Office of
Legislative Affairs

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

December 1, 2006

Mr. Barr Huefner
Hearings Clerk
Committee on the Judiciary
United States Senate
224 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Huefner:

Enclosed, please find written responses to a series of questions from Chairman Specter in order to complete the record from the Committee on the Judiciary's hearing entitled "Illegal Insider Trading: How Widespread is the Problem and is there Adequate Criminal Enforcement?" held September 26, 2006. I am also sending you an electronic copy for your convenience.

I hope that the attached responses from Linda Thomsen are helpful to the Committee. As with other issues involving the Commission's responsibilities, we welcome the opportunity to share our views on these matters. If the Committee has additional questions or requires additional materials to complete its hearing record, please do not hesitate to contact me at (202) 551-2010.

Sincerely,

Jane Cobb

Jane Cobb
Director
Office of Legislative Affairs

Enclosures

United States Senate
Committee on the Judiciary
Questions Submitted for the Record

Linda Thomsen
Director, Division of Enforcement
U.S. Securities and Exchange Commission

"Illegal Insider Trading: How Widespread is the Problem and is there Adequate Criminal Enforcement?"

September 26, 2006

Responses to the follow-up questions posed in Chairman Specter's letter dated October 19, 2006 regarding Linda Thomsen's testimony about Insider Trading on September 26, 2006, are set forth below.

1. **How many times has the SEC sought treble damages in insider trading cases over the past 5 years?**

   The SEC generally seeks treble damages in all of its litigated cases alleging insider trading. Accordingly, over the past 5 years, the SEC has sought treble damages in litigated cases against a total of 63 defendants.

2. **Identify all cases in which the SEC has secured treble damages over the last 5 years?**

   The federal courts granted treble damages against 15 of the 63 defendants against whom the SEC sought treble damages. Thus, the courts imposed treble damages in 23.8% of the instances in which the SEC sought such damages. The 15 instances in which the courts granted the SEC's request for treble damages over the past 5 years are set forth in the chart attached hereto. However, only one of these cases, *David E. Lipson v. SEC*, Civ. Action No. 97 C.2661 (N. D. Ill. Jan. 11, 2001), was the result of a jury verdict. The other awards were made by courts in the context of default judgments, bench trials or on the Commission's motions for summary judgment before trial.

3. **Please report what, if anything, the Securities and Exchange Commission has done with respect to the Measuredmarkets, Inc. Report on merger and acquisition activity suggestive of insider trading?**

   Even before the publication of New York Times article, the SEC's Division of Enforcement, through its ordinary processes, had independently commenced insider trading investigations in approximately 60% of the transactions identified by Measuredmarkets as "hits" on the basis of aberrant trading activity in advance of the public announcement of the transaction. The SEC's ongoing insider trading investigations were commenced primarily on the basis of referrals from various SROs through the Intermarket Surveillance Program previously described in my written testimony. An additional 25% of the hit transactions had been independently investigated by the SROs, but those investigations were closed without further action and did not result in referrals to the SEC. The remaining 15% of the hit transactions are still under investigation at the SRO level.

Accordingly, 100% of the transactions identified as hits in the Measuredmarkets spreadsheet have been, or are being, investigated by the SEC and the SROs. In addition, the SEC and SROs independently commenced investigations into a substantial number of the transactions identified in the Measuredmarkets spreadsheet as "maybe" or "no" regarding potential insider trading.

As a point of information, the SEC's percentages above are based on all 46 transactions identified as hits by Measuredmarkets. The Times article stated that there were 37 hits, and later stated there were 38, so the reporter apparently eliminated 8 or 9 of the hits (or about 20% of the total of 46) from further consideration for the article. The SEC has no information as to which transactions were excluded, and therefore the percentages set forth above identify the actions taken by the SEC and SROs with respect to all 46 hits.

4. **What is the SEC's view as to the efficacy of the underlying data and analysis in the Measuredmarkets Report?**

The SEC's Enforcement Division, Office of Economic Analysis and Office of Market Surveillance have reviewed the Measuredmarkets spreadsheet, but the SEC has only limited information regarding the underlying data and analysis, as Measuredmarkets considers its analytical methods to be proprietary. We understand the spreadsheet identifies transactions in which there was aberrational trading activity in advance of the public announcement of the transaction and an apparent absence of public information or events that might explain the aberration. Since all but two of the 46 transactions identified as hits by Measuredmarkets independently generated automated trading alerts at the respective SROs, the SEC has no reason to believe that the Measuredmarkets spreadsheet does not accurately identify aberrational trading activity.

