Insider Trading on Government Information

This article discusses recent events giving rise to concerns about insider trading, the scope of insider-trading laws as they apply to government officials and alleged tippees, and whether the change in administration is likely to result in a greater focus on insider trading based on government information.

By Michael C. Miller,
Michelle Levin,
Bruce Bishop and David Hirsch

The federal government has always been a source of market-moving information, but its role in creating and distributing such information has been especially pronounced during the COVID-19 pandemic. Over the past 10 months, the government has made crucial decisions relating to partial economic shutdowns, the structure and size of stimulus programs, and the identification and promotion of testing, vaccines and treatments for COVID-19. The disclosure of information relating to these critical topics often has been haphazard, with market-moving information being shared both selectively in closed-door meetings and publicly in White House Tweets. These developments have created abundant opportunities for those possessing government information to exploit it. This article discusses recent events giving rise to concerns about insider trading, the scope of insider-trading laws as they apply to government officials and alleged tippees, and whether the change in administration is likely to result in a greater focus on insider trading based on government information.

Recent Examples

The potential insider-trading risks associated with the wealth of “political intelligence” related to COVID-19 have been highlighted by two recent events. First, Sen. Richard Burr’s sale of stock holdings in the early days of the pandemic resulted in an FBI investigation. Burr, who had been receiving classified briefings on COVID-19 as chair of the Senate Intelligence Committee, sold up to $1.7 million in stock on Feb. 13, 2020. He avoided enormous losses when the market began to decline shortly thereafter. Some news outlets speculated that while he was reassuring the broader public through an editorial, he was telling a small group of business leaders that the virus was “much more aggressive in its transmission than anything that we have seen in recent history.” Tim Mak, “Weeks Before Virus Panic, Intelligence Chairman Privately Raised Alarm, Sold Stocks,” NPR (March 19, 2020).
The FBI’s decision to seize Burr’s phone in May suggests he may have criminal exposure due to his trades, though the investigation’s current status and scope remain unclear.

Second, recent reporting on meetings between Executive Branch officials and Hoover Institution board members highlights risks to investors receiving private government briefings. On February 24, Tomas Philipson, acting chair of the Council of Economic Advisers, told a public audience that the virus’s potential economic effects were “exaggerated.” Kate Kelly and Mark Mazzetti, “As Virus Spread, Reports of Trump Administration’s Private Briefings Fueled Sell-Off,” The New York Times (Oct. 14, 2020). Later that day, according to The New York Times, he told the Hoover Institution’s board members in a private meeting that he could not yet predict or estimate the magnitude of the virus’s effects on the economy. The following day, Larry Kudlow—Director of the National Economic Council—told CNBC’s television audience that the virus was contained in the United States and that it was “pretty close to airtight.” Id. He later informed the same board privately that the virus was “contained in the U.S., to date, but now we just don’t know.” Id.

William Callanan, a member of the Hoover Institution’s board and a hedge fund consultant, noticed the uncertain nature of Kudlow and Philipson’s private comments, which contrasted with the Trump administration’s public comments. Callanan included these comments, along with public information, in a confidential memo to certain hedge fund clients noting that government officials were more concerned with the virus than they were letting on publicly. Investors who received Callanan's comments apparently took bearish positions—as one put it, “short everything”—before late afternoon on February 26, when the U.S. stock markets had fallen close to 300 points from their high the previous week. Id. Sen. Elizabeth Warren soon called this a “textbook case of insider trading,” and asked the SEC and CFTC to investigate. Letter from Sen. Elizabeth Warren to the Securities and Exchange Commission and the Commodity Futures Trading Commission (Oct. 15, 2020).

**Legal Theories and Defenses**

It will take time for all of the facts underlying these allegations to become public. But the investigation of these reported events illustrates the potential dangers of receiving and sharing valuable information from the government.

Classic insider trading liability arises under §10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 when an insider breaches a duty based on a relationship of trust and confidence by trading on or sharing nonpublic material information. As the Second Circuit has explained, liability for tippers exists where the defendant “(1) tip[s] (2) material non-public information (3) in breach of a fiduciary duty of confidentiality owed to shareholders (classical theory) or the source of the information (misappropriation theory) (4) for personal benefit to the tipper.” S.E.C. v. Obus, 693 F.3d 276, 286 (2d Cir. 2012). Tippees must know that the information was disclosed in breach of the tipper’s duty. Id. at 289.

The insider trading laws do not generally distinguish between government and corporate information. Government officials, like corporate executives, have a duty of confidentiality respecting material nonpublic information. In the Executive Branch, this duty has long been formalized at 5 C.F.R. §2635.703. The 2012 STOCK Act further clarified that all federal officials, including those in the Legislative Branch, have a “duty” of trust and confidentiality with respect to nonpublic, material information that they may receive in the course of their official duties. 15 U.S.C. §78u-1(h).

Despite these broad principles, few insider trading cases have been brought against government insiders and their alleged tippees. This could be because existing law provides formidable obstacles. First, prosecutors must prove that the information involved was both material and nonpublic. Much of the information the government possesses is simultaneously publicly available from “press releases, … analysts’ reports, newspapers, magazines, rumors, word of mouth or other sources.” United States v. