Debevoise & Plimpton

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INSIDER TRADING & DISCLOSURE UPDATE

In this Issue:

From the Editors

Welcome to the Spring 2023 issue of the Insider Trading & Disclosure Update, Debevoise's periodic Update focusing on legal, compliance and enforcement developments in the areas of insider trading, the management of material nonpublic information and disclosure rules and enforcement.

The further development of the trends and predictions observed in our Fall 2022 issue, including those related to significant securities regulatory and enforcement activity at the SEC and the DOJ and newly-adopted SEC disclosure rules, figure prominently in this issue. Trading on confidential government information is also in focus, with significant developments at the Second Circuit Court of Appeals in *Blaszczak II* and Congressional consideration of legislation to further the objectives that drove adoption of the STOCK Act.

We hope that you find this Update useful and informative, and we look forward to bringing you further news and analysis in future issues.

Sincerely,

The Editorial Board

Rulemaking Activity

SEC Adopts New Rule 10b5-1 Trading Plan and Trading-Related Disclosure and Reporting Requirements

On December 14, 2022, the SEC adopted amendments to Rule 10b5-1 under the Exchange Act and new disclosure requirements relating to trading activity of corporate insiders and the trading policies of issuers. The amendments, among other things, add significant new conditions to the availability of Rule 10b5-1's affirmative defense to insider trading liability, including: (i) a cooling-off period; (ii) a certification as to the absence of possession of no material nonpublic information; (iii) limitations on overlapping and single trade plans; and (iv) a requirement to act in good faith. In addition, the amendments create new disclosure requirements regarding: (i) the adoption, modification and termination of Rule 10b5-1 and other trading arrangements by Section 16 officers; (ii) insider trading policies and procedures of issuers; and (iii) the timing of option awards to named executive officers made in close proximity to the issuer's release of material nonpublic information. The amendments also augment the reporting obligations under Section 16 of the Exchange Act for transactions made pursuant to a Rule 10b5-1 trading arrangement and gifts. The full text of the final rules is available here.

Amendments Regarding Rule 10b5-1 Trading Plans

Mandatory Cooling-Off Period

Directors and officers subject to the beneficial ownership reporting requirements of Section 16 of the Exchange Act ("Section 16 officers") will be subject to a cooling-off period extending to the later of: (i) 90 days after the adoption or modification of a Rule 10b5-1 trading plan; and (ii) two business days following the disclosure of the issuer's financial results for the fiscal quarter in which the plan was adopted or modified (but not to exceed 120 days following adoption or modification of the plan). Persons other than directors and Section 16 officers are subject to a cooling-off period of 30 days after the adoption or modification of a Rule 10b5-1 trading plan before any trading can commence under the plan. The amendments do not include a mandatory cooling-off period for the issuer, although the SEC noted that they believe further consideration of such requirements to issuers is warranted.

In certain circumstances, a stockholder should consider whether to implement the longer 90–120 day cooling-off period, such as when an individual who controls investment decisions of the stockholder is also a director of the subject company. We recommend discussing the relevant facts and circumstances with counsel in these and similar circumstances to determine the appropriate cooling-off period.

Importantly, the existence of a cooling-off period does not cleanse a Rule 10b5-1 plan entered into while in possession of material nonpublic information, even if such information becomes public prior to the commencement of trading under the plan. In fact, as noted below, the new rules require a certification as to the absence of possession of material nonpublic information at the time of adoption of the plan in addition to the imposition of cooling-off periods.

Certification of No Material Nonpublic Information

Directors and Section 16 officers will be required to include a representation in any Rule 10b5-1 trading plan certifying that at the time of the adoption of a new or modified trading arrangement: (i) they are not aware of material nonpublic information about the issuer or its securities; and (ii) they are adopting the trading arrangement in good faith and not as part of a plan or scheme to evade the prohibitions of Section 10(b) and Rule 10b-5 under the Exchange Act. The amended rules do not require that issuers make representations when adopting or modifying a Rule 10b5-1 trading arrangement, but it is typical for brokers to require that an issuer's share repurchase plan include such representations.

Restrictions on Overlapping Plans and Single-Trade Arrangements

The affirmative defense under Rule 10b5-1(c)(1) will not be available for any trades by a person, other than the issuer, that has established multiple overlapping trading arrangements. This condition also precludes separate, overlapping arrangements where each relates to a different class of securities of the same issuer. However, plans with separate brokers will be deemed to constitute a single plan if, when taken together, the plans otherwise satisfy the conditions of Rule 10b5-1(c)(1). This condition does not restrict a person from maintaining separate trading arrangements at the same time, so long as trades under the later-commencing plan do not commence until the completion or expiration of the earlier plan. However, to the extent the earlier plan was terminated before all planned transactions under the plan were completed or the time set for the plan expired (in other words, an "early" termination of the plan), the later adopted plan will be subject to an "effective cooling-off period" that begins on the date of the earlier plan's termination and runs for the full cooling-off period applicable to the person instituting the plan. An overlapping plan that provides for only "sell-to-cover" sales necessary to satisfy new tax withholding obligations also will not violate this condition under certain circumstances. In addition, other than for the issuer, the affirmative defense under Rule 10b5-1(c)(1) will only be available for one plan designed to effect a single trade in any 12-month period.

This restriction on overlapping trading arrangements, on its face, permits a participant to satisfy the cooling-off period applicable to a later-commencing plan while an existing plan is still active, unless the first plan is terminated early. In that case, the later-commencing plan would not be compliant with the rule if trades begin during an "effective cooling-off period" measured from the date of termination of the first plan. However, this aspect of the amended rule leaves room for interpretation, and it is possible the SEC could take a more restrictive view and apply the "effective cooling-off period" to the end of the first plan in all circumstances (and not just early termination).

Good Faith

A trader that has entered into a Rule 10b5-1 trading arrangement is required to act in good faith with respect to the trading arrangement (in addition to the current requirement that a Rule 10b5-1 trading arrangement be entered into in good faith), thereby making clear that the affirmative defense will not be available to a trader that cancels or modifies a plan in an effort to benefit their trading results, such as by using their influence to affect the timing of the announcement of material nonpublic information, or otherwise attempting to evade the prohibitions of the rule.

Amendments to Trading-Related Disclosure Requirements

New Item 408(a) of Regulation S-K will require an issuer to disclose in its Form 10-Q or Form 10-K, as applicable, whether, during the last fiscal quarter, any director or officer of the issuer has adopted, modified or terminated: (i) any trading arrangement that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c)(1) and/or (ii) any written trading arrangement that meets the requirements of a "non-Rule 10b5-1 trading arrangement" (as defined in new Item 408(c)).[1] The issuer must also provide a description of the material terms of any such trading arrangement—which need not include pricing terms—and indicate whether such trading arrangement is a Rule 10b5-1 trading arrangement or is a non-Rule 10b5-1 trading arrangement. Reporting companies with a calendar year fiscal year will be required to comply with the new Item 408(a) disclosure requirements in their Form 10-Q for the quarter ended June 30, 2023.

New Item 408(b) of Regulation S-K and new Item 16J to Form 20-F will require an issuer to disclose whether it has adopted insider trading policies and procedures governing the purchase, sale and other dispositions of the issuer's securities by directors, officers and employees of the issuer, or by the issuer itself, that are reasonably designed to promote compliance with insider trading laws, rules and regulations and any applicable listing standards. If not, the issuer will be required to explain why it has not done so. These disclosures will be required in annual reports on Forms 10-K and 20-F and proxy and information statements on Schedules 14A and 14C. An issuer will also be required to file a copy of their insider trading policies and procedures as an exhibit to Forms 10-K and 20-F, respectively. Reporting companies with a calendar year fiscal year will be required to comply with the new Item 408(b) disclosure requirements on their Form 10-K or Form 20-F for the 2024 fiscal year.

New Item 402(x) of Regulation S-K will require an issuer to include tabular disclosure of each option and stock appreciation right (including the number of securities underlying the award, the date of grant, the grant date fair value and the exercise price) granted to its named executive officers in the four business days before the filing of a periodic report (*e.g.*, Form 10-Q or Form 10-K) or the filing or furnishing of a current report on Form 8-K that contains material nonpublic information (except for an Item 5.02(e) Form 8-K that only discloses a material new option award grant) and ending one business day after the filing or furnishing of such report.

