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THE GAME | NOVEMBER 23, 2010

Insider Trading: The Next Frontier

By DENNIS K. BERMAN



Big Lots Sues Targets Stock-Research Firm's Methods in Digging Up Information

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Big Lots Inc. is a discount retailer that sells everything from \$19 camcorders to hamster toys. It couldn't seem further from the rarified world of hedge-fund trading. Or so everyone thought.



WSJ's Dennis Berman discusses with colleague Evan Newmark a lawsuit filed by a retailer in Florida alleging that a research house stole trade secrets and published sensitive inside information about the company.

In a case that could shake up the world of stock research, the Columbus, Ohio, retailer filed a lawsuit Monday in Florida state court. It takes aim at a small Tampa, Fla., research firm, Retail Intelligence Group, that sells stock pickers on "realizing threats and declines ahead of other investors."

Big Lots alleges the firm pried information out of store managers, in effect stealing trade secrets and aiding and abetting employees' breach of fiduciary duty. It has asked the court for an injunction to

immediately stop what it calls "wrongfully induced" snooping.

Retail Intelligence hadn't yet seen the suit Monday evening. Its director, Derek Noce, declined to comment.



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The suit comes amid a nationwide probe in which federal prosecutors are piecing together evidence that some say could expose endemic insider trading. To the public, all these insider-trading games seem to take place in the worlds of Wall Street and Greenwich, Conn., and, as many undoubtedly will argue, are in effect victimless crimes.

Not so, says Big Lots. It claims it suffered in

A Big Lots store in Culver City, Calif. The retailer claims it is a victim.

the wake of Retail Intelligence's disclosures, which show details on inventories, payroll and margins. In the highly competitive

business of discount retail, this kind of disclosure can harm a company and its share price, Big Lots claims.

More

Document: Big Lots v. Retail Intelligence

Though Big Lots' case is small compared with the dragnet of federal prosecutors, both efforts are underpinned by the same potentially disruptive assertion: That what has become completely common in the

realm of stock research also has become completely unacceptable.

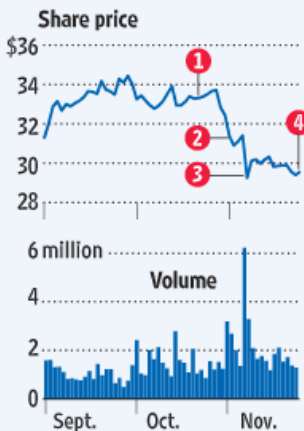
When Big Lots caught wind of an Oct. 20 Retail Intelligence report, it found the breach of ethics "jaw dropping," recalls general counsel Chuck Haubiel, who filed the suit with lawyers from New York's Cravath, Swaine & Moore LLP. "We're serious about protecting our confidential information," Mr. Haubiel said. "Legitimate research firms do not seek to obtain nonpublic information to tip off selected investors at the expense of others."

Just what are Retail Intelligence's methods? Among them is the most basic stock research tool on Wall Street: "channel checks," a vague term that has historically meant anything from counting cars in parking lots to conversations with company suppliers to casual run-ins with customers.

The Big Lots suit alleges that Retail Intelligence's channel checks took a nefarious turn. It accuses the group of illegally pinching information out of store managers, inducing them to disclose trade secrets about the discount chain's sales, inventory and foot traffic.

Big Lots' Big Case

Retailer Big Lots Inc. filed a lawsuit against a small research firm, Retail Intelligence Group, alleging it pried out secret company data of store managers and sold it to investors.



- 1 Oct. 20: Retail Intelligence Group issues a "field action" report that says Big Lots' sales growth "appears to have wound down." Basing its analysis on interviews with 72 Big Lots store managers, Retail Intelligence questions "BIG's outlook going forward given wide competitive pressure and limited closeouts." It says it expects sales to rise 1.8%.
- 2 Oct. 29: Big Lots shares trade down 5.4% by close of trading.
- 3 Nov. 4: Big Lots reports third-quarter earnings, with the company CEO warning of "inconsistent sales trends." The stock drops another 6%.
- 4 Nov. 22: Big Lots files suit against Retail Intelligence, accusing it of stealing trade secrets.

For Big Lots, the offense wasn't just the leaking of a few bits of information. It was how Retail Intelligence built a broader mosaic of confidential data points, enabling it to dissect its

performance in ways that others couldn't. The complaint doesn't clarify what the inducements to employees were.

Some might call this exactly what stock analysts are supposed to do. But Big Lots views it as crossing the proverbial gray area into dark, illegal territory.

Retail Intelligence's Oct. 20 "Field Action" report, filed as a sealed exhibit to the case in Hillsborough County, Fla., is impressively detailed. Deploying a 21-question survey of 72 store managers, it concludes the company's sales growth was beginning to falter. The managers even were asked to estimate the chain's year-over-year performance, pegging it at a sluggish 1.8% gain. Big Lots, the report concludes, is due for a "substantial slowdown in 3Q performance."

That about nailed it: When Big Lots reported earnings Nov. 4, sales growth was 2.4%. The company's stock sold off 7% that day.

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
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