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## *PH COVID-19 Client Alert Series: Novel Legal Issues Arise from U.S. Lawmakers' Potential "Insider" Trades Based on Information Regarding COVID-19 Threat*

By [Kenneth M. Breen](#), [Phara A. Guberman](#) & [Scott Glicksman](#)

According to media reports, at least four U.S. Senators allegedly sold millions of dollars' worth of stock shortly before the nearly unprecedented market declines triggered by the COVID-19 pandemic. The U.S. Department of Justice ("DOJ"), in conjunction with the U.S. Securities and Exchange Commission ("SEC"), is investigating whether these members of Congress traded based on confidential information ahead of the market turmoil caused by the COVID-19 crisis.<sup>1</sup> On March 30, 2020, it became public that the FBI has already reached out to Senator Richard Burr (R. N.C.) regarding his sale of approximately \$1.7 million in stocks in late January and early February 2020.<sup>2</sup>

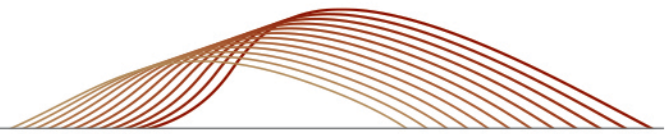
A novel question remains as to the legality of these actions under various insider trading laws and any potential downstream charges stemming from these trades. Where an issue like the COVID-19 pandemic has been covered so extensively by the media, it will likely be difficult to establish what information was material nonpublic information and what information was part of the public domain.

There is also a more general question about whether regulatory information is considered "property" for purposes of insider trading law. The government is not a business and it may either carry out or deviate from its planned adoption of regulations or action. Pre-decision regulatory information may or may not be considered the government's "stock in trade" and, therefore, may or may not be considered "property" for purposes of a Title 18 criminal violation.<sup>3</sup>

Regardless of the potential defenses and novel theories of prosecution, DOJ and SEC investigations of this trading activity have already begun. There will likely also be shareholder actions against the members of Congress and the downstream tippees, some of which have already started.

### **Previous Insider Trading Cases Against Members of Congress**

There is at least some precedent for insider trading investigations involving members of Congress. This year, former Rep. Christopher Collins (R. N.Y.) was sentenced to more than two years in prison after pleading guilty to charges<sup>4</sup> in connection with his participation in an insider trading scheme in which he used his position as a board member of Innate Immunotherapeutics ("Innate"), an Australian biotech company, to tip off his son about potential biotech investment losses. In June 2017, Collins



learned that a key multiple sclerosis drug that Innate was developing had failed a critical drug trial, and tipped that information to his son, Cameron Collins, who was also a substantial Innate shareholder. Cameron Collins traded on the inside information and passed it to other individuals who similarly traded on the information. While Christopher Collins received the most significant sentence, criminal charges and/or SEC civil charges were brought against the other individuals involved in the trading. The case against Christopher Collins is the first example where an active member of Congress was found guilty of insider trading, albeit not for information learned in his Congressional capacity.

In the Collins case, Cameron Collins was sentenced to five years of probation, including six months of home confinement, and a \$150,000 fine.<sup>5</sup> Stephen Zarsky, who had a personal relationship with Cameron Collins, and traded on the information provided, received a sentence of four years of probation.<sup>6</sup> Cameron Collins and Stephen Zarsky also reached settlements with the SEC in December 2019, agreeing to disgorge their avoided losses with prejudgment interest, totaling \$634,299 and \$159,880, respectively.<sup>7</sup>

In another example, former Senate majority leader Bill Frist was investigated by the DOJ and SEC when in 2005, he sold all of his stock in the \$25 billion international company called Hospital Corporation of America (“HCA”), which was founded by his father and brother—and at which his brother was a director at the time. Frist sold a large sum of shares in the company just days before HCA’s stock price fell by nine percent in a single day. After an 18-month investigation, the DOJ and SEC jointly decided to not file charges in 2007. Ultimately, documents indicated that he began the process of selling the stock in late April 2005, months before he knew of HCA’s troubles. According to records Frist produced during the investigation, he had consulted with a staff attorney at that time when he said he was unaware of HCA’s problems collecting payments from uninsured patients.<sup>8</sup> In this case, like Collins’ case, Frist’s alleged “insider position” was not due to his position in Congress, making it distinct from the COVID-19 trading investigations.