Amendments to Trading-Related Reporting Requirements

The amendments enhance reporting obligations of Section 16 officers, directors and beneficial owners of more than 10% of an issuer's registered equity securities ("Section 16 insiders") under Section 16 of the Exchange Act relating to: (i) sales or purchases made pursuant to a Rule 10b5-1 trading arrangement, which must now be identified by a "check box" on the Form and (ii) dispositions of equity securities by Section 16 insiders that constitute bona fide gifts, which must now be reported on Form 4 (previously, gifts could be reported annually on Form 5).

For more information about the amendments to Rule 10b5-1 under the Exchange Act and new disclosure requirements relating to trading activity of corporate insiders and trading policies of issuers, please see our Debevoise Update here.

SEC Adopts Share Repurchase Disclosure Rules

On May 3, 2023, the SEC adopted a series of new rules requiring additional disclosures by issuers of purchases of equity securities made by or on behalf of an "issuer" or any "affiliated purchaser" registered under Section 12 of the Exchange Act, aiming to enhance the "quality, relevance, and timeliness" of such disclosures.[2]

While the SEC acknowledged in the adopting release that share repurchases are generally implemented for legitimate business reasons (*e.g.*, reducing dilution from equity incentive plan issuances), the SEC expressed concerns about the use of share repurchases for earnings management or to increase management's compensation.[3] The new rules seek to address these concerns by providing investors with additional information to help investors better understand the extent of an issuer's activity in the market and an issuer's motivation for share repurchases, and to allow investors to gather knowledge about the potential relationship among executive compensation, stock sales and share buybacks. Most significantly, the new rules require:

- most issuers to disclose their daily share repurchase activity on a quarterly basis;
- additional disclosures in periodic reports regarding the objective and structure of an issuer's repurchase program, including Rule 10b5-1 trading arrangements, and policies relating to trading activity by officers and directors during repurchase programs;
- issuer periodic reports to identify trading activity by officers and directors in close proximity to an announcement of a share repurchase program; and
- the tagging of share repurchase information with inline eXtensible Business Reporting Language.

The full text of the rules is available here.

For most issuers, the rules apply to the first periodic report on either Form 10-Q or Form 10-K in respect of the first full fiscal quarter that begins on or after October 1, 2023. The quarterly reporting requirements for foreign private issuers will apply with the first full fiscal quarter that begins on or after April 1, 2024, using the new Form F-SR, while the annual reporting requirements will apply beginning with the first Form 20-F filing after the first Form F-SR is filed. For listed closed-end funds, the rules will apply beginning with the Form N-CSR for the first six-month period that begins on or after January 1, 2024.

For more information about the new share repurchase disclosure rules, please see our Client Debrief here.

SEC Maintains Focus on Non-GAAP Financial Measures

Non-GAAP financial measures remain a significant focus of the SEC, exemplified by frequent SEC staff comment letters, a recent enforcement action against DXC Technology Company ("DXC") that settled in March 2023 and new and revised Compliance and Disclosure Interpretations ("C&DIs") issued in December 2022.

SEC 2022 Comment Letters on Non-GAAP Measures

Non-GAAP financial measures were a frequent topic in comment letters issued by the staff of the Division of Corporation Finance of the SEC (the "Staff") during 2022. At the 2022 Association of International Certified Professional Accountants & Chartered Institute of Management Accountants conference, representatives of the Staff noted that non-GAAP financial measures continue to be an area of concern because the Staff believes that registrants continue to misapply applicable guidance.[4] The Staff also indicated that non-GAAP financial measures remain one of the most frequent topics of comment letters issued to registrants.[5] Based on our analysis of publicly available comment letters issued to over 230 issuers in 2022, approximately 15% of comment letters issued by the Staff in 2022 included at least one comment relating to non-GAAP financial measures. Based on this review, we note that the Staff's comments in relation to non-GAAP financial measures most frequently address the following points:

- presenting the most directly comparable GAAP financial measure with equal or greater prominence as the non-GAAP financial measure;
- providing an appropriate reconciliation of the non-GAAP measure to the most directly comparable GAAP financial measure;
- disclosing why management believes the non-GAAP financial measure provides useful information to investors and the additional purposes, if any, for which management uses such measure;
- identifying and clearly labeling non-GAAP financial measures; and
- non-GAAP measures that the Staff believes are based on individually tailored accounting principles.

SEC Brings Enforcement Action for Misleading Non-GAAP Measures

In line with its heightened focus on non-GAAP financial measures, on March 14, 2023, the SEC announced the settlement of charges against DXC, an IT services company, relating to the use of allegedly misleading non-GAAP disclosures and the failure to maintain sufficient disclosure controls and procedures.[6] DXC agreed to settle SEC charges that it made misleading disclosures about its non-GAAP financial performance in multiple reporting periods from 2018 until early 2020. The SEC alleged that DXC materially increased its reported non-GAAP net income by negligently misclassifying tens of millions of dollars of expenses as non-GAAP adjustments for so-called transaction, separation and integration-related ("TSI") costs, which resulted in DXC improperly excluding these costs from its non-GAAP measures of earnings.

The SEC alleged that, throughout the relevant period, DXC failed to accurately describe the scope of expenses included in TSI costs, causing DXC's non-GAAP net income and non-GAAP diluted EPS in periodic reports and earnings releases to be materially misleading. DXC presented TSI as comprising "one-time" or "non-recurring" expenses. However, the SEC alleged that DXC did not have sufficient non-GAAP policies and procedures or disclosure controls and procedures to ensure that costs classified as TSI were consistent with the company's description of those costs in its public disclosure. DXC agreed to pay an $8 million penalty relating to violations of the Securities Act, the Exchange Act and Regulation G. DXC also agreed to develop and implement appropriate non-GAAP policies and disclosure controls and procedures.

The SEC's substantial settlement with DXC demonstrates the SEC's ongoing focus on non-GAAP financial measures and highlights the importance of incorporating considerations relating to non-GAAP measures within a reporting company's disclosure controls and procedures. The undertakings agreed by DXC provide a framework for the type of disclosure controls and procedures relating to non-GAAP measures that public companies should consider.

SEC Releases Updated Guidance on Non-GAAP Financial Measures

On December 13, 2022, the Staff issued guidance relating to the use of non-GAAP financial measures through new C&DIs, reflecting an ongoing focus on the use of potentially misleading non-GAAP financial measures. The Staff revised three existing C&DIs and added two new C&DIs to clarify existing guidance and to provide new guidance on a variety of common non-GAAP financial measure disclosure practices and presentations. The updates provide greater insight into the types of non-GAAP measures the Staff believes are misleading and clarifies when the Staff will view a non-GAAP measure as having greater prominence than a GAAP measure. Please see our Debrief for additional information about the new C&DIs.

We expect the SEC and its staff to continue prioritizing non-GAAP financial measures in disclosure reviews and enforcement actions. To enhance compliance with Regulation G and Item 10(e) of Regulation S-K, issuers should review the newly issued C&DIs and evaluate the potential impact of this guidance on their upcoming earnings releases and periodic reports. Issuers should also review their disclosure controls and procedures relating to how they record, process, summarize and report non-GAAP financial measures, particularly in light of the undertakings included as part of the DXC settlement.

Please see our Debevoise In Depth for a more detailed discussion on this subject.

Enforcement Activity

Blaszczak II and Trading on Confidential Government Agency Information

To the disappointment of pro-enforcement observers, the Second Circuit's December 27, 2022 opinion in *Blaszczak II* articulated a further limitation on insider trading enforcement by holding that certain confidential government information is not property or a thing of value as necessary to establish a violation of 18 U.S.C. §§ 1343 (wire fraud) and 1348 (securities and commodities fraud), which apply to fraudulent schemes to obtain "money or property," and 18 U.S.C. § 641 (public money, property or records), which applies to embezzlement, theft or other unauthorized disposition of "property" or a "thing of value."

