the testimony and to "question the witness briefly at the conclusion of the testimony to clarify any of the answers the witness gave during testimony."[12] Even experienced SEC defense counsel typically refrain from objecting or asking clarifying questions for fear of antagonizing the SEC staff. As a result, while the transcript of the proceeding facially bears resemblance to a civil deposition transcript, the content of the transcript often amounts to a police interrogation summary or FBI investigation report, lacking objectivity or any effort to adduce exculpatory or explanatory evidence.

Many counsel and parties do not properly consider the consequences of taking a passive approach to SEC OTR testimony, failing to fully appreciate how the SEC will use the biased record to its benefit if a trial ensues. There are several reasons why counsel should caution clients about the importance and possible pitfalls of providing testimony during the investigation stage. Although the record is controlled only by the SEC, the testimony can be and usually is recorded by audio, audiovisual, and/or stenographic means.[13] As such, the testimony can later be used against the defendant during

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enforcementmanual.pdf ("[T]he SEC investigative process does not have targets.").

[4] *See* FED. R. CIV. P. 30(d)(1) (limiting the length of a deposition to one day of seven hours).

[5] Indeed, one of the SEC lawyers stated during his questioning of Mr. Obus in 2002 that the SEC is not subject to the Federal Rules of Civil Procedure, implying that this gives the SEC the upper hand during investigative testimony: "Well, I think, as you know, we don't — we're not subject to the civil — the civil rules here." (N. Obus Aug. 29, 2002 OTR Tr. 234:4-5).

[6] SEC Enforcement Manual § 3.3.5.2.3.

[7] N. Obus Aug. 30, 2002 OTR Tr. 442:1-5, 442:23-24 ("[SEC ATTORNEY]: Let me just note for the record Mr. Cohen is writing the names of the people on the list down. Let me just say that we are — we did not provide copies of the exhibits to witnesses or their counsel, and frankly, I object to writing the names down, Mr. Cohen. . . . Mr. Cohen, I already asked you not to copy the names on the list.").

[8] SEC Enforcement Manual § 3.3.5.2.4. The SEC did not deny our request for a transcript of Mr. Obus's testimony.

[9] *See* FED. R. CIV. P. 30(e).

[10] SEC Enforcement Manual § 3.3.5.2.5.

[11] *Id.* § 3.3.5.2.2.

[12] *Id.*

[13] *Id.* § 3.3.5.1.

a deposition or at trial. Although such testimony, when offered to prove what it asserts, is hearsay, several hearsay exceptions may be applicable.[14] The most common of these is the prior inconsistent statement exception, which allows for the admission of the investigative testimony as substantive evidence during a deposition or at trial.

During the *SEC v. Obus* trial, the SEC relied heavily on the statements made by the defendants during their OTR testimony 12 years earlier, in 2002. The SEC trial team looked for every opportunity to impeach the defendants during trial to portray them as liars in front of the jury based on snippets of "gotcha" OTR testimony, which had been adduced without allowing the witnesses to review documents or to refresh their recollections. Even when the defendants testified consistently between 2002 and 2014, the SEC sought to publish to the jury excerpts from their 2002 testimony, ostensibly to bolster its case.

While many attorneys believe it is safer to simply muddle through the SEC's OTR investigative questioning and not seek to adduce helpful additional evidence at this stage, it is advisable for counsel to clarify questions where appropriate to avoid witness confusion and to keep the record clear. Counsel should also advise the witness to ask for clarification from the SEC when necessary. Finally, if the SEC persists in asking questions that seriously violate the norms of admissible trial testimony, counsel should consider objecting — even though there is no mechanism that allows for this — as doing so will embed in the record the unfairness of the questions if, and when, the SEC tries to use selective testimony excerpts at trial. Trial judges are accustomed to ruling on deposition objections and there is good reason to expect they will apply their same broad trial management authority to exclude inadmissibly adduced OTR evidence even if the SEC views its OTRs as beyond the scope of the Federal Rules of Evidence.

The Wells Submission

After receiving documents and taking testimony during an investigation, the SEC will make a determination regarding whether it will recommend that the Commission bring a case against the investigated individual or entity for violating the federal securities laws. This recommendation is communicated to the prospective defendant (and his counsel) in writing in what is known as a "Wells" notice. The Wells notice informs the person of the SEC's recommendation, identifies the alleged securities laws violations, and provides notice that the prospective defendant may make a submission to the SEC and the Commission concerning the SEC's proposed case, which is called a "Wells submission."[15]

Although Wells submissions may be discoverable in private civil litigation, and although the SEC considers them to be party admissions that can be used in ensuing litigation,[16] counsel should not reflexively take a defensive approach during the Wells process. Instead, counsel should consider whether it is appropriate to use the Wells submission as an opportunity to develop affirmative, offensive arguments, and present the SEC with a compelling theory of the case based on the documents and testimony previously provided to the SEC.

In the *Obus* matter, the defense presented a coherent theory of the case in its Wells submissions — a theory maintained throughout the life of the litigation, right up through closing arguments at trial. Many practitioners fear setting forth their defense themes so openly in a Wells submission, believing that doing so provides the SEC with an opportunity to seek additional evidence or charge a case around such arguments. The Obus defense team rejected this approach, hopeful that more experienced SEC staff would see the strength of its positions and think twice before charging. The Obus Wells submission argued that Wynnefield's trading in SunSource on June 8, 2001 was not based on a tip of material, non-public information, but rather was the result of a reaction to an unsolicited offer presented to Wynnefield by a broker and was just another trade in Wynnefield's four-year history of purchasing stock in SunSource and carefully following the company.

