# Insider Trading, Congress and COVID-19: A Renewed Focus on the STOCK Act

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The recently-reported sales of stock by several U.S. Senators following private briefings on the COVID-19 pandemic, apparently allowing them to avoid significant losses before the markets plummeted, have focused attention on the Stop Trading on Congressional Knowledge (STOCK) Act.[1] The Act, which President Obama signed into law in 2012, followed the public outcry resulting from a "60 Minutes" report on lucrative trades by members of Congress during the debate over the Affordable Care Act and prior to the 2008 financial crisis. The statute amended the Securities Exchange Act to make explicit that the prohibition against insider trading under the Exchange Act applies to members and employees of Congress. The STOCK Act therefore also has implications for those who receive inside information from Congress about executive or legislative action, including companies, broker-dealers, investment advisers and other entities that use lobbying or political intelligence firms, as well as their officers, directors, and employees, who may be liable for trading on such information.

Although lauded at the time of its passage as a necessary measure to deter rampant insider trading by members of Congress and their staffers, the STOCK Act has been little utilized, a reflection of the difficulties in pursuing insider trading charges against congressional, as opposed to corporate, insiders and their tippees (discussed below). In 2014 and 2015, the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ) conducted much-publicized investigations into suspected insider trading in the stock of Humana and other health insurers, based on a tip to a lobbyist by a senior staffer on the Health Subcommittee of the House Ways & Means Committee concerning a planned announcement by the Centers for Medicare & Medicaid Services (CMS) about reimbursement rates for private insurers. Those investigations did not result in charges, and to date, neither the SEC nor the DOJ has brought a case under the STOCK Act.

The Act has taken on a new relevance, however, since the onset of the COVID-19 crisis. In addition to the heated public reaction to news of the Senators' trades, the SEC, just days after the story broke, issued pointed warnings about insider trading related to the pandemic (which we discussed here and here), while the DOJ has flagged COVID-19-related fraud as a priority and reportedly has opened an investigation into Senator Richard Burr's COVID-19-motivated sales.

*The Government's Burden*

Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder prohibit the purchase or sale of a security on the basis of material non-public information and in breach of a duty of trust or confidence.[2] The STOCK Act applies such a duty to members and employees of Congress, based on their "relationship of trust and confidence" with Congress, the federal government as a whole, and citizens of the United States, with respect to "material, nonpublic information derived from such person's position" as a member or employee or "gained from the performance of such person's official responsibilities."[3] (Members of Congress and their staffers are also subject to ethical rules that separately forbid profiting from inside information.)

Insider trading liability under the Exchange Act also extends to "tippees" – those who receive material non-public information disclosed by insiders ("tippers"). The Supreme Court has held that a tipper is liable only where he or she receives a benefit in exchange for the tip.[4] The Second Circuit has determined that because a tippee's liability derives from that of the tipper, to prove a case against a tippee, the government must show that the tippee knew of the benefit to the tipper.[5] This knowledge requirement has proven a significant hurdle for the SEC and DOJ, especially against "remote" tippees who acquire inside information from another tippee, rather than directly from the original tipper. Moreover, the courts have struggled to define exactly what kind of benefit a tipper must obtain in the corporate insider trading context. It is far less clear what sort of benefit a member of Congress or aide would need to receive in order to establish

tipper or tippee liability under the STOCK Act.

*Non-Public Information?*

The government faces additional difficulties in proving that information is non-public under the STOCK Act. Information meets this standard if it is "specific and more private than general rumor."[6] In the corporate context, this analysis is often straightforward, involving closely guarded information about discrete transactions or earnings announcements. The question becomes murkier with respect to Congress. Members routinely state publicly and emphatically how they plan to vote on particular bills, and they and their staffers are closely scrutinized by journalists, bloggers, and non-governmental organizations, some of which publicize congressional activity in real time. In many cases, this will narrow the scope of legislative information that is truly outside the public domain.

In addition, Congress routinely deliberates over issues that are already the focus of public attention, whether or not its members have addressed them. COVID-19 is a timely illustration. Senator Burr has claimed that his trades were based upon television news reports of the crisis, rather than information he learned in briefings on Capitol Hill. Given the media saturation on the pandemic over the past several weeks, the government might well have difficulty proving otherwise. (On the other hand, the public statements of two of the Senators downplaying the severity of the crisis may complicate this argument.)