The SEC takes issue, however, with the apparent conclusion that aberrational trading patterns necessarily suggest insider trading. The Measuredmarkets spreadsheet data, as interpreted by the New York Times reporter ("MM/NYT"), proceeds by process of elimination. Upon establishing an aberrational trading pattern, MM/NYT seeks to find publicly known information or events that might account for it. In the absence of such public announcements or events, MM/NYT suggests that the activity necessarily must have been the result of insider trading. But that conclusion may be inaccurate, as the aberrational trading pattern may result from any number of other factors. For example, traders often proceed on the basis of rumor, intuition or hunch. Some traders may have observed a specific industry for years and may simply view a particular company as ripe for acquisition. Others may notice a spike in trading volume in a stock and trade only because they see others doing so. These factors may provide legitimate alternative explanations for an aberrational trading pattern, but there may be no public record that these factors were at work. In such cases, based on the apparent lack of public information, the MM/NYT methodology would generate false hits.

Aberrational trading activity alone does not establish potential insider trading. Before any such conclusion can be drawn, the type of aggregate trading information relied on by Measuredmarkets must be broken down into specific trades by specific traders in order to identify which traders may have had access to, and traded on, material nonpublic information. To our knowledge, Measuredmarkets does not have access to the kind of detailed trading records that would enable it to establish a demonstrable link between aberrational aggregate trading patterns and any specific instances of insider trading.

Through the Intermarket Surveillance Program, the SEC and the SROs have full access to precisely the type of detailed trading records necessary to determine whether there is a plausible link between aberrant trading patterns and potential insider trading. The SROs' trading records reveal the identities of the traders, the size and frequency of specific trades and the timing of specific trades in relation to the release of public information. Based on this information, the SROs also have the ability to conduct followup investigations. For example, in insider trading investigations, the SROs routinely request that companies survey their employees to identify any contacts the employees may have had with a list of persons identified as traders. Because of the availability of detailed trading records and related information, the SEC and SROs have the ability to conduct much more focused investigations of whether aberrational trading patterns were caused by possible insider trading, and the results of those investigations are likely to be far more reliable than conclusions based on the Measuredmarkets methodology.

5. **What, if anything, is the SEC going to do in the future to stem the tide of unlawful insider trading in advance of mergers and acquisitions?**

The SEC will continue to use every tool available to it to combat insider trading, particularly the Intermarket Surveillance Program. Since 44 of the 46 hits identified by Measuredmarkets also generated trading alerts and followup investigations at the SROs, the Measuredmarkets spreadsheet itself confirms that the SROs' surveillance systems are highly effective in identifying aberrant trading patterns. Moreover, detailed trading records and other investigative tools available to the SROs ensure that they will continue to have the ability to make reliable insider trading referrals to the SEC. The SEC will support and coordinate with the SROs in their ongoing efforts to further improve the Intermarket Surveillance Program. Notably, the SEC is presently assisting the SROs in a effort to track potential flows of inside information in market transactions. In addition, the SEC is an active participant in the monthly meetings organized by the SROs to combat insider trading. The SEC also intends to study the referrals it has received from the SROs in recent years and the resulting SEC enforcement investigations in order to further improve the referral process and to ensure that referrals are consistent with SEC and SRO enforcement priorities.

6. **Would the SEC support legislation to address the adverse rulings in the Scrushy and Stringer district court opinions raised at the hearing?**

   We believe *Scrushy* and *Stringer* were wrongly decided and run counter to the substantial weight of federal case law endorsing cooperation between the Department of Justice and the SEC. Consistent with our view, most federal courts in subsequent cases have not followed the logic underlying *Scrushy* and *Stringer*, most recently in *United States v. Luce*, No. 05 CR 340, 2006 WL 2850478 (N.D. Ill. Sep. 29, 2006) (Manning, J.) and *United States v. Mahaffy*, 446 F.Supp.2d 115 (E.D.N.Y. 2006). Since *Stringer* is presently on appeal, we believe the optimal solution would be for the Ninth Circuit Court of Appeals to reverse the district court's opinion. If the Ninth Circuit does not reverse the lower court's opinion, however, the Enforcement Division would revisit the advisability of legislation.