While the SEC never shared what impact these arguments had on its appetite to proceed with a case, the long delay — the SEC waited nearly four years after procuring documentary and testimonial evidence from Mr. Obus and Wynnefield before filing its complaint in the case — suggests that these arguments made the SEC think twice. Indeed, the SEC charged the case in 2006, only weeks before the five-year statute of limitations

[14] *See, e.g.*, FED. R. EVID. 801(d)(1)(A) [Prior Inconsistent Statements Given under Penalty of Perjury at a Trial, Hearing, or Other Proceeding or in a Deposition]; 801(d)(2) [An Opposing Party's Statement]; 803(3) [Then-Existing Mental, Emotional, or Physical Condition]; and 803(5) [Recorded Recollection].

[15] SEC Enforcement Manual § 2.4.

[16] *Id.*

was set to expire, and years after all of the relevant evidence had been gathered and the Wells submissions made.

The threat of a lawsuit hanging over the prospective defendants' heads for nearly five years weighed heavily on them. The SEC's practice at the time was not to notify parties as to whether the SEC had abandoned or closed its investigation, leaving Mr. Obus, his fund, his colleagues, and his investors in years of limbo. Many individuals and entities in a similar situation understandably conclude that they cannot accept the debilitating financial and reputational costs over the course of a protracted investigation, and elect simply to settle with the Commission to avoid further harm. Fortunately, under the new provisions of the Dodd-Frank Act, within six months of issuing a Wells notice, the SEC must either bring an enforcement action or notify the Division of Enforcement of its intent not do so.[17] Defense counsel is advised to check in with the SEC after this statutory deadline has run, to determine whether the SEC will disclose its decision regarding whether or not to bring a case.

Unfortunately, the SEC waited until the eleventh hour to file its case against the defendants in the *Obus* case. Little did Mr. Obus know that when the complaint was filed, it would take eight more years to clear his name.

PRE-TRIAL LITIGATION AND DISCOVERY

The SEC filed its complaint against the three defendants (and the Wynnefield Funds as relief defendants) in April 2006. The SEC claimed that Mr. Obus told two witnesses that he had been tipped — Maurice Andrien, the CEO of SunSource, and Daniel Russell, an executive at Allied. According to the SEC, Mr. Obus learned material, non-public information about the Allied-SunSource acquisition from his analyst, Mr. Black, who had learned about it during a telephone conversation with his college friend, Mr. Strickland, who was working on potential financing for the acquisition in his role as an underwriter at GE Capital. Upon learning about the acquisition, the SEC alleged, Mr. Obus immediately contacted Mr. Andrien and acknowledged that he had been tipped. Then, months after the public announcement of the acquisition, Mr. Obus allegedly telephoned Mr. Russell, a complete stranger to Mr. Obus, and said that he had been tipped to the acquisition. Lacking any direct evidence of a tip, such as recorded phone call or e-mail, the SEC proceeded with a circumstantial case.

In its original complaint, the SEC invoked the classical theory of insider trading. Defendants moved to dismiss the case, and the judge denied the motion in early 2007.[18] Then, in the SEC's amended complaint — after the defendants highlighted in their motion to dismiss the deficiencies in the SEC's classical theory — the SEC alleged that the misappropriation theory also applied. As counsel for Mr. Obus and the Wynnefield Funds, our experience defending this case is instructive.

The defendants approached the discovery phase of the case with an eye toward trial. Instead of remaining on the defensive and reacting as the SEC prosecuted its case, defense counsel was proactive in developing evidence and themes. The defendants subpoenaed third parties that on the surface seemed remote to the core facts of the SEC's case, but who were involved in some way in the Allied-SunSource transaction. The defendants gathered evidence to undermine the SEC's timelines of key events, including when Mr. Strickland first learned material, non-public information through his job at GE Capital, which in turn helped to establish when his fiduciary duty to SunSource and GE Capital arose. When deposing the SEC's witnesses, defense counsel did not hold back. We challenged their recollections of events, their credibility, and their motives. We asked lines of questioning designed to run down every possible explanation and scenario, in an effort to leave no stone unturned.

Such diligence paid off. For example, one of the most effective videotaped deposition clips adduced during discovery, which was later used at trial to impeach the main witness against Mr. Obus, resulted from unexpected answers to an unplanned line of

[17] Dodd-Frank Act, 15 U.S.C. § 78d-5 (2012).

[18] Liability under the classical theory is contingent upon a corporate insider's breach of a fiduciary duty owed to the shareholders of his company, which the insider violates by trading on the basis of material, non-public information. *United States v. O'Hagan*, 521 U.S. 642, 652 (1997). A corporate "outsider" cannot be liable under the classical theory unless he becomes a temporary insider by "hav[ing] entered into a special confidential relationship in the conduct of the business enterprise." *Dirks v. SEC*, 463 U.S. 646, 655 n.14 (1983) (citations omitted). Liability for tippees is derivative. A tippee is only liable if the tipper has breached a fiduciary duty owed to the corporation's shareholders and the tippee knows, or has reason to know, that tipper breached that duty. *See id.* at 661. If that is the case, the tippee becomes "subject to the same duty as the insider" and "breaches the fiduciary duty which he assumes from the insider" by disclosing the information or trading while in knowing possession of that information. *See id.* at 656.

questions. The defendants spent two days deposing Maurice Andrien, the former CEO of SunSource. Mr. Andrien had claimed since 2002 that Mr. Obus called him before the announcement and asked him why he was selling SunSource. We knew from our client that this telephone conversation definitely took place, but that it took place *after* the acquisition news had been publicly announced, not before. This crucial issue of timing could directly undercut the SEC's claimed circumstantial evidence that Mr. Obus possessed and traded on material, non-public information before the announcement.

