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Insider Trading Law Update 2018

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Insider Trading Elements

- Material
- Nonpublic
- Disclosed by an insider or tipper in breach of a duty of trust or confidence
- With the expectation that the recipient would trade on it.
- Downstream tippee—recipient of information—must know that the information was disclosed by an insider in breach of a duty of trust or confidence with the expectation that person the insider made the disclosure to would trade on it or tip others.

Supreme Court Decision in *Salman v. U.S.*: Recap of *U.S. v. Newman*

- Dell Investor Relations employee provided information to former colleague who moved to Neuberger Berman.
- Neuberger Berman tippee passed info to various hedge fund analysts, who passed info to portfolio managers.
- In exchange for "tips," Neuberger Berman tippee provided occasional career advice to Dell IR employee.
  - Jury convicted, but Court of Appeals reversed.
    - Insufficient personal benefit.
    - Downstream tippee did not know tipper received personal benefit.

Salman v. U.S. (cont'd)

- Salman knowingly received tips from his brother-in-law, who was tipped by his brother at Citigroup.
- Reaffirmed that a "personal benefit" to the tipper includes "the benefit one would obtain from simply making a gift of confidential information to a trading relative or friend."
- Tipper need not receive something of a pecuniary or similarly valuable nature in exchange for the gift to family or friends.
- No clear guidance.
  - "Determining whether an insider personally benefits from a particular disclosure, a question of fact, will not always be easy for courts."

U.S. v. Newman: Tipping Liability

- Tipper is liable when he discloses information in breach of duty of trust or confidence and in exchange for personal benefit.
  - Includes benefit received from making gift of confidential information to a friend.
  - Requires evidence of "a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature."
- Tippee is liable when he knows that the information was confidential and disclosed in exchange for a personal benefit.

U.S. v. Martoma, Limiting the Newman Test

- In June of this year, a panel of the Second Circuit amended its earlier decision in United States v. Martoma to interpret and water down the Second Circuit's earlier Newman decision.
  - The panel reasoned that *Salman v. United States* implicitly abrogated *Newman*'s personal relationship test.
  - The panel then held that the test can be satisfied by a showing that the relationship between the tipper and tippee suggests:
    - (1) that the tip was part of a *quid pro quo;* or
    - (2) that the tipper intended the tip to benefit the tippee.
  - The panel explained that "because there are many ways to establish a personal benefit, we conclude that we need not decide whether *Newman*'s gloss on the gift theory is inconsistent with *Salman*."

Martoma Background

- Tipper was doctor involved in clinical drug trial who engaged in paid consulting calls with Martoma.
- Doctor was not paid for the allegedly criminal consultations.
- Martoma argued that he and the doctor were not sufficiently close to meet Newman's "meaningfully close personal relationship" test.
- Court of Appeals rejected Newman's test.
- "[A]n insider or tipper personally benefits from a disclosure of inside information whenever the information was disclosed with the expectation that [the recipient] would trade on it."
  - The tip resembles trading by the insider—a personal benefit—followed by a gift of the profits to the recipient.
  - Doorman example.

Interactions with Management: *SEC v. Cooperman*

- SEC charged that Atlas Pipeline Partners Executive informed Cooperman that Atlas was in negotiations to sell a facility for $650 million, and that the Executive was preparing for an upcoming board meeting to discuss the sale.
- According to the Executive, he told Cooperman about the sale "because he believed Cooperman had an obligation not to use this information to trade APL securities."
- According to the Executive, "Cooperman explicitly agreed that he could not and would not use the confidential information . . . to trade APL securities."

Interactions with Management: *SEC v. Cooperman*

- Before these conversations, Omega owned $150 million in APL stock. After receiving this information, Omega purchased $3.8 million more for two managed accounts that, according to Omega, were underweighted in APL.
- Omega did not sell after APL's announcement of the sale.
- Omega also bought calls at a strike price of $15 when APL traded at around $10. But, according to Omega, this offset earlier sales of calls at the same strike price.
  - Size of the trade does not matter.