Parallel Charges by the SEC and DOJ

In 2017, the U.S. Securities and Exchange Commission (the "SEC") charged Christopher Worrall, a former employee of the Centers for Medicare & Medicaid Services ("CMS"), with violating the Securities Exchange Act of 1934 (the "Exchange Act") § 10(b)/Rule 10b-5 and Securities Act § 17(a)(1), and breaching his duty as an executive branch employee under the Stop Trading on Congressional Knowledge Act (the "STOCK Act"). According to the SEC's Complaint, Worrall provided confidential information to David Blaszczak, an employee of a private political intelligence firm, about CMS's reimbursement rate decisions before the agency released its decisions to the public. Blaszczak then provided the information to two hedge fund employees, Theodore Huber and Jordan Fogel, who in turn traded in securities of companies that would be impacted by the rate changes. Blaszczak, Huber and Fogel were charged alongside Worrall for violations of Exchange Act § 10(b)/Rule 10b-5 and Securities Act § 17(a)(1), but Worrall was the only defendant charged pursuant to the STOCK Act.

In a parallel action, the U.S. Department of Justice ("DOJ") brought criminal charges against Worrall, Blaszczak, Huber, Fogel and Robert Olan—another hedge fund employee.[7] Worrall, Blaszczak, Huber and Olan were charged under § 10(b)/Rule 10b-5, § 1348, as well as Title 18's wire fraud (18 U.S.C. § 1343), conversion of government property (18 U.S.C. § 641), and conspiracy statutes (18 U.S.C. §§ 371, 1349).[8] In addition, Fogel was charged under § 10(b)/Rule 10b-5, § 371, § 641 and § 1349, but he pled guilty and began cooperating with the government.[9]

A key difference between charges brought under Rule 10b-5 versus § 1348 is that Rule 10b-5 requires the government to establish that a fiduciary duty was breached in connection with the purchase or sale of a security.[10] There is no such duty requirement under § 1348. The government asserted that the requisite duty in the case of Worrall, for purposes of Rule 10b-5, was established under the STOCK Act, which provides that executive branch employees, such as Worrall, 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 non-public information ("MNPI") derived from their position and responsibilities as executive branch employees.[11] The STOCK Act was not directly relevant for establishing the culpability of the other defendants.

Trial Convictions Upheld in Blaszczak I

At trial in 2018, Worrall, Blaszczak, Huber and Olan were acquitted of all substantive securities fraud charges under Rule 10b-5, but they were all convicted on at least one count of wire fraud (§ 1343) and conversion (§ 641).[12] Blaszczak, Huber and Olan were also convicted on counts of § 1348 securities fraud and conspiracy.[13]

On appeal, defendants relied on the definitions of §§ 1343 and 1348, which apply to fraudulent schemes to obtain "money or property," and § 641, which applies to conversion of "money[] or [a] thing of value" of the government. Defendants argued that their convictions under these statutes could not hold because CMS's confidential information as to its plans for announcing changes in medical service reimbursement rates was not government "property" or a "thing of value[.]"[14]

A split panel of the Second Circuit disagreed in *Blaszczak I* and the defendants' convictions were affirmed in 2019. *Blaszczak I* held that CMS had a "property right in keeping confidential and making exclusive use of its nonpublic predecisional information.[15] *Blaszczak I* also held that the government can prosecute insider trading, under both the criminal securities fraud provisions and wire fraud statutes under Title 18, without any proof of a "personal benefit" to the tipper[16]—that is, the government need not allege or prove that the tipper breached a duty in exchange for a direct or indirect personal benefit, or that the downstream tippee knew of a personal benefit to the tipper. In doing so, *Blaszczak I* declined to extend the "personal benefit" requirement—established in *Dirks v. SEC*[17] for Title 15 securities fraud cases—to Title 18 cases.[18]

It appeared at the time that §§ 1343 and 1348 could serve as viable and attractive alternatives to Rule 10b-5 insider trading prosecutions, including those targeting members of Congress and other government personnel, given the arguably more flexible set of elements under Title 18. But the story did not end there.

Supreme Court Relies on Kelly to Vacate Judgment

Following the Second Circuit's decision in 2019, the Supreme Court decided *Kelly v. United States*, the so-called "Bridgegate" decision.[19] In *Kelly*, prosecutors charged officials from the Port Authority of New York and New Jersey, and officials in former New Jersey Governor Chris Christie's office with devising a political retribution scheme by closing traffic lanes leading to the George Washington Bridge during rush hour. The Court rejected the government's argument that depriving the Port Authority of the use of traffic lanes was a taking of "property" under Title 18's wire fraud and federal program fraud provisions, and held that the defendant's scheme was a mere interference in the Port Authority's intangible rights of "allocation, exclusion, and control" in its regulatory affairs, which "do not create a property interest."[20]

Following *Kelly*, the *Blaszczak I* defendants successfully petitioned the Supreme Court for a *writ of certiorari*—with support from the government—and the Court vacated the judgment in *Blaszczak I* and remanded the case for "further consideration in light of" *Kelly*.[21]

Blaszczak II Holds That Confidential CMS Regulatory Information is not "Property" or "Thing of Value" under Title 18

On remand, the government conceded that the convictions on the Title 18 securities fraud, wire fraud, conversion of government property and certain conspiracy counts must be overturned, based on *Kelly*.[22] The Court, in a 2-1 opinion showing deference to the government's position, held that the defendants could not be convicted for violating the relevant statutes under Title 18, unless the "objective of their schemes and conduct was money or property of CMS."[23] The majority embraced *Kelly*'s conclusion that "a scheme to alter . . . a regulatory choice is not one to appropriate the government's *property*" and determined that the CMS information did not involve any greater property interest.[24] The majority concluded that the information about pending CMS regulations and the timing of relevant disclosures are "regulatory in nature and do not constitute money or property of the victim; and they are not a 'thing of value' to CMS that is susceptible to being 'convert[ed]'[.]"[25] The Court ultimately remanded the case to the district court for resubmission of the remaining conspiracy counts to the jury.[26]

In his dissent, Judge Sullivan argued that the majority's holding was wrong, not compelled by *Kelly*, and would lead to further confusion. Judge Sullivan likened the information in question in *Blaszczak II* to the kinds of information recognized as constituting property rights in the Supreme Court's decisions in *Carpenter v. United States*[27] (publication schedule and contents of forthcoming columns in *The Wall Street Journal*) and *United States v. O'Hagan*[28] (law firm's and its client's pre-acquisition information), and argued that "it is difficult to see a meaningful distinction" between these types of information.[29] Accordingly, the dissent concluded that the "government's right to exclude the public from accessing its confidential information concerning the content and timing of its reimbursement rates . . . squarely implicates its role as a property holder," as opposed to its "regulatory role as sovereign[.]"[30] The dissent also rejected the position that a non-commercial entity, such as a government agency, cannot have a property interest in confidential information.[31]

Looking Ahead

While it remains to be seen whether the Second Circuit's decision is adopted by other circuits, *Blaszczak II* has the potential to significantly limit insider trading liability under § 1348, especially with regard to congressional insider trading, because successfully prosecuting a case against members of Congress may now require the government to establish that the defendant devised a scheme to defraud the victim—Congress—to obtain "money or property." If confidential information about government agency reimbursement rate decisions is not considered property, various types of information obtained in congressional sessions may similarly be characterized as "not property."

Jury Convicts Former Congressman Stephen Buyer of Insider Trading

On March 10, 2023, Stephen Buyer, former nine-term Congressman who represented Indiana in the U.S. House of Representatives between 1993 and 2011, was convicted by a Manhattan federal jury on four counts of insider trading charges.[32] Buyer's case had drawn significant media attention due to Buyer's former position and from growing criticism during the COVID-19 pandemic of members of Congress who engaged in trades while in possession of potential insider information.

