

Insider lawsuit is familiar

- [Kathleen Pender](#)

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The Securities and Exchange Commission this week charged that a Palo Alto drug executive illegally made \$680,000 trading on inside information about his company.

The case has some similarities to the famous insider trading case that put ImClone founder Sam Waksal in jail and led, indirectly, to the imprisonment of Martha Stewart.

The new case involves Alexander Yaroshinsky, a vice president involved in drug development and clinical trials with Connetics Corp., a Palo Alto maker of prescription acne medication including Evoclin.

The SEC alleges that Yaroshinsky sold most of his Connetics stock and purchased put options on Connetics -- a bet that the stock would fall -- after learning last year that the Food and Drug Administration had concerns about a new drug Connetics was testing called Velac Gel.

The SEC alleges that Yaroshinsky made the trades -- in his account and in another account in his mother-in-law's name -- before Connetics made the FDA's concerns public.

The SEC case, filed in U.S. District Court in Manhattan, is a civil one. It seeks disgorgement of ill-gotten gains and monetary penalties, which could be up to three times the gains. The agency cannot put anyone in jail, although its cases are sometimes taken up by criminal prosecutors, which is what happened in the Waksal case.

Katrina Church, general counsel for Connetics, says the SEC case doesn't contain any information the company didn't previously know.

She says Connetics investigated Yaroshinsky's trading activity last year and took disciplinary action against him. She would not discuss the discipline but says that Yaroshinsky is still employed at Connetics and that "there is no current plan to change anything."

Church says the SEC suit "makes his activity look worse" than it is. For example, it does not mention that Connetics executives discussed FDA concerns about the drug in a conference call with analysts last year before most of Yaroshinsky's trading occurred.

Neither Yaroshinsky nor his attorney, Shirli Fabbri Weiss, returned phone calls.

According to the SEC, on April 13, 2005, Yaroshinsky participated in a conference call during which the FDA discussed its "preliminary views as to the result of a carcinogenicity study of Velac Gel" in mice.

The FDA apparently was concerned about a mouse in the Velac study that had developed tumors.

The next day, an account was opened in the name of Yaroshinsky's mother-in-law at the same Charles Schwab branch where he had an account, the SEC says. It alleges that Yaroshinsky "funded and controlled" his mother-in-law's account.

On April 26, Connetics announced its first-quarter earnings and said it would hold a conference call after the close of trading during which it would provide "an update on the regulatory status of Velac."

During the call, chief executive Thomas Wiggans said, "We recently received communications that indicated FDA were interpreting results of one of our pre-clinical studies in a different fashion than we did in our submission." He added that the company was "surprised to receive this information from the

FDA."

The next day, Connetics stock dropped 19 percent on heavier-than-normal volume. Analysts attributed the decline mainly to fears that the FDA inquiry could delay the approval of Velac.

The SEC did not mention the April 26 conference call nor the market's reaction in its case.

It did say that on April 26, Yaroshinsky purchased 10 Connetics put contracts. On April 27, he sold 15,100 of his 16,913 shares and purchased 41 put contracts, "which reflected his expectation that the price of Connetics would decline," the suit says.

On May 12, he allegedly transferred \$363,000 from his Schwab account into his mother-in-law's account and on June 6, he added \$150,000.

These funds were used to purchase 2,025 Connetics put contracts, the SEC says.

On June 13, before the market opened, "Connetics announced that the FDA had issued a 'not approvable letter' for Velac Gel because the drug caused cancer in mice in a pre-clinical study," the suit says.

Connetics stock ended the day down 27 percent on heavy volume.

The SEC alleges that Yaroshinsky realized more than \$680,000 in ill-gotten gains and losses avoided in his and his mother-in-law's account.

Between August 2005 and March 20, Yaroshinsky transferred most of the money out the Schwab accounts. About \$662,000 went to a title company, apparently to buy a house, says John Reed Stark, chief of the SEC's office of Internet enforcement.

As of March 22, there was \$165,000 remaining in the accounts, the suit says. On Friday, Yaroshinsky's attorney allegedly told the SEC that he planned to use the funds in his Schwab account to pay his taxes.

The SEC asked a federal judge to freeze the assets remaining in the accounts. The judge granted the request.

Stark, who teaches securities regulation at Georgetown University, described the Yaroshinsky suit as a textbook case. "It's the kind of insider trading case you teach about. I'm going to talk about it tonight in class," he said.

It's hard to believe that any drug executive would trade on nonpublic FDA information after what happened to Waksal.

In late 2001, the ImClone founder allegedly told his daughter and father that the FDA was going to turn down an application to approve the company's main drug, Erbitux. His father and daughter sold about \$10 million worth of ImClone shares just before the company announced the FDA decision. ImClone stock plunged on the news.

Waksal admitted that he had tipped off his daughter and tried to sell about 80,000 of his own ImClone shares by transferring them to his daughter's account. The charges involving his father were later dropped.

Waksal pleaded guilty to six counts of bank and securities fraud, perjury and obstruction of justice. To settle SEC charges, he agreed to pay \$800,000 and never serve as an officer or director of a public company.

Stewart, a friend of Waksal's, went to jail for five months for lying to federal prosecutors about her role in the scandal. Stewart allegedly sold almost 4,000 ImClone shares after an assistant to her stock broker, who was also Waksal's broker, told her that the Waksal family was dumping their shares. Stewart was never charged with illegal insider trading.

Net Worth runs Tuesdays, Thursdays and Sundays. E-mail Kathleen Pender at kpender@sfnchronicle.com.

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