Interactions with Management: *SEC v. Cooperman*

- Is the Executive truthfully reporting the conversation with Cooperman?
  - If the Executive did not get a pledge of confidentiality, he likely violated Reg FD.
- What is the take-away?
  - Even communications with management require caution.

STOCK Act

- Stop Trading on Congressional Knowledge Act
- Members and Employees of Congress, and Executive Branch Employees, owe "a duty arising from a relationship of trust and confidence to the United States Government and the citizens of the United States with respect to material, nonpublic information derived from their position."
- Amendment:
  - In 2013, one year after the signing of the STOCK Act, Congress passed an amendment scrapping a provision of the Act that would have required high-ranking government workers to post their financial information on a publicly available online database.
  - Under the amended Act, the stringent reporting requirements will still apply to the President, Vice President, members of Congress and candidates for Congress, in addition to certain appointed officials.

STOCK Act: Big Question

- What is “nonpublic information” taken in breach of a duty of “trust and confidence” in the inherently public world of elected officials and government?
  - Members of Congress are expected to make their positions clear and inform the public how they intend to vote, and may provide constituents information on how votes are likely to turn out.
  - Government is supposed to be transparent.
- Unhelpful Guidance:
  - House Ethics Committee: MNPI includes “any information concerning a company, security, industry or economic sector, or real or personal property that is not available to the general public and which an investor would likely consider material in making an investment decision.”
  - GAO: It may not always be possible to determine precisely when non-public information becomes “public.”

Focus on Political Intelligence: *U.S. v. Blaszczak*

- On May 24, 2017, SDNY and SEC charged political consultant David Blaszczak (former CMS employee), CMS employee, and three Deerfield Management analysts, one of whom pled guilty and is cooperating.
- CMS sets Medicare reimbursement rates.
- Prediction of cuts to radiation oncology treatment, yielded $1.8 million.
- Weaknesses in Government's case.
  - Prediction was meaningfully inaccurate.
  - Deerfield analysts did not know CMS source.
  - Predictions were included in broadly disseminated reports.
  - CMS insider denies providing confidential information.

Focus on Political Intelligence: U.S. v. Blaszczak

- Why was case brought?
- Emails regarding Blaszczak's contacts with CMS:
  - Unrelated unsuccessful effort to get answers from Medicare contractor through deception: "Just tell him you're doing God's work."
  - Getting useful input from contractor would be "bigger than bonanza bananas bazooka."
  - Blaszczak: "Staff has proposed this. There is concern about politics."
  - Blaszczak: Other consultant is "good guy but does not known anyone at CMS. His guesses are just wild random guesses."
  - Blaszczak: "There was a meeting 6/27 between OMB and senior staff at CMS. Dave heard from an attendee that RadOnc was not on the agenda."

Focus on Political Intelligence: U.S. v. Blaszczak

- Emails regarding Blaszczak's reliability:
  - "exactly as we expected"
  - "I think Dave earned his bonus with his work on RadOnc. We did pretty well on that and it was really 100% Dave."
- Blaszczak's specificity: 90 minutes to 60 minutes.
- Inside CMS: "Where does he get his information? It is pretty unbelievable and will probably blow up at some point." "It is obviously someone with access to our impact papers."
- Lessons learned.

Focus on Political Intelligence: U.S. v. Blaszczak

- On May 3, 2018, all four defendants were found guilty of multiple counts at trial, including conspiracy, conversion of government property, wire fraud, and securities fraud.
- Interestingly, the defendants were acquitted of Title 15 securities fraud, but were convicted of Title 18 securities fraud based on the same underlying conduct.
- This was the first time that a criminal defendant had been acquitted of Title 15 insider trading – historically considered the traditional insider trading statute – but convicted of Title 18 securities fraud, which was adopted in 2002 as part of the Sarbanes-Oxley Act.
- In fact, only a handful of prosecutions post-*Newman* have charged Title 18 securities fraud in insider trading cases, though prosecutors in the SDNY have successfully done so twice already this year – in *Blaszczak,* and in *United States v. Chow*.