At the beginning of the deposition, rather than merely asking Mr. Andrien perfunctory background questions, we focused quickly on issues of memory. For example, we asked Mr. Andrien whether he was under any medical treatment, to which he surprisingly replied that he was. We then proceeded to ask whether he was taking any drugs that impacted his ability to remember things. Unexpectedly, he answered that his wife believed that the drugs he was taking affected his memory. Fast forward six years: When we cross-examined Mr. Andrien at trial, he refused to admit that he had memory problems. We were then able to impeach Mr. Andrien with his 2008 video deposition testimony in which he commented that his wife thought that he had memory problems. At trial, Mr. Andrien said that he was joking during his deposition, but he appeared quite serious during the deposition, which sent confusing signals to the jury and raised a witness credibility issue.

The defendants also pushed hard to obtain discovery from GE Capital about its internal investigation of the circumstances surrounding Mr. Strickland's alleged tip to his friend, Mr. Black. We rejected concerns that seeking this evidence might lead to even more damaging disclosures because we felt there was an opportunity to develop a more fundamental theme: that GE Capital did not view itself as a victim of information theft. Our suspicions proved correct. We obtained powerful evidence that after a lengthy internal investigation, overseen by well-regarded outside counsel,[19] GE Capital concluded that when Mr. Strickland spoke with his friend Mr. Black at Wynnefield, he was trying to engage in innocent underwriting by asking Mr. Black for his thoughts on SunSource's management, to whom GE Capital was considering loaning money as part of the Allied-SunSource acquisition; that while he had violated GE Capital's internal policies in doing so, he did not intend harm; and that Mr. Strickland was entitled to remain employed at GE Capital. As the SEC's more recent theory of liability — misappropriation of confidential information from GE Capital — depended on its proving that the defendants breached a duty of confidentiality to GE Capital, this countervailing evidence offered a rich vein to challenge the SEC's case during pre-trial motions or, if necessary, at trial.

While the defendants took full advantage of discovery to depose several people, gather documents from third parties, and test different theories, the SEC showed little initiative in exploring the evidence or developing a coherent theory of its case. Discovery for the SEC was a missed opportunity, as it remained wedded to a rigid prosecution theory without exploring alternative explanations of key events or documents. The SEC also relied heavily on the 2002 investigative testimony by reading the prior testimony — both of the defendants and third-party witnesses — into the record during its discovery depositions.

In contrast, apart from the evidence we gathered about GE Capital's view of Mr. Strickland's adherence to the duties owed to his employer, the defendants used discovery to develop a record calling into question whether the SEC could prove under the classical theory that SunSource had itself been owed a duty of confidentiality by GE Capital, which was inherited by Mr. Strickland, its employee and the alleged tipper. The defendants thus utilized discovery to attack both the classical theory of liability (where SunSource was the alleged victim) and the misappropriation theory of liability (where GE Capital was the alleged victim). We chipped away at the SEC's case bit by bit to better position ourselves to attack what remained. Cases rarely are won with a knockout blow — rather, victories are secured through a succession of smaller strategic successes.

With this in mind, we recognized the value — both at the summary judgment stage and at trial — of attacking the notion that SunSource was a victim of the alleged insider trading. We knew that the key witnesses against our client were mostly SunSource senior executives. We wanted to prevent the SEC from arguing that those executives were victimized so we could more freely challenge their credibility without fearing the jury would see this as "attacking the victims." Accordingly, we deployed a multi-pronged discovery plan that sought equally to reduce the scope of the charges after summary

[19] The external investigation was conducted by Debevoise & Plimpton, whose Litigation Department was overseen by none other than Mary Jo White, who later became Chairperson of the SEC. This fortuitous involvement helped insulate GE Capital's internal review from the SEC's expected arguments that the review was not robust or reliable.

judgment and to better position ourselves to challenge the SEC's most damaging expected trial testimony.

At the close of discovery, we moved for summary judgment because the SEC had developed no new evidence beyond that adduced during the investigative stage. Although the SEC had expected us to contest materiality, we opted not to challenge this element, as we knew the alleged tip — if accepted as true — plainly met the materiality standard. Instead, we argued that the evidence had established no duty or breach of duty under either the classical or misappropriation theories of insider trading. We believed strongly that the SEC had failed to adduce enough evidence to establish liability under the classical theory, but we moved for summary judgment under both theories. Knowing that summary judgment is extremely difficult to obtain, as all reasonable inferences must be taken in the light most favorable to the non-moving party,[20] we focused on developing a novel summary judgment theory: lack of deception.

One year later, Judge Daniels granted our motion for summary judgment, finding that under both the classical and misappropriation theories, the SEC had failed to adduce evidence of duty and breach. In granting summary judgment, the court accepted our argument that the SEC had not adduced sufficient evidence under the classical theory. Judge Daniels also adopted our more inventive and untested theory — that even if Mr. Obus had in fact been tipped, the SEC's theory that he immediately called the SunSource CEO to tell the CEO that he had been tipped was inconsistent with the requisite deception the SEC had to prove. The SEC had expected our attack on the classical theory, as our discovery requests and depositions made clear this was an objective we sought. The SEC was apparently caught off guard by the novelty of our "lack of deception" argument.

