

Don't Expect Much From The Kinnucan Case

Law360, New York (February 24, 2012, 2:04 PM ET) -- You may remember a dust up from late 2010 when FBI agents approached John Kinnucan at his house in Portland, Ore., and tried to convince him to cooperate in the U.S. Department of Justice's widening investigation into insider trading. Kinnucan, the principal of his own expert consulting firm, Broadband Research Corporation, was not ready to play along. After the visit, in fact, he sent an email out to his clients saying:

Today two fresh faced eager beavers from the FBI showed up unannounced (obviously) on my doorstep thoroughly convinced that my clients have been trading on copious inside information. (They obviously have been recording my cell phone conversations for quite some time, with what motivation I have no idea.) We obviously beg to differ, so have therefore declined the young gentleman's gracious offer to wear a wire and therefore ensnare you in their devious web.

Kinnucan wasn't arrested then, and except for a few bizarre and anti-Semitic emails and voicemails to prosecutors and reporters, things went quiet for a while. But he was arrested on Feb. 16, when agents came to Portland again. The DOJ and the U.S. Securities and Exchange Commission have both charged Kinnucan with running Broadband Research as a funnel for material nonpublic information about F5 Networks Inc.

To take the SEC's case in particular, it is interesting how narrowly pled it is. It may be that Kinnucan was at the center of a hurricane of illegal trading, but you aren't going to learn that from the SEC's complaint. It is focused on a single quarterly earnings announcement for F5, a Seattle-based provider of networking technology, in July 2010. The SEC claims that on the morning of July 2, Kinnucan learned that F5 had generated better-than-expected financial results for the third quarter of its 2010 fiscal year, with the public announcement scheduled for July 21.

Within hours of learning this, Kinnucan had phone conversations or left messages with several clients to convey that F5's revenues would exceed market expectations. At least three clients, an analyst and two portfolio managers, then traded on the basis of Kinnucan's inside information. The trading resulted in profits or avoided losses of nearly \$1.6 million.

The Southern District of New York's case is somewhat broader, and includes references to Sandisk Corporation and Flextronics International Ltd. as well. The thing is, except for these isolated instances, Broadband Research might have been an entirely legitimate business, collecting and coordinating data for clients to make their trades smarter and more educated. But once you've crossed the line into delivering material, nonpublic information about these issuers — any of them at all — you've put yourself at risk for investigation and indictment by criminal authorities.

There may yet be a case in the current expert network insider trading wave that blurs that line and defines for those networks everywhere how far they can go, but I don't think Kinnucan's is the one. Advance inside information about a publicly traded company's quarterly earnings is not legitimate information to trade on. We all know that. Kinnucan will be found guilty or not guilty (and liable or not, in the SEC's case), but his case likely won't provide the definition that many traders crave.

Other cases are out there where the SEC really is pushing the bounds of materiality in the insider trading context, and SEC v. Steffes (N.D. Ill.) is one of them. That case has survived a motion to dismiss and further developments will be interesting to watch.

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