Focus on Political Intelligence: U.S. v. Blaszczak

- The split verdict in *Blaszczak* suggests that the jury understood that the crime for insider trading included an essential element (or, elements) not required by the wire fraud or Title 18 securities fraud charges.
- This is likely to be an issue of first impression if and when the Second Circuit hears arguments in *Blaszczak* on appeal.
- In the meantime, entities need to be vigilant to ensure that they do not receive confidential information, regardless of whether:
  - The confidential information relates to company information or government decisions;
  - The information crosses the materiality threshold; or
  - The entity and its employees have any knowledge of whether the information was obtained in violation of a duty.

Emails/IMs: Dangers

- Written quickly and without thought.
- Informal and cursory.
- Last forever.
- They can be forwarded anywhere. You have no control.
- Emails/IMs can easily be found by any recipient's compliance department, the SEC or another government agency.
- Careless Emails/IMs become key evidence in Litigation and Governmental Investigations.

Emails/IMs: Examples of the Dangers

- *U.S. v. Sanjay Valvani:* Valvani asked that Visium give expert Gordon Johnston a raise saying: "[Johnston] is without question the most valuable consultant I've ever worked with and I'm pushing to reinforce the value of the relationship and encourage him to continue to go above and beyond for our team."

- *SEC v. Leon Cooperman:* Cooperman emails consultant that Atlas Pipeline is a "shitty business." Subsequently, Cooperman speaks with the Atlas CEO and is allegedly tipped, and then buys Atlas call options.

- *United States v. Allen:*
  - Swap Trader: "APPRECIATE 3S GO DOWN, BUT A HIGH 3S WOULD BE NICE . . . CHEERS CHIEF.
  - Allen: "I AM FAST TURNING INTO YOUR LIBOR BITCH!!!!"
  - Swap Trader: "JUST FRIENDLY ENCOURAGEMENT THAT'S ALL, APPRECIATE THE HELP."
  - Allen: "NO WORRIES MATE, GLAD TO HELP . . . .WE JUST STUFFED OURSELVES WITH GOOD OL PIE, MASH N LICKER!!"

  - Swap Trader: ". . . put 0.88% then."
  - LIBOR submitter: "Don't worry mate—there's bigger crooks in the market than us guys."

How to Write an Email/IM

- Don’t Unless You Have to.
- If You have to, Think and Slow Down.
- Assume It Will Read by the SEC or Appear in the WSJ.
- Do Not Overstate the Value of Information or the “Connections” of Sources.
- Do Not Overstate Your Confidence.
- Do Not Overstate the Confidence of Outside Experts/Analysts.
- Describe Your Basis for Predictions.
- Don’t Be Clever or Funny or Angry
- Before Sending, Know Who Is Receiving, and Assume It Will Be Misdirected.
- If You Can’t Do any of the Above, Don’t Send.

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Michael is a partner in the Litigation Department and Co-Chair of the firm's White-Collar Defense Practice Group. His practice focuses on the representation of financial institutions, investment advisers, public companies and their executives in white collar criminal defense, securities enforcement matters, internal investigations, and complex commercial litigation.

In 2018, *Chambers USA* presented Michael its White Collar Crime & Government Investigations Award, its top honor nationwide for criminal defense work. In ranking him among the leaders in White Collar & Government Investigations, *Chambers USA* highlighted that “sources confirm that he is ‘an excellent all-around lawyer’ who is ‘thorough, creative and really digs into legal and factual issues.’” *Chambers* previously cited his “exceptional judgment, great client skills and amazing credibility with government lawyers.” In 2017, Michael was named “Litigator of the Week” by *The American Lawyer* for winning a landmark victory dismissing all charges in the first U.S. LIBOR manipulation case before the Second Circuit Court of Appeals. Michael was also a recipient of the award for “Most Important Development in Investigations” at the GIR Awards 2017 in connection with the same landmark victory, and was named as one of *Law 360*’s 2017 MVPs in the area of White Collar.