The SEC appealed Judge Daniels's decision, but it proceeded only under the misappropriation theory. Although the Second Circuit later reversed Judge Daniels's decision, we had succeeded in knocking out the classical theory, the theory that the SEC originally had pled. Thus, we knew as we headed into trial that we only had to contend with the SEC's misappropriation theory. An additional consequence of the summary judgment motion and appeal was a four-year delay until the trial. While our clients were eager to clear their names at trial, we understood that older memories generally are less reliable ones. As the SEC's case remained one premised mostly on a few key telephone calls, strategically the delay worked to our benefit. That we had whittled down the SEC's case to misappropriation alone — premised on the theory that GE Capital was a victim when it had largely concluded it was not victimized at all — also positioned us to succeed at trial.

TRIAL

Using Pre-trial Motions to Discern the SEC's Theories

In addition to pursuing the offensive themes developed during the investigation and discovery phases of the case, we made several pre-trial *in limine* motions challenging the SEC's proffered evidence and witnesses. The SEC had no witnesses in its control to tell its story to the jury; nor did it have any expert witnesses to put on, as it did not designate any experts during discovery. Instead, the SEC only had a series of third-party witnesses and circumstantial evidence upon which to rely. This proved to be a sticking point for the SEC that it repeatedly tried to overcome through various maneuvers.

One of those maneuvers was an attempt to inject neutral witnesses into the trial. One set of witnesses included employees of T. Rowe Price, the entity that had sold the block of SunSource stock that Mr. Obus purchased on June 8, 2001. During discovery, each T. Rowe witness stated that he did not know who bought the block of SunSource stock that T. Rowe sold to Mr. Obus (and indeed, that it would be unethical to know the identity of the party on the other side of a trade). Accordingly, we argued that, other than the fact that a trade had taken place (which no one disputed), there was no relevant testimony for these witnesses to offer. Nonetheless, the SEC argued that it needed these witnesses to (1) provide background information about SunSource (even though it would call one or more SunSource executives in its case) and (2) to rebut the defendants' affirmative argument that Mr. Obus purchased the SunSource stock at issue because he thought the stock was undervalued. The staff repeatedly claimed that without the T. Rowe witnesses, the SEC had no one who could prove that someone would want to sell SunSource stock when Mr. Obus wanted to buy it. Thus, we had to continuously remind the judge that this evidence had no relevance to the facts at issue; fortunately, the judge agreed, and the SEC was not permitted to present its proffered T. Rowe witnesses.

[20] *See, e.g., Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986).

Another neutral witness whom the SEC wanted to call was a custodian of records for a trading database called AutEx, a subscription-based database sometimes used by securities professionals to monitor and publish indications of interest for the purchase and sale of stocks. Although Mr. Obus's fund never subscribed to AutEx, and although AutEx was only used by half of the market (while the remainder of the market used other, similar databases offered by competitors like Bloomberg and Reuters), the SEC argued that data from the AutEx database would establish that there were many large blocks of SunSource stock available prior to the alleged tip that Mr. Obus did not buy, and that there were no large blocks of SunSource stock available after the alleged tip, until the date on which Mr. Obus purchased SunSource stock, two weeks after the alleged tip. The SEC argued that it needed to present this evidence to counter the defendants' affirmative argument that the two-week time gap between the alleged tip (May 24) and the trading in SunSource (June 8) was significant and exculpatory; based on this AutEx evidence, the SEC explained, the jury could infer that June 8 was the very first opportunity for Mr. Obus to purchase SunSource shares after he was allegedly tipped.

However, the SEC failed to point out to the judge that the shares Mr. Obus bought on June 8 were not listed in the AutEx database. The SEC also failed to note that in its own trial exhibits containing the closing price and trading volume for SunSource stock on a daily basis, there were almost 200,000 shares of SunSource stock traded between May 24 and June 7. When we corrected the record and pointed out that the AutEx evidence did not, in fact, demonstrate what the SEC was arguing, Judge Daniels agreed that it was not relevant and the SEC was not permitted to call an AutEx witness at trial.

Finally, we moved to exclude the testimony of a lawyer for SunSource whom the SEC wanted to call as a witness at trial. The SEC intended to offer testimony from this attorney regarding privileged communications he had with a SunSource executive. During the course of the SEC's investigation in 2002, the SEC drafted an affidavit for the attorney in lieu of taking his OTR testimony in response to SunSource's request to preclude the OTR testimony in order to maintain the attorney-client privilege. In this affidavit, the attorney stated he reviewed the SunSource executive's OTR testimony and that his "recollection of [his] conversations with [the executive] . . . is consistent with the testimony provided by [the executive]." When the defendants sought to depose the attorney about the content of these conversations to which he attested in his affidavit, the attorney asserted SunSource's attorney-client privilege. The defendants then sought intervention from the judge, and at that hearing, the SEC stated that, "the SEC does not take a position whether or not there is waiver here."[21]

