LAW360

Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

The Latest Roadblock For Insider Trading Enforcement

By **Justin Shur and Lauren M. Weinstein** (June 1, 2016, 10:42 AM EDT)

Over the last few years, the government has faced major setbacks in its efforts to pursue insider trading cases. Several U.S. Department of Justice insider trading convictions have been overturned based on the ruling in United States v. Newman, which dealt a severe blow to the government by raising the bar for proving tipper-tippee liability. On top of that, the U.S. Securities and Exchange Commission's ability to use administrative judges to hear enforcement actions has been and continues to be contested in litigation across the country. And a case set for argument before the Second Circuit this month raises yet another significant obstacle to the government's enforcement efforts in this area: the Constitution's "speech or debate" clause.

"Speech or Debate" Clause

The "speech or debate" clause, found in Article I, Section 6 of the Constitution, provides that "for any Speech or Debate in either House, [Members of Congress] shall not be questioned in any other Place." The clause has been construed as intending to protect the independence and integrity of the Legislature by allowing members the freedom of speech and debate without fear of intimidation by the executive branch or the judiciary. As a practical matter, however, the clause provides members and their staff immunity from prosecutions or civil suits and from being compelled to testify or produce documents relating to protected activity.

While the clause has been expanded beyond its literal terms (i.e., speech or debate) to cover "legislative acts," what exactly constitutes a legislative act and is thus protected activity is not entirely clear. In SEC v. Committee on Ways and Means, No. 15-3818, the Second Circuit will consider the distinction between protected and unprotected activity and decide to what extent the speech or debate clause applies to two subpoenas issued by the SEC in connection with an insider trading investigation.

The Investigation

The investigation at issue involves allegations that do not fit the prototypical insider trading profile. Typically, insider trading cases are based on the use of inside information obtained through corporate channels (think Bobby Axelrod, the hedge fund manager from "Billions," trading based on advance word of a merger or details about a company's earnings). By contrast, the allegations in this case are based on the use of inside information obtained through government channels: the allegations concern whether a congressional aide tipped off investors about an announcement regarding Medicare reimbursement rates, which caused a runup in certain health care stocks.

According to court documents, a House Ways and Means Committee staffer named Brian Sutter discussed with a lobbyist an upcoming announcement by the Centers for Medicare & Medicaid Services regarding reimbursement rates. The government alleges that the lobbyist then emailed an analyst at an investment research firm to say he had "heard from very credible sources" that Medicare reimbursement rates would not be cut as anticipated. The lobbyist also allegedly added: "Our intel is that a deal was already hatched." The research firm then purportedly sent a similar alert to its hedge fund clients, who traded ahead of the announcement.

Apparently both the DOJ and the SEC are investigating the alleged leak of inside information and the circumstances surrounding it, and trying to determine whether any of the conduct at issue constitutes illegal insider trading. As part of the investigation, the SEC issued subpoenas to Sutter and the Ways and Means Committee seeking documents and testimony regarding communications involving Sutter, the lobbyist and CMS. Congress refused to comply. It argued, among other things, that the speech or debate clause barred the subpoenas, setting the stage for a constitutional showdown.

The district court generally required Congress to comply with the subpoenas. But it provided some guidance to the parties, highlighting the difficulty in determining whether the clause protects a particular activity. The court ruled, for example, that responsive communications created as part of the House committee's information gathering concerning a matter that might be the subject of legislation are protected and need not be produced. However, responsive documents that lack a sufficient connection to legislative activity, such as communications that reflect "cajoling" or "exhorting" with respect to the administration of a federal statute, are not protected and must be produced. While the Second Circuit will have the opportunity to address — and clarify — those limitations, the protections afforded by the clause will undoubtedly have implications for enforcement authorities.

Enforcement Implications

As illustrated by the current litigation, disputes over the clause's protections can significantly delay an investigation. It's been over two years since the SEC issued its subpoenas to Sutter and the committee. While arguments in the case are scheduled for this month, the SEC's fight with Congress could continue for months, if not years.

Even more problematic for the government are the evidentiary obstacles posed by the speech or debate clause. The clause forbids the government from offering proof of "speech or debate" protected activity to advance its case. But in pursuing these allegations, evidence of such activity may be essential.

The government, for example, would need to prove that Sutter (the tipper) misappropriated inside information. That is, he accepted a personal benefit in exchange for disclosing material nonpublic information obtained by reason of his position. Ordinarily, the government might seek to establish the necessary quid pro quo through circumstantial evidence. But if the manner in which Sutter allegedly acquired and/or disclosed the information falls within the realm of protected activity, the SEC may not be able to use the quid itself as evidence of an unlawful agreement and thus may be unable to prove this necessary element.

Likewise, the clause could preclude a case against nongovernment officials because tippee liability is derivative. A tippee is liable for insider trading only if, among other things, the tipper breached a fiduciary duty and there is evidence that the tippee knew it. If the SEC is unable to establish the tipper's breach in the first instance because it requires inquiry into "speech or debate" protected activity, it would be unable to make a case against first-generation tippees (like the lobbyist who Sutter allegedly

spoke with) as well as other tippees further down the information distribution chain (like the research firm and its hedge fund clients).

* * *

Following argument, which is set for June 13, the Second Circuit will weigh in on the debate over the scope of the clause and its application to the SEC's subpoenas. But regardless of which side prevails, the protections afforded by the clause are likely to present significant challenges for enforcement authorities in pursuing insider trading allegations based on inside information obtained through legislative channels — and might limit such enforcement actions altogether.

—By Justin V. Shur and Lauren M. Weinstein, MoloLamken LLP

Justin Shur is a partner in the New York and Washington, D.C., offices of national litigation boutique MoloLamken. He is a former deputy chief of the U.S. Department of Justice's Public Integrity Section of the Criminal Division, where he investigated and prosecuted white collar crime.

Lauren Weinstein is an associate in MoloLamken's Washington office.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.