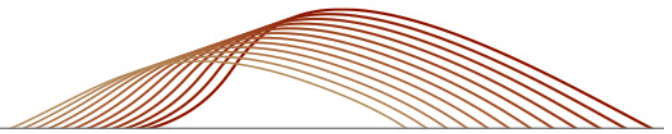
Senator Frist was also at the center of another trading controversy later in 2005, when he announced that the Senate would vote on a bill which would make \$140 billion of public funds available to pay off asbestos liability claims.<sup>9</sup> In the days prior to Frist’s announcement, the stock prices of several firms that could have been subject to asbestos liability claims rose, prompting an informal SEC investigation into the possible transmission of information from Frist’s office to asset management firms. Again, the investigation yielded no charges.

## **Insider Trading Investigations Involving Leaks of Media Embargoed Content**

There is also at least some precedent for government enforcement of insider trading laws relating to leaks of media embargoed content. In 2003, John M. Youngdahl, a former senior economist at an investment bank, pleaded guilty to criminal charges, including insider trading, theft of government property, wire fraud, and conspiracy, brought by the DOJ in connection with the purchase of millions of dollars of 30-year bonds and bond futures minutes ahead of a Treasury Department’s announcement that it was ending the sale of such bonds.<sup>10</sup> Youngdahl, his tipper, Peter J. Davis, and his former employer also reached separate civil settlements with the SEC for charges associated with the same conduct.<sup>11</sup>

## **Specific Insider Trading Prohibitions and Protections for Members of Congress**

There is no “loophole” for members of Congress to avoid insider trading investigations. The Stop Trading on Congressional Knowledge (“STOCK”) Act,<sup>12</sup> signed into law on April 4, 2012, expressly affirms that insider trading prohibitions apply to members of Congress, as well as congressional staff



and other federal officials. Section 3 of the Act explicitly bars any member of Congress or employee of Congress from “us[ing] nonpublic information derived from such person’s position as a member of Congress or employee of Congress or gained from the performance of such person’s official responsibilities as a means for making a private profit.” STOCK Act, § 3.<sup>13</sup>

Section 4 explains that this prohibition derives from a duty owed by members of Congress “arising from a relationship of trust and confidence to the Congress, the United States Government, and the citizens of the United States.” STOCK Act, § 4. In recognition of, and in furtherance of that duty, the Act explicitly states that “Members of Congress and employees of Congress are not exempt from the insider trading prohibitions arising under the securities laws, including section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.” STOCK Act, § 4.

Even with the STOCK Act in place, the DOJ and/or SEC might face difficult burdens to establish insider trading liability as to a Senator or House Representative. In the case of the recent conduct related to COVID-19, this would mean showing much more than that a member of Congress received a briefing on the potential impact of COVID-19 and then purchased or sold securities. For example, challenges would include whether much of the information relied upon was likely already in the public domain, and whether any confidential information obtained was not specific to a particular issuer or industry.

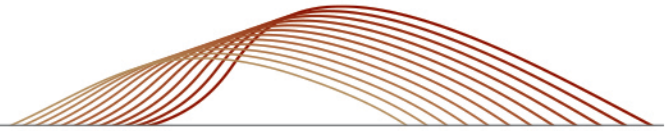
Further complicating an investigation is the existence of the Speech or Debate Clause of the U.S. Constitution, which protects members of Congress from prosecution for legislative activities.<sup>14</sup> There is at least a question of whether the government is precluded from using any information that a member of Congress acquired in committee hearings as a basis for prosecution, which would also create significant discovery issues in an investigation.

## **Conclusion and Recommendations**

These insider trading investigations into members of Congress may continue to expand how insider trading can be charged, including for downstream tippees as the prosecution risk is not limited to members of Congress. There is already precedent for criminal and civil charges against entities for trading on pre-decision government information.<sup>15</sup> Broker-dealers or other entities that the members of Congress may have spoken with or worked with in the lead-up to COVID-19 selloffs will likely become involved in these and other investigations during and after the pandemic.