Then, six years later, the SEC suddenly indicated it would be calling the attorney as a witness at trial and would be seeking to enter his 2002 affidavit into evidence. We moved *in limine* to preclude this evidence in its entirety, given the extreme prejudice that could result from the fact that the defendants had never been, and would never be, able to probe the content of the communications between the attorney and the executive because SunSource was not waiving the privilege. Then, despite the SEC's efforts in 2002 to maintain SunSource's privilege at its request, and despite the SEC's "take no position" comment in 2008, the SEC proclaimed just before trial that it believed that "the truth of the matter is [the attorney] may have waived [the privilege], and the court suggested very seriously he may have waived."[22]

Judge Daniels indicated that he would not permit the attorney's testimony under these circumstances, but the SEC continued to press the issue, arguing that even if the attorney was not allowed to testify, it would elicit from the SunSource executive and other witnesses that they called a lawyer after speaking with Mr. Obus. The SEC again argued that it needed to present this evidence to rebut the defendants' affirmative arguments that these witnesses did not, after speaking with Mr. Obus, act in a manner consistent with the nature of the discussions with Mr. Obus that the SEC was alleging. Judge Daniels also quickly disposed of this argument. He found that the SEC's intention for the jury to draw an inference from the mere fact of contacting a lawyer — without disclosing the content of the conversation with the lawyer, given that the lawyers asserted privilege over those communications — was entirely improper.

Through these motions, we forced the SEC to reveal important facets of its trial strategy. With this additional insight, we successfully prevented the SEC from offering irrelevant and potentially prejudicial witness testimony at trial. These motions also allowed us to narrow and focus the issues to be resolved at trial, which enabled us to focus our energy and resources appropriately. We were particularly mindful of the SEC's efforts to deviate from what it alleged — through our *in limine* motions, constant vigilance, and frequent reminders to the Judge, we were able to keep the SEC in check and hold it to its Amended Complaint.

[21] June 11, 2008 Hr'g Tr. 24:17-19.

[22] Apr. 25, 2014 Hr'g Tr. 116:12-14.

Ultimately, we prevented the SEC from calling five witnesses at trial. The end result of the favorable in limine indications from Judge Daniels was that the defendants were able to tell their story naturally, from beginning to end, while the SEC was forced to work backwards, asking the jury to make inferential leaps based on shaky circumstantial evidence that was open to several interpretations.

Neutralizing Expected Juror Bias

In a climate of hostility towards and skepticism of Wall Street, juror bias against a hedge fund and its employees was a serious concern. To counteract this bias, we were prepared to emphasize at trial that our client was not a typical hedge fund manager; rather, he and his fund operated in a small niche of the industry (small cap value investing), employed a "buy and hold" strategy, and worked hard to earn well-deserved profits. We also emphasized the personal background of each of the defendants, to humanize them, and make clear that they were ethical, upstanding businessmen who took the rules seriously.

This strategy was particularly important, given that Judge Daniels did not allow use of a juror questionnaire during the *voir dire* process. Thus, we were given only a limited view into the opinions and potential biases of each prospective juror, making the composition of the jury more of a wild card than we would have preferred. Nonetheless, we believed that even in the potentially hostile atmosphere facing hedge fund defendants accused of insider trading in New York City, it was possible to obtain a fair jury.

Jury selection is a combination of art and science. It is more an exercise in seeking to exclude profoundly unfair prospective jurors than identifying those who are likely to favor one's case. Our work with jury consultants focused on identifying jurors who likely held profoundly biased views that might prevent them from carefully considering our defense and holding the SEC to its burden of proof. Through our jury research, we confirmed that intelligent, educated New Yorkers with at least a basic understanding of investing were generally willing and able to give our defense fair consideration. Based on the SEC's use of its peremptory strikes during *voir dire*, it appeared that the SEC sought to exclude this same juror type, namely more educated jurors. Even when prospective jurors revealed in their answers to the court's questions an inability to communicate well in English, the SEC argued there was no cause to remove these individuals from the jury.

The jury we ultimately selected consisted of five men and five women. There was great diversity among their ethnic, religious, and cultural backgrounds. The jury included a graphic designer, a musician, a bartender, an historian, a real estate broker, and a special education teacher, among others. The jurors appeared to take their obligations at the trial seriously, paid close attention while witnesses testified, and proved willing to hear close evidence dispassionately. Many observers warn that a financial services or hedge fund-associated defendant cannot expect to receive a fair hearing from a jury, especially a New York jury, in such a matter given the broad public sentiments about professional investors. We and our clients rejected this proposition. Although each case is different, the outcome in this case demonstrates that regulators and Wall Street defendants alike may overestimate the impact of juror bias. Our jurors rejected the SEC's efforts to incite emotional reactions against our clients based on their status, and in so doing, the jurors proved that they were willing to be impartial and not check their common sense at the courthouse door.

Use of SEC Investigative Testimony

As described above, the SEC was able to obtain an abundance of investigative, OTR testimony before it filed its lawsuit in this case. Unsurprisingly, the staff sought to make use of much of that testimony during the trial; all three defendants had been questioned by the SEC and those statements were clearly admissible as party admissions. However, we did not anticipate the lengths to which the SEC would go to offer OTR testimony from third parties. Unbeknownst to us, one of the SEC's two main witnesses apparently made clear to the SEC that he had virtually no memory of the key events in 2001. The SEC never informed the court or the defense of this significant change in its evidence. Indeed, during its opening statement to the jury, the SEC made no mention of this evidentiary deficiency. Instead, when finally required to call the witness at trial, the SEC repeatedly impeached its own witness, offering his recollections from 2002 to contradict his current lack of memory.

