Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—S.D.N.Y.: SEC settlement did not extinguish investors' claims against SAC Capital, (Aug. 14, 2014)

Click to open document in a browser

Securities (Federal) > News & Current Awareness > Securities Regulation Daily > Securities Regulation Daily Wrap Up > 2014 > August 2014 > August 14, 2014 > FRAUD AND MANIPULATION—S.D.N.Y.: SEC settlement did not extinguish investors' claims against SAC Capital, (Aug. 14, 2014)

By John M. Jascob, J.D.

A federal district court in Manhattan has declined to dismiss several investor claims against hedge fund adviser S.A.C. Capital Advisors, L.P. (SAC) and several affiliated persons arising from the defendants' trading on inside information in the securities of Elan Corporation and Wyeth LLC. Judge Victor Marrero ruled that SAC's disgorgement of $275 million in ill-gotten profits in a related settlement with the SEC did not serve to extinguish the class action plaintiffs' claims against SAC, founder Stephen A. Cohen, and former portfolio manager Mathew Martoma (*Kaplan v. S.A.C. Capital Advisors, L.P.*, August 14, 2014, Marrero, V.).

Background. Following what authorities have described as the largest insider trading scheme in history, SAC agreed to disgorge to the SEC $275 million in illegally gained profits and avoided losses resulting from the firm's trading in Elan and Wyeth shares between August 2006 and July 18, 2008 (see *Securities Regulation Daily*, March 15, 2013). As part of the scheme, Martoma obtained confidential information from defendant Sidney Gilman, one of the doctors supervising the clinical trials, regarding the safety and efficacy of bapineuzumab, a drug developed jointly by Elan and Wyeth to treat Alzheimer's disease. SAC then used the information to trade ahead of a negative public announcement regarding the clinical trial's results. Shareholders of Elan and Wyeth alleged that, by trading contemporaneously with SAC while SAC was in possession of the insider information, they suffered damages as defined in Exchange Act Section 20A, Section 10(b), and Rule lOb-5.

Disgorgement setoff. The court rejected SAC's argument that the $275 million disgorgement paid by SAC to settle the SEC's charges precluded the plaintiffs' claims for damages in relation to the drop in Wyeth and Elan share prices. Although noting that Exchange Act Section 20A requires that any damages from the price drop be reduced by the disgorgement from a settlement with the SEC, the court ruled that the plaintiffs could nevertheless attempt to prove the insufficiency of the SEC settlement and recover any difference between actual profits and the amount disgorged to the SEC. Similarly, the court also declined to dismiss the plaintiffs' claims against Gilman.

The court stated that SAC's contention that the settlement extinguished the plaintiffs' claims amounted to a "novel and curious proposition" because the plaintiffs' appraisal of their damages at the pleading stage was merely an estimate, not a mathematical fact. Moreover, SAC presupposed that the amount of the disgorgement under the SEC settlement was "an absolute benchmark, giving it the status of scientific truth." The court noted, however, that the settlement amount was not determined through a public adversarial proceeding, but was negotiated privately by SAC and the SEC. Accordingly, the court lacked authority to hold that the amount of the disgorgement was incontestably accurate and not open to question by other interested persons.

Tysabri disclosure. The court also declined to dismiss the plaintiffs' claims for damages regarding the drop in Elan's value that occurred following the company's disclosure on August 1, 2008, of problems with its signature drug, Tysabri. SAC argued that, because the Tysabri drop was not attributable to any misconduct on SAC's part, the firm should not be required to disgorge losses avoided and profits gained due to that drop. The court ruled that SAC's arguments were inappropriate at this stage in the proceedings, however, because damages in an action under Section 20A are measured by determining the difference between the price the realized by the insider and the market price of the securities within a reasonable time after the inside information has been disseminated. The determination of the "reasonable amount of time period" is not properly made at the motion to dismiss phase, the court reasoned, because the inquiry is highly fact-intensive and depends on when the

defrauded sellers or buyers reasonably should have digested the disclosed information and have taken steps to protect their interests.

As to SAC's contention that allowing the plaintiffs to collect damages based on a market event wholly unrelated to the alleged insider trading would represent an improper windfall recovery, the court observed that this argument was rejected by the Second Circuit in *Elkind v. Liggett & Myers, Inc.* (2d Cir. 1980). Similar to the defendants in *Elkind*, SAC had no knowledge of the impending drop when it liquidated its position in Elan. Still, by trading on inside information, SAC assumed the risk that other independent factors could compound the decrease in share value following Elan's disclosure of the bapineuzumab clinical trials.

The case is No. 12-cv-9350 (VM).

Attorneys: Audra Jan Soloway (Paul Weiss Rifkind Wharton & Garrison LLP) and Martin B. Klotz (Willkie Farr & Gallagher LLP) for S.A.C. Capital Advisors, L.P.; S.A.C. Capital Advisors, Inc.; CR Intrinsic Investors, LLC.

Companies: S.A.C. Capital Advisors, L.P.; S.A.C. Capital Advisors, Inc.; CR Intrinsic Investors, LLC

LitigationEnforcement: FraudManipulation NewYorkNews