

BLOG POST

Stock T[r]ipping

July 9, 2014

On Tuesday, the Southern District of New York lost its first stock tipping case under the stewardship of U.S. Attorney Preet Bharara when a federal jury acquitted former Galleon Group LLC manager Rengan Rajaratnam of participating in an insider trading conspiracy. This broke a winning streak of more than 80 convictions or guilty pleas in insider trading cases. The government's case encountered trouble from the beginning, when the government had to drop four of the seven charges in the indictment under criticism from the court. The government lost two more charges during trial when the court determined that the government had failed to produce sufficient evidence to sustain them. The acquittal removed the single remaining charge.

In the words of Austin Powers, "Very ouch, baby."

Whenever the government loses at trial or on appeal, especially in a high profile case, there are lessons to be drawn. This case presents no exception. Here, an aggressive U.S. Attorney's Office – an office willing to take litigation risks – ran into a rapidly narrowing area of law and a defense counsel who was able to exploit it.

Legally, the court signaled its perception of this case right away when it criticized the indictment as being inconsistently charged, which led to the government dropping counts. At the same time, the Second Circuit sent defense-friendly signals in a separate case, noting that while the government must show that a person who provided a tip received some kind of benefit in order to prove insider trading, it is likely that the government must also prove that the defendant who used the tip knew about that benefit. The government was unable to prove this fact in this case. With the legal landscape changing around it, the government did little to adapt. Why?

It is widely known that psychologically, people become more invested in cases the longer that they spend working on them. This investment may lead to a skewed valuation of the strength of the case. It's why experienced practitioners work hard on objectively analyzing the strengths and weaknesses of a case before proposing a route forward, and re-evaluate these strengths and weaknesses obsessively.

Confused? Think about it this way: look at the beginning of each season for your local sports team. Do you tend to value your team's potential for success more highly at the beginning of each season? More so than other teams? It's because you become optimistic about your team based on the information flow that is controlled by local news coverage. And that information saturation about your local team is vastly greater than what you get about any other team. That selective information flow is largely what happens in trial preparation, too.

Did the government overvalue its case here? Was it too invested to take a clear look at the evidence and probable outcome? No one can say for certain, but it certainly looks like it. What we do know is that notwithstanding significant headwinds from the courts, the government still proceeded to trial, and according to post-trial juror interviews, did not really address the source of the courts' concerns.

The government makes mistakes, too, you see. (I know, right?!) This psychological impact of an investment of time applies equally to federal agents and federal prosecutors. Often, recognizing this makes all the difference in a case – and it's why having practitioners who have experienced both the government and private sides may be able to appeal to a different part of prosecutors' psyches in order to achieve positive results for their clients.

In the end, this will certainly cause the SDNY to reevaluate its docket of stock tipping cases before the next one is charged. And in all likelihood, it will also cause the government to reflect on why its case valuation was so much at odds with the jury's verdict.

Both are healthy steps to avoid tripping on the next tipping case.