As we discussed in our previous Update, the SEC and DOJ brought parallel insider trading charges against Buyer in July 2021, which led to Buyer's arrest.[33] The government alleged that Buyer—who formed a consulting firm after he left Congress in 2011—engaged in two separate, but related, insider trading schemes while providing consulting services. First, Buyer allegedly learned about his client T-Mobile's plans to acquire Sprint during a golf outing with a T-Mobile executive.[34] Despite having agreed to protect T-Mobile's confidential information and being told that the acquisition information was to be kept confidential,[35] Buyer breached his duty of confidence by purchasing shares of Sprint while in possession of MNPI. He subsequently made a profit of over $126,000 when he sold the acquired shares after the planned acquisition was publicly announced.[36]

Second, Buyer allegedly engaged in a similar scheme as part of consulting services provided on behalf of another client, Guidehouse LLP ("Guidehouse"). Through his communications with Guidehouse's Managing Director, Buyer gathered that Guidehouse planned to acquire Navigant Consulting, Inc. ("Navigant") and then purchased shares of Navigant. On the day that the Navigant acquisition was publicly announced, Buyer sold almost all of the acquired shares and profited more than $220,000.[37]

The SEC charged Buyer under Exchange Act § 10(b)/Rule 10b-5, while DOJ's case included four counts under § 10(b)/Rule 10b-5 and 18 U.S.C. § 1348, a criminal securities fraud statute adopted in 2002 as part of the Sarbanes-Oxley Act. At trial, Buyer's lawyers argued that Buyer "did research about both the stocks" and relied on publicly available information to trade shares of Sprint and Navigant, while prosecutors focused on the timing of Buyer's trades.[38] The jury was ultimately not convinced by the defense and returned a guilty verdict at the end of the two-week trial.

Buyer is scheduled to be sentenced in July 2023. Following trial, U.S. Attorney Damian Williams stated that the prosecution showed DOJ's intent "to detect and hold accountable those who break our insider trading laws just to make a buck."[39] The SEC's civil case against Buyer has been stayed since September 2022, pending the completion of the parallel criminal proceedings.[40]

Divided Congress Continues to Consider Whether and How to Update Congressional Insider Trading Laws

When the STOCK Act was signed into law by President Barack Obama in April 2012, many observers were optimistic about the prospect of effective enforcement against congressional insider trading. By virtue of their official positions and responsibilities, members of Congress have access to nonpublic information about various topics, and trading on the basis of such information presents the same problematic issues as everyday insider trading. In order to address the issue, the STOCK Act affirms that members of Congress, as well as executive and judicial branch officials, are not exempt from the federal insider trading laws.[41] The STOCK Act also expressly imposes a duty upon legislative, executive and judicial branch personnel with respect to MNPI derived from their official positions and responsibilities in the government.[42] Pursuant to the STOCK Act, members of Congress cannot trade securities based on MNPI derived from their official positions and responsibilities in the government, and they must report trades above a threshold, made by themselves or certain family members, within 45 days after the transaction.[43]

The efficacy of the STOCK Act has been closely scrutinized since the COVID-19 pandemic, in light of extensive media coverage regarding widespread trading by members of Congress in the stock of companies in key industries impacted by the pandemic.[44] From that scrutiny, a view developed that existing penalties were not having a strong enough deterrent effect on lawmakers. In fact, the applicable penalties for violations of the STOCK Act are both minimal in amount and can be waived by congressional ethics officials.[45] Further, federal law enforcement efforts utilizing the STOCK Act have yet to produce concrete results. While there have been successful enforcement actions against former members of Congress, such as Stephen Buyer discussed above, those actions were not brought under the STOCK Act and did not relate to congressional activities.

In October 2021, the SEC opened an investigation into trades made by former U.S. Senator Richard M. Burr and his brother-in-law, Gerald Fauth, to determine whether Burr and Fauth violated federal securities laws, including the STOCK Act, by engaging in unlawful insider trading as a result of information obtained by Burr through briefings about the potential impact of COVID-19 on the U.S. and global economies.[46] Burr had sold $1.6 million worth of stock in the early days of the pandemic. In response to the allegations, Burr said in March 2020 that he "relied solely on public news reports to guide [his] decision regarding the sale of stocks" and that he "closely followed CNBC's daily health and science reporting out of its Asia bureaus at the time."[47]

According to the SEC, shortly after placing his trades, Burr had also called Fauth, who "one minute later placed a call to his own broker to sell certain stocks held in an account in his wife's name,"[48] therefore also bringing Fauth within the scope of the investigation. However, it was announced in January 2023 that the SEC closed its investigation without action. Though it is unclear what led the SEC to close the investigation,[49] the agency's decision demonstrated that enforcing insider trading laws against members of Congress under the STOCK Act remains a complex undertaking.

Lawmakers frustrated with the current reach and impact of the STOCK Act have made several attempts to reform congressional trading rules. For example, first in 2020 then again in 2021, Representatives Abigail Spanberger (D-VA) and Chip Roy (R-TX) introduced bipartisan bills with considerable support—called the TRUST in Congress Act—to require the placement of certain investments into a qualified blind trust until 180 days after the end of a lawmaker's tenure, effectively banning members of Congress from trading certain stocks.[50] However, a vote on the proposed bill did not take place by the end of the 117th Congress ending in January 2023—despite growing pressure from the public—due in part to the consideration of a competing bill with reported loopholes, which itself was subsequently aborted.[51]

The 118th Congress has already seen the introduction of renewed proposals in this area. On January 1, 2023, the TRUST in Congress Act was introduced for a third time in the House with 52 co-sponsors.[52] There has also been activity in the Senate: on January 24, Senator Josh Hawley (R-MO) introduced a bill called the Preventing Elected Leaders From Owning Securities and Investments (PELOSI) Act.[53] Senator Hawley's bill would—among other things—prohibit members of Congress and their spouses from holding or trading individual stocks and certain related financial instruments, and require disgorgement to the Treasury of any profit made in violation of the prohibition. Finally, in late April, a bipartisan and bicameral bill—called the Ending Trading and Holdings in Congressional Stocks (ETHICS) Act—was introduced in the House and Senate.[54] Notably, the ETHICS Act would require that a violation of the ETHICS Act result in a fine set to be at least the monthly pay of the member of Congress.

While the STOCK Act received overwhelming bipartisan support in both the Senate (passed by a 96-3 vote) and House (passed by a 417-2 vote), and notwithstanding support voiced by a range of congressional representatives, it is fair to say that passage of new legislation intended to address perceived or real misuse of inside information by members of Congress may face long odds in a divided Congress.

Recent SEC Enforcement Action Re: Rule 10b5-1 Plan Trades

On March 1, 2023, the SEC charged Terren S. Peizer, Executive Chairman of Ontrak Inc. ("Ontrak") with insider trading for allegedly selling more than $20 million of Ontrak stock between May and August 2021 while in possession of material nonpublic information related to Ontrak's largest customer. Mr. Peizer sold Ontrak stock pursuant to two trading plans purportedly established under Rule 10b5-1 of the Exchange Act. In a parallel action, DOJ announced criminal charges against Mr. Peizer.

Background

The SEC alleged that Mr. Peizer, prior to entering into the two trading plans, was aware that Cigna, Ontrak's then-largest customer, had been communicating confidentially to key Ontrak personnel that it was dissatisfied with Ontrak and that it was increasingly likely to terminate its contract with Ontrak. Ontrak's 2020 annual report stated that "Our business currently depends upon four large customers; the loss of any one of such customers would have a material adverse effect on us." In March 2021, Ontrak had publicly announced that another major customer was terminating its contract, which resulted in Ontrak's stock dropping by over 46%.

In May 2021, Mr. Peizer, while aware of Cigna's communications regarding the likely termination of its contract, entered into a trading plan to sell shares of Ontrak stock. In August 2021, aware that Cigna was on the verge of terminating its contract, Mr. Peizer entered into a second trading plan. In connection with both plans, Mr. Peizer represented that he was not aware of any material nonpublic information concerning Ontrak or its securities. Mr. Peizer did not implement a cooling-off period before sales began under either trading plan.

On August 19, 2021, Ontrak disclosed that an unidentified customer (in actuality, Cigna) was terminating its contract, which resulted in Ontrak's stock dropping by over 44%. By that time, Mr. Peizer had allegedly sold over $20 million of Ontrak stock since May 2021, avoiding losses of over $12.7 million.