The most well-known way to avoid prosecution, as set forth in Rule 10b5-1, is for members of Congress to invest personal holdings through a third-party that has set up a predetermined investment plan at a time prior to the receipt of material nonpublic information, or to set up a “blind trust,” with professional advisers who are solely and independently responsible for all investment decisions. Under a blind trust, the trustees and beneficiaries generally communicate only to discuss asset distributions, general investment goals, or summary trust information required for tax purposes.

Further, robust compliance procedures and internal controls are always critical for broker-dealers, investment advisers, and other regulated entities. It is important for investment advisers and hedge funds to continue to exercise caution to prevent the receipt of any illicit confidential information. Investment advisory firms may want to reevaluate their internal policies regarding confidential information. Such policies should cover “government decisions” and pre-decision information including, but not limited to, approvals, funding, and policy decisions. Relationships with and information from paid consultants who are former government officials should also be closely evaluated.



These entities should also evaluate relationships they have with members of Congress and government agencies and implement special procedures for the treatment of any information obtained from discussions with any government employee. As part of internal compliance procedures, the best practice may be to require all employees to disclose to the internal compliance team any such relationships with any government employee, recently departed government employee, and/or his or her immediate family members.

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*If you have any questions concerning these developing issues, please do not hesitate to contact either of the following Paul Hastings New York lawyers:*

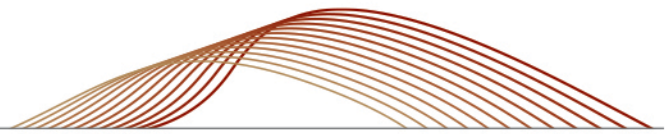
Kenneth M. Breen  
1.212.318.6344  
[kennethbreen@paulhastings.com](mailto:kennethbreen@paulhastings.com)

Phara Serle Guberman  
1.212.318.6252  
[pharaguberman@paulhastings.com](mailto:pharaguberman@paulhastings.com)