The SEC was permitted to offer this evidence, over defense objections, and notwithstanding the clear mandate in Rule 32 that a deposition may only be used against a party on the condition that "the party was present or represented at the taking of the deposition or had reasonable notice of it."[23] The very nature of the OTR testimony meant that none of the defendants was present during this third-party witness's OTR testimony, nor were the defendants given notice of it; indeed, when

[23] FED. R. CIV. P. 32(a)(1)(a).

the testimony was taken in 2002, there were not yet any "defendants" to whom notice could be given. Nonetheless, these prior statements were presented to the jury.

Faced with these prior statements that the defendants were never able to cross-examine, and unable to obtain relief from the court at trial, we made the case directly to the jury. We repeatedly emphasized through our questioning that the SEC's witness remembered next to nothing about a supposed conversation years earlier in which Mr. Obus allegedly revealed to him (a perfect stranger) that he had been "tipped off" to the SunSource acquisition. Of course, this was one of the key "nuggets" that the SEC had derived in its closed-door OTR investigation interviews over a decade earlier. The jury seemed to understand that something strange was going on — in one of the few notes sent to Judge Daniels requesting evidence during its deliberations, the jury requested to hear this forgetful witness's OTR testimony and to view his deposition testimony taken six years later.

We also made effective use of another bit of evidence that our broad pre-trial discovery had revealed: in 2001, less than two weeks after Mr. Obus's alleged admission, the same witness had failed to mention any such conversation when asked by the NASD to respond to an inquiry regarding possible insider trading in SunSource. What's more, we were able to adduce that the SEC itself never confronted the witness with this glaring inconsistency in 2002 or 2008 or 2014, even though it was well-aware of the inconsistency and had premised its decade-long case against the defendants on this witness's 2001 recollection that Mr. Obus had said that he had been "tipped." The SEC's aggressive use of the OTR process and its failure to account for contradictory evidence quickly unfolded before the jury. And ultimately, the jury saw through the SEC's attempt to rely on dubious OTR testimony.

Challenges and Benefits of Old Evidence

Due to a variety of factors discussed above, the case was tried 13 years after the relevant events took place. As one might expect, this presented many challenges. Memories naturally fade, and it becomes harder to piece together what really happened years earlier. In addition, the separate SEC investigation in 2002 followed by traditional pre-trial discovery in 2008 meant that in addition to fading memories, we had to contend with multiple sets of testimony for all of the relevant witnesses that were at times consistent and at times inconsistent. The first set, the OTR testimony, was not subject to testing by vigorous cross-examination. Simply stated, the SEC had used the OTR examination process in 2002 to fashion a partial evidentiary record that fit its desired narrative. The SEC presumably assumed that, as in most of its cases, the defendants would settle without challenging through discovery and trial the bona fides of its investigative record.

Equally, the SEC had obtained OTR testimony from the defendants applying the same questionable tactics. Rather than explaining the evidence against them to the defendants during the OTR interviews, the SEC used the OTR process to surprise and intimidate. This record raised particular challenges in preparing the defendants for trial. So, we highlighted to the jury the essentially unfair nature of the OTR process and the sometimes abusive "gotcha" nature of the questioning. Of course, we had raised these concerns repeatedly with the investigating staff and later with senior enforcement staff during the Wells process, to no avail. But juries are not the SEC. Properly selected and educated at trial, juries can identify unfairness and gamesmanship when it is present.

Despite the inherent unfairness of the OTR interview process, the OTR testimony proved helpful in cross-examining the SEC's key witnesses. The combination of faded memories and multiple sets of testimony provided significant fodder to undermine the memories and recollections of these witnesses. We ignored insignificant inconsistencies between testimony taken of the same witnesses in 2002 and 2008, believing that jurors would not view them as meaningful. Instead, we marshaled and adduced the significant inconsistencies that might meaningfully weaken their trial testimony. We developed an intimate familiarity with the various iterations of testimony, which proved particularly advantageous during trial. Our clients were prepared to acknowledge and explain (if necessary) their prior statements, and we were prepared to take advantage of every meaningful inconsistency and inaccuracy in the opposing witnesses' testimony. Over the course of the trial, we demonstrated to the jury that we were in control of the facts, that our witnesses were credible and reasonable, and that the SEC's witnesses were not.

Credibility of Defense Witnesses

Given the civil nature of the claims, the SEC called all three defendants in its case-in-chief. Thus, the credibility of our clients was a paramount focus from the trial's inception. Notwithstanding its pre-trial motions to exclude "emotional" arguments from the trial, the SEC's trial counsel repeatedly vilified hedge funds and the world in which they operate. From stating that people in the financial world trade inside "information amongst themselves like baseball cards"[24] (which had no relevance to the facts of our case), to questioning our clients about "betting against the success of a company" and "root[ing] for bad things to happen to a company" by "shorting" stock[25] (again, irrelevant to the facts of our case), the staff sought to capitalize on every possible anti-Wall-Street bias it could muster.