The SEC claimed that the Rule 10b5-1 affirmative defense was not available for the trading plans, as Mr. Peizer entered into the trading plans (i) while aware of material nonpublic information about Ontrak and (ii) not in good faith, but as part of a scheme to evade insider trading prohibitions.

Takeaways

- **SEC Scrutiny of Rule 10b5-1 Plans**. This action was not brought under a new or novel legal theory—in the SEC's press release, Chair Gensler stated: "We allege that Mr. Peizer violated Rule 10b5-1 as it has existed for two decades by establishing and executing trading plans while aware of nonpublic information." Nevertheless, Mr. Gensler also highlighted the timing of this action in connection with the recent Rule 10b5-1 amendments, noting that "[t]oday's action comes the week that updated amendments to Rule 10b5-1 become effective. These reforms to Rule 10b5-1 will further help prevent unlawful trading by executives on the basis of nonpublic information and help build greater confidence in the market."
- **Cooling-Off Periods Are Relevant to Intent and Good Faith**. In alleging that Mr. Peizer acted with scienter, the SEC's complaint discussed the lack of a cooling-off period for both trading plans in alleging that Mr. Peizer "sold Ontrak stock in haste in order to avoid losses before Customer A formally terminated its contract and that information became public, sending the price of Ontrak stock significantly lower, as had happened with Customer B." The SEC noted that Mr. Peizer declined to adopt a trading plan with the first broker he reached out to because the broker required at least a 14-day cooling-off period, instead using a broker that did not require a cooling-off period. The SEC's complaint also describes how Mr. Peizer disregarded an email from an employee of the second broker, stating that "it is an industry best practice to insert a 30-day 'cooling off' period between the time of the execution of the plan and the commencement of trading," and continued without a cooling-off period.

Elon Musk and Tesla Avoid Liability in Shareholder Lawsuit over 2018 Tweets

In February 2023, in a rare instance of a securities class-action lawsuit proceeding to trial, a jury found that Elon Musk and Tesla were not liable for losses suffered by Tesla shareholders after Mr. Musk tweeted in August 2018 that he had secured funding to take Tesla private and the take-private failed to materialize. On August 7, 2018, Mr. Musk tweeted that he had "funding secured" and that "[i]nvestor support [was] confirmed" to take the company private at $420 per share, a premium of about 23% to the prior day's close. Following Mr. Musk's tweets, the stock price immediately jumped by more than 6%. Tesla's stock price then dropped a few days later, on August 16, when Mr. Musk confirmed in an interview with *The New York Times* that he would not be taking the company private.[55] Ultimately, the jury concluded that Mr. Musk's tweets did not cause Tesla shareholders' losses.

Background

As we covered in a previous update, Mr. Musk settled securities fraud charges arising from the same tweets in a $40 million settlement with the SEC in September 2018. In their complaint, Tesla shareholders accused Mr. Musk of securities fraud under Section 10(b) and Rule 10b-5 of the Exchange Act— the SEC's general anti-fraud rule—alleging that Mr. Musk knew his tweets were false, and they had cost the investors billions of dollars.[56]

The successful verdict for Mr. Musk and Tesla came notwithstanding the plaintiffs' success in the courtroom up to that point, including a partial grant of summary judgement for the plaintiffs in April 2022, in which Judge Edward M. Chen had found that most of the elements of liability under Section 10(b) and Rule 10b-5 were satisfied.

Takeaways

- **Corporate Communication Can Include Social Media**. There was little question that Mr. Musk's tweets constituted a corporate communication within the ambit of Section 10(b) and Rule 10b-5 after Tesla notified investors in November 2013 that it would use Mr. Musk's Twitter account as a means of communication with investors.[57] While Tesla's decision to use Twitter as an official means of communication is somewhat unusual, this case serves as a reminder of the risks faced by public company executives when making statements about potential transactions, and that public companies must implement internal controls over the company's and its executives' use of social media as a forum to communicate with the public.
- **Falsity Can Hinge on the Details**. In his order partially granting the plaintiffs' motion for summary judgement, Judge Chen held that Mr. Musk's statements that he had "funding secured" and that investor support was confirmed, were untrue. In his testimony, Mr. Musk insisted that he had verbal commitments from funders for a take-private, and as a result his statements were not false, but when pressed by the judge, he acknowledged that no investor had committed to funding a specific dollar amount.[58] Mr. Musk's lawyer also pointed to written exchanges supporting Mr. Musk's plan to take the company private between Mr. Musk and Dan Dees, co-head of global banking and markets at Goldman Sachs, and Oracle Corp. CEO Larry Ellison.[59] Given the uncertainty of these communications, Judge Chen found that no reasonable jury could find that Mr. Musk's statements that he had funding secured were accurate and not misleading.
- **Intent May Be Inferred from the Circumstances**. Judge Chen also ruled that Mr. Musk's statements were not only untrue, but that he was reckless in posting them, given their weak factual basis. While scienter is normally a "subjective inquiry," Judge Chen noted that the "objective unreasonableness of a defendant's conduct may give rise to an inference of scienter." Given Mr. Musk's knowledge of the uncertain nature of his discussions with investors, Judge Chen concluded that no reasonable investor could find that he was not reckless in making his statements.
- **Loss Causation and Materiality Are Intertwined**. As a result of Judge Chen's rulings on falsity and intent, the only factual matter left for the jury to decide was whether the misstatement had harmed shareholders by artificially inflating Tesla's share price. Even when a misstatement appears linked to a change in stock price, as was the case here, that gives rise to a rebuttable presumption of materiality (*i.e.*, the "fraud on the market theory"). In denying summary judgement on the questions of loss causation and materiality,

Judge Chen noted that there was some evidence that the misrepresentations did not affect the stock price. For example, he cited the fact that following a blog post on Tesla's website by Mr. Musk on August 13, which provided additional details about his discussions with investors, Tesla's stock price did not decline significantly, and that, arguably, the jump in Tesla's stock price could have been due to Mr. Musk contemplating taking the company private, and not due to his false statements. Ultimately, the jury simply declined to determine that Mr. Musk's tweets caused the shareholders' losses.

AT&T Settles Long-Running Regulation FD Case

As we previously covered in our Debrief, on December 5, 2022, the SEC announced that AT&T agreed to pay a $6.25 million penalty, and three AT&T executives each agreed to pay a $25,000 penalty, to settle SEC charges that the executives had selectively disclosed MNPI to financial analysts in 2016. The SEC's complaint, filed in the U.S. District Court for the Southern District of New York on March 5, 2021, alleged that AT&T violated Regulation Fair Disclosure ("Regulation FD") and Section 13(a) of the Exchange Act, and that the three investor relations executives who made the calls to analysts aided and abetted those violations. According to the SEC, the penalty that AT&T agreed to pay in this settlement is the largest ever in a Regulation FD case.

Background

In its complaint, the SEC alleged that AT&T's chief financial officer, hoping to avoid missing analysts' consensus revenue estimates for a third consecutive quarter, instructed AT&T's investor relations director to "work the analysts who still have [revenue from smartphone sales] too high." The director then asked his team to "walk the analysts down" from their initial estimates. During the six weeks before AT&T announced its quarterly results, the three investor relations executives made private phone calls to 20 equity stock analysts. In those calls, the executives purportedly disclosed MNPI, including AT&T's projected and actual smartphone sales rates and its projected and actual revenue from wireless equipment. In some of those calls, the executives allegedly misrepresented AT&T's internal results as publicly available consensus estimates, conduct which the SEC pointed to as evidence that they understood the disclosures were prohibited. The SEC's complaint also noted that AT&T's Regulation FD training, which was provided to the Investor Relations Department, labeled both revenue information and smartphone sales data as "material."