Furthermore, much of the information that Congress receives consists of confidential briefings from executive branch agencies, as in the Humana investigation. Those agencies are subject to requests under the Freedom of Information Act (FOIA). If details included in a briefing to Congress by the Environmental Protection Agency about a proposed emission standard are not known to the public at present, but could be obtained by a reporter through a FOIA request, are they non-public? The lack of clarity on this issue creates a further complication.

Finally, the information that lobbying and political intelligence firms typically provide to clients may consist of analysis or insights based on a mix of insider tips and publicly available data on economic, political, or social trends. To prevail on a STOCK Act charge based on this kind of "hybrid" information, the government would be forced to unpick the confidential detail from the public information, likely an impossible task in many, if not most, cases.

*Constitutional and Public Policy Issues*

Charges under the STOCK Act also face a potential constitutional roadblock: the Speech or Debate Clause in Article I of the U.S. Constitution, which protects members of Congress and their aides from liability for legitimate acts within the scope of their legislative role. The Supreme Court has held that the Clause covers "anything generally done in a session of [Congress] by one of its members in relation to the business before it."[7] Courts have held that the Clause also prevents the government from obtaining documents or testimony reflecting those acts.[8]

The Speech or Debate Clause likely will not protect every category of evidence relating to congressional acts. In an SEC action to enforce its subpoena to the House staffer in its Humana investigation, a federal district court held that the Clause applies only to information having a legislative purpose, and hence, not to external communications (in that case, phone calls and emails between the staffer and the lobbying firm), non-legislative communications with executive branch agencies, or phone records of calls that are not legislative in nature. [9] Nevertheless, the limited scope of information that the SEC was able to obtain apparently prevented it from building a record sufficient to support charges, and the Clause is likely to hamper future investigations similarly.

Finally, public policy arguments, including a possible chilling effect on full and frank communication between the executive and legislative branches that would result from intrusion by law enforcement, and a view that legislative integrity is best served by secrecy, present further potential impediments.

*Compliance Still Critical*

Despite these obstacles, the SEC and DOJ have signaled a new urgency about pursuing insider trading, and the uproar over Senators' COVID-19-related sales may well increase political pressure on the agencies to make use of the STOCK Act. Moreover, the Second Circuit last year widened the path for the DOJ to prosecute insider trading based on government-sourced information when it upheld the convictions of a political intelligence consultant and two hedge fund employees whom he tipped with CMS reimbursement rate details. The defendants were convicted of violating the federal criminal securities fraud and wire fraud statutes, which, the court held, unlike the Exchange Act do not require a breach of a duty or personal benefit.[10] The decision thus provides the DOJ with additional and more flexible tools for pursuing charges in this area.

In light of these developments, prior to trading on information obtained from lobbying or political intelligence firms, companies, broker-dealers and investment advisers, as well as their officers, directors and employees, should take steps to determine whether that information contains or is based upon material non-public information. A best practice would be to include language in their contracts with those firms providing that any reports, analyses or other intelligence will not include or reflect such information. Entities would also be well-advised to inquire about the sources of the information provided and document the answers. They should also review their policies and procedures to ensure that they specifically address insider trading based on government-derived information.

We will continue to provide updates on this evolving topic.

**Foley Hoag has formed a firm-wide, multi-disciplinary task force dedicated to client matters related to the novel coronavirus (COVID-19). For more guidance on your COVID-19 issues, visit our Resource Page or contact your Foley Hoag attorney.**

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[1] Pub. L. No. 112-105, 126 Stat. 291 (2012).

[2] *See United States v. Newman*, 773 F.3d 438, 445 (2d Cir. 2014) (citing *Chiarella v. United States*, 445 U.S. 222, 226-30 (1980)); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 202-06 (1976); 15 U.S.C. § 78j(b).

[3] 15 U.S.C. § 78u-1(g)(1).

[4] *Dirks v. SEC*, 463 U.S. 646, 662 (1983).

[5] *United States v. Martoma*, 894 F.3d 64, 76 (2d Cir. 2017); *Newman*, 773 F.3d at 450.

[6] *United States v. Mylett*, 97 F.3d 663, 666 (2d Cir. 1996).

[7] *Doe v. McMillan*, 412 U.S. 306, 311 (1973).

[8] *See, e.g., SEC v. Committee on Ways & Means of the U.S. House of Representatives*, 161 F. Supp. 3d 199, 242-43 (S.D.N.Y. 2015) (citations omitted).

[9] *Id.* at 245-48.

[10] *United States v. Blaszczak*, 947 F.3d 19 (2d Cir. 2019).

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