Then, even though the SEC had specifically moved *in limine* to preclude the defendants from making any reference to the negative impact this lawsuit has had on the defendants' lives, or to offer any evidence of the defendants' good character, the SEC called each of the defendants a liar in its closing arguments. What's more, the SEC did so after explicitly stating that it was not there to call anyone a liar:

> Now the SEC, we're not here to call people names, I'm not here to tell you that Strickland is a liar or tell you Black is a liar or tell you Obus is a liar. I'm certainly not here to tell you they're bad people, that they don't have good things and don't do good things and they're not good people. But I am here to tell you that they have not told the truth in this case. The evidence has shown that they have not told the truth in this case.[26]

After accusing the defendants of blatantly lying to everyone for 13 years, the SEC staff made it personal for the jury. The SEC attorney stated that what was at stake in this case was the integrity of the stock market, where "hard-working people save for their retirement and save for their kids' college and save for a rainy day."[27] Why was this important? Because, the SEC said, the jury needed to tell the defendants that "even though [they] may have more money than most people and be more sophisticated than most people and be able to get the CEO of a company on the phone at a drop of a hat, they still have to follow the same rules as everybody else."[28]

This onslaught of stereotypes is what many financial institutions, investment funds, and individuals reasonably fear they will face if they refuse to give in to SEC settlement demands and, instead, fight. Confronted with such cheap shots designed to play to prejudices the jury might have, we decided to meet the allegations head-on. We emphasized that our clients worked hard for their success and that they earned their money through old-fashioned hard work. What's more, we made clear that our clients respected the stock market as an institution based on American ideals — a system that allowed companies to raise money to realize their dreams. In the end, we believe this narrative carried the day with the jury. Our clients had nothing to hide, they were proud of their work, and they were certainly not insider traders.

THE CASE'S LEGACY LIVES ON

Although the trial is over, the legacy of the *Obus* case lives on and looms large. The Second Circuit's *Obus* decision has far-reaching implications for insider trading jurisprudence. First, the Second Circuit made clear that neither the tipper nor tippee need have actual knowledge of a breach of fiduciary duty in order to be liable under the misappropriation theory. Further, and more controversially, the Second Circuit's decision in *Obus* has been interpreted by some courts and commentators as standing for the proposition that tippee liability does *not* require knowledge of a personal benefit to the tipper. If this interpretation proves correct, liability for downstream tippees will be expanded dramatically.[29]

In *Obus*, the Second Circuit took the opportunity to articulate each element of insider trading under the misappropriation theory. Specifically, the court held that tipper liability requires that: (1) the tipper has a duty to keep material, non-public information confidential; (2) the tipper intentionally or recklessly breaches that duty; and (3) the tipper receives a personal benefit for the tip.[30] In turn, tippee liability requires that: (1) the tipper breached a duty by tipping confidential information; (2) the tippee knew or had reason to know that the tipper breached a fiduciary duty; and (3) the tippee, while in knowing possession of the material, non-public information, uses that information by trading or tipping for his own benefit.[31] Further, the court explained that downstream tippee liability "may [] result from conscious avoidance."[32]

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[24] Trial Tr. 65:8-15.

[25] *Id*, at 1094:19-1095:8.

[26] *Id.* at 1695:19-1696:1.

[27] *Id.* at 1698:7-9.

[28] *Id.* at 1698:21-25.

[29] Perhaps this explains why so many SEC and Department of Justice prosecutors attended portions of the *Obus* trial.

[30] *SEC v. Obus*, 693 F.3d 276, 289 (2d Cir. 2012).

[31] *Id.*

[32] *Id.* at 288-89 (citing *SEC v. Musella*, 678 F. Supp. 1060, 1063 (S.D.N.Y. 1988)).

Applying those elements to the facts, the Second Circuit in *Obus* held that the "undisputed fact that Strickland and Black were friends" provided sufficient evidence that Strickland may have received a benefit by tipping Black.[33] The Second Circuit explained that the term "personal benefit" has a "broad definition," and stated that the SEC's burden of proof as to the "personal benefit" element is "not a high one."[34] Notably, the court made no mention of any requirement that the tippee have knowledge of a personal benefit to the tipper. The court's silence on this issue was particularly striking when considered against the backdrop of previous cases, which had expressly held that a tippee's knowledge of the tipper's personal benefit was a required element for liability.[35]

In the wake of *Obus*, courts within the Southern District have split. In *United States v. Whitman*, Judge Rakoff held that in order to be liable, a tippee must know that the tipper received some type of personal benefit.[36] Judge Rakoff acknowledged that in cases involving a remote tippee, the government could have trouble satisfying the personal benefit element.[37] But he explained that this "unfortunate 'loophole'" is the result of "the topsy-turvy way the law of insider trading has developed in the courts," and something which only the legislature can change.[38] In contrast, the court in *United States v. Newman* reached the opposite conclusion.[39] There, Judge Sullivan interpreted *Obus* as "mak[ing] clear that the *tipper's* breach of fiduciary duty and receipt of a personal benefit are *separate* elements and that the *tippee* need know only of the former."[40]

Despite acknowledging the open question, the Second Circuit recently declined to resolve the personal benefit issue.[41] It is expected, however, to address the question head-on when it decides *United States v. Newman*. The *Newman* defendants have argued that the district court erred by failing to instruct the jury that the government was required to prove that the tippees knew the tippers disclosed information for some personal benefit.[42] The government, on the other hand, maintains that "the securities fraud statute's *mens rea* provision does not expressly apply to the benefit requirement," and it is therefore not an element of the offense.[43] *Newman* thus offers the Second Circuit a chance to navigate the unsettled legal waters that *Obus* left in its wake.