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- <sup>1</sup> Aruna Viswanatha and Dave Michaels, *Justice Department Investigating Lawmakers for Possible Insider Trading*, WALL ST. J. (Mar. 30, 2020), [https://www.wsj.com/articles/justice-department-investigating-lawmakers-for-possible-insider-trading-11585586365?emailToken=97a738f579a8f9e857d9e67525bb1b40ey6EvXHTyjQkVly5qXG7yED8Iwy2PGI4pPz7YS4AXn3512+Zf317BH22PlqhXFbx/3HAoje65RApUYjKoUpr2R5VOHGuil9pkJd6iG/EGbPI9xhC3XK6/Tx2JPyya9JSU12LCEnmvfdgF/K8LoT6lg%3D%3D&reflink=article\\_email\\_share](https://www.wsj.com/articles/justice-department-investigating-lawmakers-for-possible-insider-trading-11585586365?emailToken=97a738f579a8f9e857d9e67525bb1b40ey6EvXHTyjQkVly5qXG7yED8Iwy2PGI4pPz7YS4AXn3512+Zf317BH22PlqhXFbx/3HAoje65RApUYjKoUpr2R5VOHGuil9pkJd6iG/EGbPI9xhC3XK6/Tx2JPyya9JSU12LCEnmvfdgF/K8LoT6lg%3D%3D&reflink=article_email_share).
  - <sup>2</sup> Eric Tucket, *FBI reaches out to Sen. Burr over stock sales tied to virus*, ASSOCIATED PRESS (Mar. 30, 2020), <https://www.apnews.com/27957dd84cbfaba7c8c26cd354711956>.
  - <sup>3</sup> See *United States v. Blaszczyk*, 947 F.3d 19, 46-48 (2d Cir. 2019) (Kearse, J., dissenting).
  - <sup>4</sup> Collins pleaded guilty to one count of conspiring to commit securities fraud, and one count of making false statements to law enforcement officials after he lied to the FBI to cover up participation in the scheme. See *Congressman Christopher Collins Pleads Guilty To Insider Trading Scheme And Lying To Federal Law Enforcement Agents*, U.S. DEP'T OF JUSTICE (Oct. 1, 2019), <https://www.justice.gov/usao-sdny/pr/congressman-christopher-collins-pleads-guilty-insider-trading-scheme-and-lying-federal>.
  - <sup>5</sup> *Son of former Congressman Chris Collins sentenced to 5 years of probation*, WGRZ NEWS, CBS 2 (Jan 23, 2020), <https://www.wgrz.com/article/news/crime/son-of-former-congressman-chris-collins-cameron-collins-sentencing/71-2b6fea7b-8265-4f50-87b8-925fbc6ebfe2>.
  - <sup>6</sup> *Report: Stephen Zarsky sentenced to probation in Collins' insider trading case*, WKBW NEWS, ABC 7 (Jan. 24, 2020), <https://www.wkbw.com/news/local-news/report-stephen-zarsky-sentenced-to-probation-in-collins-insider-trading-case>.
  - <sup>7</sup> *Former Congressman and Two Others Settle Insider Trading Charges*, U.S. SECURITIES AND EXCHANGE COMMISSION (Dec. 9, 2019), <https://www.sec.gov/news/press-release/2019-257>.
  - <sup>8</sup> Carrie Johnson, *Frist Not Charged as Investigators Close Probe of His Hospital Stock Sales*, WASH. POST (Apr. 27, 2007), <https://www.washingtonpost.com/wp-dyn/content/article/2007/04/26/AR2007042602343.html>.
  - <sup>9</sup> Matthew Barbabella, Daniel Cohen, Alex Kardon & Peter Molk, *Insider Trading in Congress: The Need for Regulation*, 9 J. BUS. & SEC. L. 199, 202-03 (2008).
  - <sup>10</sup> Jonathan Fuerbringer, *Economist Pleads Guilty in 30-Year Bond Trades*, N.Y. TIMES (Nov. 13, 2003), <https://www.nytimes.com/2003/11/13/business/economist-pleads-guilty-in-30-year-bond-trades.html>.
  - <sup>11</sup> *Former Goldman Economist Youngdahl Agrees to Fraud Injunction and \$240,000 Penalty in SEC Treasury Bond Insider Trading Case*, U.S. SECURITIES AND EXCHANGE COMMISSION (Nov. 12, 2003), <https://www.sec.gov/news/press/2003-155.htm>; John Connor, Gregory Zuckerman, Susanne Craig and John R. Wilke, *Goldman Sachs Will Pay Penalty for Bond Trades*, WALL ST. J. (Sept. 3, 2003), <https://www.wsj.com/articles/SB106263276591794500>.
  - <sup>12</sup> Stop Trading on Congressional Knowledge Act of 2012 ("STOCK Act"), Pub. L. No. 112-105, 126 Stat. 291 (2012).

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- <sup>13</sup> Section 9 of the Act places this prohibition on other federal officials in other branches of government and also affirms the non-exemption from insider trading prohibitions for these officials: “Executive branch employees, judicial officers, and judicial employees are not exempt from the insider trading prohibitions arising under the securities laws, including section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.” STOCK Act, § 9.
- <sup>14</sup> The Clause reads: “The Senators and Representatives . . . shall in all Cases, except Treason, Felony and Breach of the Peace, be privileged from Arrest during their Attendance at the Session of their respective Houses . . . for any Speech or Debate in either House, they shall not be questioned in any other place.” U.S. CONST. art I., § 6.
- <sup>15</sup> See, e.g., *SEC Charges Political Intelligence Firm*, U.S. SECURITIES AND EXCHANGE COMMISSION (Nov. 24, 2015), <https://www.sec.gov/news/pressrelease/2015-266.html> (Marwood Group agreed to pay a \$375,000 penalty and admitted wrongdoing for failures to properly inform compliance officers after their analysts received potential material nonpublic information from government employees regarding pending regulatory approvals at the Centers for Medicare & Medicaid Services and the Food and Drug Administration); *Hedge Fund Firm Charged for Asset Mismarking and Insider Trading*, U.S. SECURITIES AND EXCHANGE COMMISSION (May 8, 2018), <https://www.sec.gov/news/press-release/2018-81> (Visium Asset Management agreed to pay more than \$10 million to settle, without admitting wrongdoing, claims that included insider trading based on confidential government information related to generic drug approvals and Medicare reimbursement rates from former government employees working as paid consultants).