

Is the O'Hagan Precedent Central to Ackman's Defense of Allergan's Insider Trading Claims?

August 17, 2014 - by Robert W. Welkos - First came the civil suit accusing New York hedge fund manager William A. Ackman of using nonpublic insider knowledge in acquiring a huge stake in Botox maker Allergan, Inc. (AGN). Then news reports surfaced this week that the Securities and Exchange Commission was looking into Ackman's arrangements with Canadian drug maker Valeant Pharmaceuticals International (VRX) to see whether their dealings violated insider trading rules.

But for a high-wire investor like Ackman, who has pursued such companies as Target, McDonald's and Wendy's, experts say the attention he's getting in the Allergan matter comes with the territory. "I think this is sport (to him)," said New York securities lawyer Jenice L. Malecki. "I think he's a smart businessman. Look, companies have whole floors where they have people picking at loopholes—accountants, lawyers—asking how can we make an extra buck without violating the law? (Ackman's) just a private individual who has a company or several companies and he's picking at the loopholes and seeing what he can do. For hedge fund people, that's sport."

Still, Malecki added, "I'm glad to see the SEC is looking at it. They should look at these types of things...because there are so many investors involved and money involved and these things can really disrupt a company...."

Allergan filed suit Aug. 1 in U.S. District Court for the Central District of California accusing Ackman and his hedge fund, Pershing Square Capital Management, along with Valeant, of fraud in the acquisition of Allergan's shares. They accused the defendants of sidestepping SEC Rule 14(e)-3 prohibiting fraud in connection with a tender offer.

(See <http://ctfinancialnews.com/did-valeant-and-pershing-square-side-step-insider-trading-rules-with-a-jointly-owned-delaware-llc/>)

Experts in securities law point out that it's not unusual to see parallel investigations in insider trading cases—one conducted by the SEC while another is winding its way through the courts between by private companies engaged in a legal dispute. "I don't think it matters," said Loyola law professor Michael Guttentag, who specializes in securities law. "I think the SEC can sniff around and I don't think it will affect the civil case."

Ackman has called the lawsuit a "shameless attempt by Allergan to delay the shareholders' fundamental right to call a special meeting and vote their shares." One of the key questions the suit raises is whether Ackman traded on nonpublic information when one of his entities—PS Fund 1—began purchasing a massive number of Allergan's shares. The present case could be governed by a 1997 U.S. Supreme Court ruling that reinstated the conviction of a Minneapolis lawyer named James H. O'Hagan, who purchased shares of Pillsbury after he learned through his law firm that one of its clients, Grand Metropolitan P.L.C., would be making a tender offer for Pillsbury.

"The people who had that information—his law firm—told him not to use that information and he went and used that information anyway," Guttentag said. "What the Supreme court said is, if you misappropriate material, nonpublic information and use it to trade, you are violating the insider trading law."

"What Bill Ackman is arguing is that the O'Hagan precedent does not apply to his situation because he did not misappropriate the information. Valeant chose to give him the information. It's always a fun thing when you are teaching this case. Suppose O'Hagan had been told by his law firm and by Grand Metropolitan that it's okay to use this? Then, according to the Supreme Court, it's not insider trading. So essentially, what Ackman maintains is the O'Hagan precedent does not apply to him because he did not get that information by misappropriation."

“...The Supreme Court said, ‘O’Hagan, you lose on both counts. You lose because the material, nonpublic information you were trading on you misappropriated and you lose because under 14-(e)-3 you use this information about a tender offer.”

“Ackman has to show that neither of the problems O’Hagan had are relevant in his situation,” Guttentag said. Added Malecki: “I don’t think it was insider trading—I think it was outsider trading.”

© 2014 Connecticut Financial News. All rights reserved. No reprints, forwarding, sharing or other redistribution of this content is permitted.