THE ROAD LESS TRAVELLED — UNTIL NOW

Following the SEC's back-to-back trial losses in the *Obus* case and a second insider trading trial a week later,[44] the head of the SEC's enforcement division, Andrew Ceresney, announced to the District of Columbia Bar that the SEC is planning to bring future insider trading cases as SEC administrative proceedings, rather than as lawsuits in federal court.[45] Mr. Ceresney was quoted as saying, "I do think we will bring insider trading cases as administrative proceedings in appropriate cases. . . . We have in the past. It has been pretty rare. I think there will be more going forward."[46]

As Mr. Ceresney indicated, historically the SEC has filed very few insider trading cases as administrative proceedings. One such proceeding in recent history against former Goldman Sachs Group Inc. director Rajat Gupta was originally filed administratively. However, the SEC later dismissed and refiled the suit in federal court after Mr. Gupta sued the SEC in federal court alleging that by bringing an administrative proceeding rather than a federal lawsuit, the SEC was violating Mr. Gupta's right to due process.[47]

Earlier this year, defendants in two different SEC administrative actions filed suits in federal court seeking to have their administrative proceedings enjoined as violating their due process rights.[48] However, both

[33] *Id.* at 291.

[34] *Id.* at 292.

[35] *See, e.g., United States v. Rajaratnam*, 802 F. Supp. 2d 491, 498-99 (S.D.N.Y. 2011).

[36] 904 F. Supp. 2d 363, 370 (S.D.N.Y. 2012).

[37] *Id.* at 372.

[38] *Id.*

[39] No. 12 Cr. 121 (RJS), 2013 U.S. Dist. LEXIS 70242 (S.D.N.Y. May 7, 2013).

[40] *Id.* at *5 (emphasis in original).

[41] *United States v. Whitman*, No. 13-491-cr, 2014 U.S. App. LEXIS 2942, at *17-18 (2d Cir. Feb. 19, 2014).

[42] *United States v. Newman*, 13-1837, Aplt. Br. of T. Newman, at 33.

[43] *United States v. Newman*, 13-1837, Aplee. Br., at 35.

[44] *SEC v. Moshayedi*, No. 12-01179 (C.D. Cal.).

[45] Sarah N. Lynch, *SEC to File Some Insider-Trading Cases in Its in-House Court*, REUTERS, June 11, 2014.

[46] *Id.*

[47] *Gupta v. SEC*, 796 F. Supp. 2d 503 (S.D.N.Y. 2011).

[48] *See Jarkesy v. SEC*, No. 14-114 (BAH), 2014 WL 2584403 (D.D.C. June 10, 2014); *Chau v. SEC*, No. 14-CV-1903 (S.D.N.Y. Mar. 18, 2014).

challenges failed to halt the impending administrative proceedings and these defendants were forced to proceed in the SEC's administrative setting. Nonetheless, should a challenge to administrative proceedings prove successful in the future, the SEC may have to reconsider how it pursues its cases.[49]

It's no surprise that the SEC would prefer to bring administrative proceedings whenever possible — it enjoys a kind of home-court advantage in such proceedings that are presented to an administrative law judge, not a jury, and the SEC can also take advantage of that forum's more limited discovery rules and more lenient evidentiary rules, including the admissibility of hearsay. This is the same home-court advantage that the SEC uses when it gathers evidence through the one-sided OTR process. The SEC's General Counsel, Anne K. Small, recently acknowledged that the rules governing SEC administrative proceedings may well be out of date and in need of revision.[50] Speaking at a Q&A session with members of the District of Columbia Bar, Ms. Small noted that it was "entirely reasonable to wonder" if those rules should be updated to correspond with the more complex administrative matters the SEC expects to take on — including insider trading actions — such as by allowing more flexibility on current limits to trial preparation time or allowing for depositions to be taken.[51] "We want to make sure the process is fair and reasonable, so [changing] procedures to reflect the changes makes a lot of sense," she said.[52] Of course, it remains to be seen whether any meaningful changes will actually be made to the rules governing SEC administrative proceedings.

CONCLUSION

Mr. Obus's saga belies the notion that challenges to threatened SEC actions cannot succeed in the current environment. Not every defendant has the stamina, resources, or wherewithal to mount the challenge. But for those who opt to do so, there are ways to prevail. And even for those defendants who ultimately resolve the charges before trial, a vigorous defense strategy can position the defendant for a much more favorable settlement. Above all, it is critical to develop a defense strategy that (1) is based on common sense and (2) directly challenges the SEC staff at every turn. Based on our experience defending Mr. Obus, the due process afforded by a federal jury trial was critical to expose the shortcomings in the SEC's case and provided defendants with an opportunity to finally explain what *really* happened. There was no insider trading and the SEC had gotten it wrong from day one. ■

[49] On August 8, 2014, the plaintiff in *Jarkesy* filed his notice of appeal to the United States District Court for the District of Columbia, challenging the district court's dismissal of his complaint. *See* Civil Joint Notice of Appeal, *Jarskey v. SEC*, No. 1:14-cv-00114-BAH, (D.D.C. Aug. 8, 2014), ECF No. 23. Plaintiff Chau's case against the SEC is pending; although the district court refused to grant Mr. Chau's request for a preliminary injunction to halt the administrative proceeding against him, the court has not yet issued a decision on the merits of Mr. Chau's claims that the SEC violated his constitutional equal protection and due process rights.

[50] Daniel Wilson, *SEC Administrative Case Rules Likely Out of Date, GC Says*, Law360, June 17, 2014.

[51] *Id.*

[52] *Id.*