Takeaways

- **Internal Metrics and Discussions Matter in Determining Materiality**. In his opinion denying summary judgment for AT&T in September 2022, just two months prior to the settlement, U.S. Federal District Judge Paul Engelmeyer cited AT&T's internal policies, emails and Regulation FD training materials in concluding that the information disclosed to analysts was material. Specifically, AT&T internally identified revenue and sales as key financial metrics both for the operation of its business and for its stockholders. In fact, AT&T's internal policies and training documents, including its Regulation FD training materials, specifically instruct employees that revenues and sales data are material to investors. Judge Engelmayer also cited evidence that AT&T's executive suite considered the company's total revenue, equipment revenue and upgrade rate metrics in the first quarter of 2016 to be material, including e-mail exchanges between executives, including the chief financial officer and chief executive officer, that emphasized the importance of these metrics and their impact on AT&T potentially making or missing analysts' consensus as to total revenue.

- **Whether Information Is Public or Nonpublic Is Evaluated in Hindsight**. Judge Engelmayer also concluded that the internal results were nonpublic when disclosed to stock equity analysts. Judge Engelmeyer relied on evidence that, during private phone calls between investor relations executives and analysts, analysts were provided updated metrics consistent with AT&T's unreleased internal numbers. A number of analysts updated their models immediately after these private conversations, from which Judge Engelmayer inferred that new nonpublic information had been disclosed on the calls, whether explicitly or by indirect "guidance."
- **Intent Is Usually a Subjective Matter**. The only element on which Judge Engelmayer did not find clearly in favor of the SEC was intent, finding that there was substantial evidence based upon which a jury could find for either side as to whether the named executives in fact knew, or were reckless in not knowing, that they were disclosing information that was both material and nonpublic. On one hand, there was a systematic campaign initiated by AT&T executives to lower analysts' estimates, which involved clear violations of internal policies relevant to Regulation FD, such as prohibitions on contacting analysts because their estimates were believed to be incorrect. On the other hand, there was an absence of evidence that any person at AT&T expressed any alarm or reservation about the legality of the ongoing selective disclosures, suggesting that there may not have been consciousness of wrongdoing on the part of any AT&T executives. Judge Engelmayer ultimately decided that a defendant's subjective state of mind, including whether he took action knowing it was a violation of a legal standard, is a determination that should be made by the jury.

Fourth Circuit Rules That the SEC Can Rely on Circumstantial Evidence in Insider Trading Case

On February 23, 2023, the U.S. Court of Appeals for the Fourth Circuit reversed a controversial judgment granted in *SEC v. Clark* by the trial court against the SEC regarding the ability of the Commission to meet its burden of proof by presenting merely circumstantial—rather than direct—evidence of insider trading.[60] The decision was a relief for the SEC, given that it frequently relies on indirect evidence and market surveillance tools to identify and allege insider trading.

The SEC had charged Christopher Clark and his brother-in-law William Wright, a former Corporate Controller of CEB Inc. ("CEB") with violations of Section 10(b) and Rule 10b-5 under the Exchange Act, asserting that Clark was tipped repeatedly by Wright about the impending acquisition of CEB and subsequently purchased "highly speculative, out-of-the money call options," and directed his son to do the same.[61] As part of the evidence in support of its case, the SEC alleged that Clark and Wright communicated at least five times during the weeks of intensified merger negotiations. Clark subsequently purchased CEB call options, which was allegedly the first time that Clark took a bullish position on CEB in more than five years.[62] Over an approximately year-long period, Clark purchased 377 short-term call options, in addition to his son's purchases. The SEC argued that Clark took several steps to raise cash for his purchases, including selling assets in his wife's IRA account, borrowing under—and nearly maxing out on—a line of credit, and taking out a loan on his car.[63] The SEC also highlighted Clark's frequent communications with Wright and Clark's son that coincided with the timing of the trades, and gave examples of increasingly short-term positions taken by both Clark and his son as merger negotiations finalized.[64] As a result of the scheme, Clark and his son allegedly made an aggregate profit of approximately $300,000.[65]

While Wright settled his case, Clark took the SEC to court. At trial, the district court unexpectedly dismissed the SEC's case without hearing any evidence from the defendant or allowing the jury to weigh the evidence. According to Judge Claude M. Hilton, the evidence put forward by the SEC was too speculative to "justify a finding that [Clark] got insider information and took some action on it" and that "highly suspicious trading" was not sufficient evidence from which a reasonable jury could conclude that Clark received inside information from Wright.[66] The result at trial shocked many observers and raised questions about the viability of the SEC's use of statistical data and other market surveillance tools in future cases.

Following the SEC's appeal, the surprising trial result was reversed by the Fourth Circuit in February 2023. In its decision, the Fourth Circuit clarified that "because a defendant or interested party rarely makes a statement or reveals information that amounts to direct evidence of impermissible trading based on confidential insider information" the SEC could present circumstantial evidence to meet its burden of proof.[67] While the Court agreed that "conjecture and speculation" are insufficient to overcome a motion for judgment as a matter of law, it emphasized that circumstantial evidence "is not only sufficient, but may also be more certain, satisfying and persuasive than direct evidence."[68] In reversing the trial court's decision and remanding for further proceedings, the Fourth Circuit reasoned that a reasonable jury considering the SEC's evidence could reasonably infer that Clark received inside information and used it to trade "in a way that would be reckless if he did not have inside information."[69]

Ultimately, the Fourth Circuit's opinion proved correct the skeptics of the district court's approach to circumstantial evidence. With the closing of what could have been a critical window of opportunity to defend against charges, the SEC will likely continue to rely on data-based and indirect evidence to prove its insider trading cases.

Blackbaud Charged with Disclosure Violations Following Ransomware Attack

On March 9, 2023, the SEC announced charges against Blackbaud Inc. ("Blackbaud")—a technology company that provides donor management software to nonprofit organizations—for making misleading disclosures regarding a ransomware attack that compromised sensitive customer information.[70]

According to the SEC's Order, Blackbaud's technology personnel discovered on May 14, 2020 that it had been the victim of a ransomware attack. On July 16, 2020, Blackbaud notified customers of the incident, informing them that "[t]he cybercriminal did not access . . . bank account information, or social security numbers."[71] Shortly after this disclosure was made, certain Blackbaud personnel learned that the attacker had in fact accessed and exfiltrated customer bank account and social security data.

However, the company's financial reporting team was not apprised of the discovery and subsequently filed the company's Form 10-Q on August 4, 2020, which stated that the attack affected "a copy of a subset of data" and described in hypothetical form that a compromise of personal data could adversely affect its reputation, operations and financial condition.[72] Blackbaud did not disclose that the attacker had in fact accessed customer bank account and social security data until the company filed a Current Report on Form 8-K on September 29, 2020.

The SEC found that the company's disclosure controls and procedures were insufficient to ensure that information relevant to cybersecurity risks and incidents was communicated to the appropriate management and disclosure personnel. Blackbaud agreed to settle the matter with the SEC, including a penalty of $3 million resulting from violations of Sections 17(a)(2) and (3) of the Securities Act and Section 13(a) of the Exchange Act and Rules 12b-20, 13a-13 and 13a-15 thereunder.

McDonald's Settles SEC Disclosure Charges Related to Termination of Former CEO

On January 9, 2023, the SEC charged McDonald's Corporation ("McDonald's") and the company's former CEO, Stephen Easterbrook, with fraud and failure to adequately disclose the circumstances leading to Easterbrook's termination from the company and his compensation under the related separation agreement.[73]

In October 2019, McDonald's conducted an internal investigation into an alleged inappropriate personal relationship between Easterbrook and a company employee. The SEC found that, during this investigation, Easterbrook improperly withheld information about his prior relationships with other McDonald's employees, which caused the company to make incomplete disclosures when it subsequently terminated Easterbrook in November 2019. Additionally, the SEC found that McDonald's failed to sufficiently disclose the circumstances of Easterbrook's termination in its SEC filings on November 4, 2019 and April 9, 2020, including in particular the fact that the company exercised discretion in treating Easterbrook's termination as "without cause," which enabled him to receive approximately $44 million in equity-based compensation that he otherwise would not have received under his separation agreement.[74] During a second internal investigation in July 2020, McDonald's learned of Easterbrook's other inappropriate relationships and sued the former CEO to recover the compensation he received pursuant to the separation agreement.

