

CFTC

NFA Updates BASIC to Assist With Bylaw 1101 Diligence on Delegating CPOs

The National Futures Association (NFA) has updated its Background Affiliation Status Information Center (BASIC) system to help NFA members conducting Bylaw 1101 due diligence to determine whether the commodity pool operator (CPO) of a particular commodity pool is properly registered or exempt from CPO registration. As reported in the [Corporate and Financial Weekly Digest](#) edition of October 17, 2014, the Commodity Futures Trading Commission's Division of Swap Dealer and Intermediary Oversight (DSIO) provided self-executing relief from registration to certain would-be CPOs that delegate all of their investment management authority with respect to a particular pool to another registered CPO. As a result of such delegations, NFA members conducting Bylaw 1101 due diligence on a pool are not always able to readily identify the pool's CPO and confirm through NFA's BASIC system whether the CPO of that pool is an NFA member.

To help members identify delegation when conducting Bylaw 1101 due diligence, CPOs are now required to provide information in NFA's EasyFile system when filing a pool's annual financial statement that indicates whether the CPO has delegated investment management authority of a particular commodity pool pursuant to the DSIO relief. This information will be publicly available in NFA's BASIC system and an NFA member generally will be deemed to have satisfied its Bylaw 1101 due diligence obligations if the pool in question is listed in BASIC under a new "Delegated Pools" heading.

NFA Notice I-15-3 is available [here](#).

LITIGATION

Second Circuit Refuses to Rehear Groundbreaking Insider Trading Case

On April 3, the US Court of Appeals for the Second Circuit denied the request of Preet Bharara, US Attorney for the Southern District of New York, for an *en banc* hearing after the court issued a ruling in December that drastically limited the scope of insider trading prosecutions. With the original ruling in *United States v. Newman* left in place, prosecutors will be required to prove beyond a reasonable doubt that the tippee had knowledge of the personal benefit received by the tipper who initially conveyed the insider information.

In requesting the *en banc* hearing, Bharara had argued that the original decision's "erroneous definition of the personal benefit requirement will dramatically limit the government's ability to prosecute some of the most common culpable and market-threatening forms of insider trading."

While a possible appeal to the US Supreme Court may be forthcoming, a spokesman for Bharara declined to comment on the matter. Given certain statements by Justices Scalia and Thomas attacking the deference given to the Securities and Exchange Commission when denying *certiorari* in *Whitman v. United States*, 574 U.S. ___, 135 S. Ct. 352, 353 (2014), it seems unlikely the US Solicitor General would want to approve such an appeal. Members of Congress are also attempting to forward legislation that lends clarity to the issue. Even prior to the Second Circuit's refusal to rehear *Newman*, Connecticut Congressman Jim Himes introduced the bipartisan

Insider Trading Prohibition Act, which seeks to explicitly ban insider trading while also clarifying the knowledge requirement and derivative liabilities. Citing the Second Circuit's *Newman* decision, Representative Himes said in a press release, "The development of the law over time on a case-by-case basis has resulted in legal standards that have become ambiguous and problematic."

U.S. v. Newman, No. 13-1837(L) (2d Cir. Apr. 3, 2015)

SEC Secures Victory on Fraud Allegations Against Technology Executive

The US District Court for the District of Columbia took the unusual step of granting summary judgment against a technology company executive who the Securities and Exchange Commission accused of various violations of the Securities Exchange Act of 1934. The court found the executive, Tamio Saito, the chief technology officer of e-Smart Technologies, made material misrepresentations in connection with the sale of securities under Section 10(b) and failed to file required ownership documents under Section 16(a).

E-Smart purported to be developing an advanced smart card, which could be used to identify people using various individual markers such as fingerprints and retina scans. According to documents filed by e-Smart, the company claimed to possess cutting edge technology that was ready for deployment at a moment's notice. The District Court found that the company misled investors to believe that e-Smart had developed both a unique product and one that was commercially viable. Beyond finding that these statements were misleading, the District Court noted that when a company makes only one product, as did e-Smart, all claims about that product are material as a matter of law.

Saito had argued that he did not draft the misleading documents and did not know the statements were misleading. The District Court reiterated the US Supreme Court precedent that it is immaterial whether Saito, acting as chief technology officer, was actually the individual who drafted and filed the misleading documents. For purposes of Section 10(b) analysis, an individual "makes" a statement if he or she had "ultimate authority" over its content. Since Saito signed the documents and served as the executive ultimately in charge of the company's technological operations, the District Court concluded that it could fairly hold him responsible for making any misleading assertions contained within the filings.

Further, given Saito's role at e-Smart, the District Court found it impossible that he lacked the requisite knowledge of the misstatements to hold him liable for the Section 10(b) violations.

In addition to the Section 10(b) violations, the District Court found Saito liable on the much narrower issue of whether he failed to file certain statements as required by Section 16(a). As an officer, Saito was required to file ownership statements with the SEC. The District Court noted that *scienter* is not required to establish liability under this section, and since Saito failed to file correctly, the District Court quickly ruled against him.

S.E.C. v. E-Smart Technologies, Inc., et. al., C.A. No. 11-895 (JEB) (D.D.C. Mar. 30, 2015)

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