As a result of these findings, the SEC ordered Easterbrook to pay disgorgement and prejudgment interest of $52.7 million and a penalty of $400,000 based on violations of Section 17(a) of the Securities Act and Sections 10(b) and 13(a) of the Exchange Act and Rules 10b-5, 12b-20 and 13a-11 thereunder. The disgorgement and prejudgment interest amount was deemed satisfied by the amount Easterbrook repaid to McDonald's as a result of the related civil case. The SEC charged McDonald's with violations of Section 14(a) of the Exchange Act and Rule 14a-3 thereunder, but the company was not required to pay a penalty due to its cooperation with the investigation.

Broker-Dealer and Trader Friends Charged in SPAC Insider Trading Probe

On March 31, 2023, the SEC announced charges against Christopher Matthaei, a former partner at a U.S. broker-dealer, and Sean Wygovsky, a former trader at a Canadian hedge fund, for allegedly engaging in insider trading in advance of seven merger announcements involving Special Purpose Acquisition Companies ("SPACs").[75] According to the SEC's Complaint, between May 2020 and April 2021, Wygovsky gathered MNPI about SPAC mergers through his employment at the hedge fund, which was involved in financing transactions for the mergers.[76] Wygovsky then tipped his close friend and business client Matthaei, who ran a trading and research group focused on SPACs, and tried to avoid detection by communicating on the encrypted messaging application Telegram, which could not be monitored by the hedge fund or broker-dealer. Based on Wygovsky's tips, Matthaei allegedly purchased securities ahead of the de-SPAC transactions and made more than $3 million in profits.

The SEC's Complaint also noted that Matthaei learned in April 2021 about an SEC investigation of Wygovsky in an unrelated front running probe. Matthaei disclosed the investigation to Wygovsky, even though he was informed not to do so, which led to the duo deciding to stop their insider trading scheme.[77]

The SEC is seeking permanent injunctive relief, disgorgement of ill-gotten gains, prejudgment interest, and civil penalties against Matthaei and Wygovsky, and an officer and director bar against Matthaei.

Wygovsky consented to a bifurcated settlement subject to court approval. As part of DOJ's parallel action—which does not involve Wygovsky—Matthaei was arrested on March 30, 2023 and charged with one count each of securities fraud conspiracy and securities fraud.[78]

SEC Charges Cousins for Insider Trading Relating to COVID-19 Government Partnership

In yet another example of COVID-related enforcement actions, the SEC charged Andrew Stiles and Gray Stiles on February 23, 2023 in relation to trading in Eastman Kodak Company ("Kodak") and Novavax Inc. ("Novavax") stock based on MNPI.[79] According to the SEC's Complaint, Andrew worked at a medical supply chain company that was assisting Kodak in obtaining funding from the government to produce certain materials required to manufacture pandemic-related medicine.[80] While the funding was being negotiated and before the government's interest in funding Kodak was publicly announced, Andrew purchased Kodak stock and tipped Gray to do the same. The cousins made a combined gain of approximately $1.5 million from their trades. The SEC also charged Andrew in relation to a different set of trades executed while Andrew worked at an accounting and consulting company. As part of his employment, Andrew helped Novavax, a pharmaceutical company, to obtain $300 million in funding to support efforts to develop a COVID vaccine. Andrew allegedly purchased Novavax stock while in possession of MNPI about funding negotiations and subsequently sold his shares to gain over $45,000. Andrew and Gray were also charged criminally by DOJ in a parallel action.[81]

Guilty Plea in First Cryptocurrency Insider Trading Tipping Case

In a case closely watched in the crypto space, DOJ announced on February 7, 2023 that Ishan Wahi, a former product manager at Coinbase, pled guilty to two counts of conspiracy to commit wire fraud in connection with an insider trading scheme involving the use of confidential Coinbase information about which crypto assets were going to be listed on Coinbase's exchanges.[82] As discussed in our previous Update, the case against Wahi had drawn significant attention as the first cryptocurrency insider trading tipping case. The SEC's parallel civil action against Wahi and his brother is pending and will likely continue to implicate the important question of whether cryptocurrencies are securities. For additional information, please see our Debevoise FinReg and FinTech Blog post here.

Notes

1 A covered person has entered into a non-Rule 10b5-1 trading arrangement where: (1) The covered person asserts that at a time when they were not aware of material nonpublic information about the security or the issuer of the security they had adopted a written arrangement for trading the securities and (2) The trading arrangement: (i) Specified the amount of securities to be purchased or sold and the price at which and the date on which the securities were to be purchased or sold; (ii) Included a written formula or algorithm, or computer program, for determining the amount of securities to be purchased or sold and the price at which and the date on which the securities were to be purchased or sold; or (iii) Did not permit the covered person to exercise any subsequent influence over how, when, or whether to effect purchases or sales; provided, in addition, that any other person who, pursuant to the trading arrangement, did exercise such influence must not have been aware of material nonpublic information when doing so.

2 An "affiliated purchaser" is any: (i) person acting, directly or indirectly, in concert with the issuer for the purpose of acquiring the issuer's securities; or (ii) an affiliate who, directly or indirectly, controls the issuer's purchases of such securities, whose purchases are controlled by the issuer, or whose purchases are under common control with those of the issuer; but does not include a broker, dealer or other person solely by reason of such broker, dealer or other person effecting Rule 10b-18 purchases on behalf of the issuer or for its account, or any officer or director of the issuer solely by reason of that officer or director's participation in the decision to authorize Rule 10b-18 purchases by or on behalf of the issuer.

3 *See* at ¶ 19, *Final Rule: Share Repurchase Disclosure Modernization* (May 3, 2023), https://www.sec.gov/rules/final/2023/34-97424.pdf.

4 *See* KPMG, *SEC's Corp Fin Explains its Priorities and Concerns* (2022), https://frv.kpmg.us/reference-library/2022/2022-aicpa-cima-conference/secs-corp-fin-explains-its-priorities-and-concerns.html.

5 *See* KPMG, *Clarifying Non-GAAP Financial Measures* (December 2022), https://frv.kpmg.us/reference-library/2022/clarifying-non-gaap-financial-measures.html.

6 *In the Matter of DXC Technology Company*, Exchange Act Rel. No. 97140 (March 14, 2023), https://www.sec.gov/litigation/admin/2023/33-11166.pdf.

7 *See* Superseding Indictment, *United States v. Blaszczak*, No. 1:17-cr-00308 (S.D.N.Y.); Information, *United States v. Fogel*, No. 1:17-cr-00308 (S.D.N.Y.).

8 DOJ Press Release No. 17-145, *Four Charged In Scheme To Commit Insider Trading Based On Confidential Government Information* (May 24, 2017), https://www.justice.gov/usao-sdny/pr/four-charged-scheme-commit-insider-trading-based-confidential-government-information.

9 *Id*.

10 *See Chiarella v. United States*, 445 U.S. 222, 231 (1980).

11 15 U.S.C. § 78u-1(h)(1).

12 *United States v. Blaszczak*, 947 F.3d 19, 29–30 (2d Cir. 2019) ("*Blaszczak I*").

13 *Id*.

14 *Id.* at 30.

15 *Id.* at 33 (internal quotation marks omitted).

16 *Id.* at 36.

17 463 U.S. 646 (1983).

18 *Blaszczak I* at 36–37.

19 140 S. Ct. 1565 (2020).

20 *Id*. at 1572.

21 141 S. Ct. 1040 (Jan. 11, 2021).

22 *United States v. Blaszczak*, 56 F.4th 230, 236 (2d Cir. 2022) ("*Blaszczak II*").

23 *Id.* at 243.

24 *Id.* (emphasis in original).

25 *Id*. at 244.

26 In parallel action, the SEC's civil case against Worrall, Blaszczak, Huber and Fogel remains open as of the date of this article, stayed pending the Second Circuit's ruling in *Blaszczak II*.

27 484 U.S. 19 (1987).

28 521 U.S. 642 (1997).
29 *Blaszczak II* at 252 (Sullivan, J., dissenting).
30 *Id.* at 254.
31 *Id.* at 255.
32 *See* Jody Godoy, *Ex-US Congressman Convicted of Insider Trading Before T-Mobile Merger*, Reuters (Mar. 10, 2023), https://www.reuters.com/legal/ex-us-congressman-convicted-insider-trading-before-t-mobile-merger-2023-03-10/.
33 *See* SEC Press Release No. 2022-128, *SEC Charges Former Indiana Congressman with Insider Trading* (July 25, 2022), https://www.sec.gov/news/press-release/2022-128; DOJ Press Release No. 22-238, *U.S. Attorney Announces Charges In Four Separate Insider Trading Cases Against Nine Individuals, Including Former U.S. Congressman, Former FBI Agent Trainee, Tech Company Executives, And Former Investment Banker* (July 25, 2022), https://www.justice.gov/usao-sdny/pr/us-attorney-announces-charges-four-separate-insider-trading-cases-against-nine.
34 *See* Indictment at ¶ 13–14, *United States v. Buyer*, 1:22-cr-00397 (S.D.N.Y. July 21, 2022), https://www.justice.gov/usao-sdny/press-release/file/1521716/download.
35 *Id.* at ¶ 11.
36 *Id.* at ¶ 23.
37 *Id.* at ¶¶ 28–37.
38 Larry Neumeister, *Ex-US Rep. Buyer Convicted of Illegal Stock Purchases*, Associated Press (Mar. 10, 2023), https://apnews.com/article/buyer-republican-congressman-indiana-f1b5acf3aed876518efd09f3c82e4971.
39 *Id*.
40 *SEC v. Buyer*, 1:22-cv-06279 (S.D.N.Y.).
41 Pub. L. No. 112-105, §§ 4(a) & 9(b).
42 15 U.S.C. § 78u-1(g)(1) & (h)(1).
43 Pub. L. No. 112-105, § 6.
44 *See, e.g.*, Alice Miranda Ollstein, *Lawmakers Made Hundreds Of Stock Transactions During Pandemic, Watchdog Finds*, Politico (Apr. 29, 2020), https://www.politico.com/news/2020/04/29/congress-stocks-coronavirus-221742.
45 *See* Dave Levinthal & Madison Hall, *78 Members Of Congress Have Violated A Law Designed To Prevent Insider Trading And Stop Conflicts-Of-Interest*, Business Insider (updated Jan. 3, 2023), https://www.businessinsider.com/congress-stock-act-violations-senate-house-trading-2021-9.
46 SEC Litigation Release No. 25261, *SEC Obtains Court Order to Enforce Investigative Subpoena for Testimony* (Nov. 10, 2021), https://www.sec.gov/litigation/litreleases/2021/lr25261.htm.
47 Dan Mangan, *Sen. Richard Burr, Brother-In-Law Spoke On Phone Just Before Stock Sales That Are Under Investigation, SEC Says*, CNBC (Oct. 28, 2021), https://www.cnbc.com/2021/10/28/sec-probes-possible-insider-stock-trades-by-sen-richard-burr-relative.html.
48 *Id*.
49 Dan Mangan, *SEC Ends Insider Trading Probe Of Ex-Sen. Richard Burr and Brother-in-law Without Taking Action, Lawyers Say*, CNBC (Jan. 6, 2023), https://www.cnbc.com/2023/01/06/sec-ends-richard-burr-insider-trading-probe.html.
50 *See* H.R. 7200, 116th Cong. (2d Sess. 2020); H.R. 336, 117th Cong. (1st Sess. 2021).
51 Bryan Metzger, *The Effort To Ban Members Of Congress From Trading Stocks Is Mostly Dead — At Least For Now*, Business Insider (Dec. 6, 2022), https://www.businessinsider.com/lawmakers-unlikely-banned-trading-stocks-for-now-2022-12.
52 H.R. 345, 118th Cong. (1st Sess. 2023).
53 S. 58, 118th Cong. (1st Sess. 2023).
54 S. 1171, 118th Cong. (1st Sess. 2023); H.R. 2678, 118th Cong. (1st Sess. 2023).
55 *See* David Gelles, et al., *Elon Musk Details 'Excruciating' Personal Toll of Tesla Turmoil* (Aug. 16, 2018) https://www.nytimes.com/2018/08/16/business/elon-musk-interview-tesla.html
56 *See* Compl. at ¶¶ 3–8, In re Tesla, Inc. Securities Litigation, 18-cv-04865 (E.D. Calif. 2019). Available at https://www.teslasecuritieslitigation2018.com/admin/api/connectedapps.cms.extensions/asset?id=0dba38e0-bb1f-4819-a425-2f9638780ffa&languageId=1033&inline=true
57 *Id.*
58 *See Elon Musk Securities-Fraud Trial* (Jan. 24, 2023) https://www.bloomberg.com/news/live-blog/2023-01-20/elon-musk-securities-trial#xj4y7vzkg
59 *See Elon Musk Securities-Fraud Trial*, Bloomberg (Jan. 24, 2023) https://www.bloomberg.com/news/live-blog/2023-01-20/elon-musk-securities-trial#xj4y7vzkg

60 *SEC v. Clark*, No. 1:20-cv-01529 (E.D.V.A. Dec. 13, 2021) (order granting defendant's motion for judgment as a matter of law).

61 SEC Litigation Release No. 24982, *SEC Charges Corporate Controller and His Brother-In-Law with Insider Trading Ahead of Merger Announcement* (Dec. 11, 2020), https://www.sec.gov/litigation/litreleases/2020/lr24982.htm.

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63 *Id*. at ¶ 7.

64 *Id*. at ¶¶ 8–10.

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67 *SEC v. Clark*, No. 22-1157, slip op. at 10 (4th Cir. Feb. 23, 2023) (internal citations omitted).

68 *Id.* (internal citations omitted).

69 *Id.* at 14.

70 *In re Blackbaud, Inc.*, Securities Act Rel. No. 11165 (Mar. 9, 2023), https://www.sec.gov/litigation/complaints/2023/comp-pr2023-48.pdf.

71 *Id.* at ¶ 7.

72 *Id.* at ¶¶ 14–15.

73 *In re Stephen J. Easterbrook and McDonald's Corporation*, Securities Act Rel. No. 11144 (Jan. 9, 2023), https://www.sec.gov/litigation/admin/2023/33-11144.pdf.

74 *Id.* at ¶¶ 22–24.

75 *See* SEC Litigation Release No. 25683, *SEC Charges Hedge Fund Trader and Broker-Dealer Partner in Multi-Million Dollar Spac Insider Trading Scheme* (Mar. 31, 2023), https://www.sec.gov/litigation/litreleases/2023/lr25683.htm.

76 *See* SEC Complaint, *SEC v. Wygovsky*, No. 2:23-cv-01810 (D.N.J. Mar. 30, 2023), https://www.sec.gov/litigation/complaints/2023/comp-pr2023-66.pdf.

77 Wygovsky was arrested in 2021 in connection with the front running scheme and pled guilty to one count of securities fraud.

78 *See* DOJ Press Release No. 23-087, *Former Partner at Broker-Dealer Firm Charged with $3.4 Million Insider Trading Scheme* (Mar. 30, 2023), https://www.justice.gov/usao-nj/pr/former-partner-broker-dealer-firm-charged-34-million-insider-trading-scheme.

79 *See* SEC Press Release No. 2023-38, *SEC Charges Cousins for Insider Trading in Kodak Stock Ahead of Company's Planned Govt. Partnership to Assist in Response to COVID-19* (Feb. 23, 2023), https://www.sec.gov/news/press-release/2023-38.

80 *See* SEC Complaint, *SEC v. Stiles*, No. 1:23-cv-01523 (S.D.N.Y. Feb. 23, 2023), https://www.sec.gov/litigation/complaints/2023/comp-pr2023-38.pdf.

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82 *See* DOJ Press Release No. 23-040, Former Coinbase Insider Pleads Guilty In First-Ever Cryptocurrency Insider Trading Case (Feb. 7, 2023), https://www.justice.gov/usao-sdny/pr/former-coinbase-insider-pleads-guilty-first-ever-cryptocurrency-insider-trading-case.

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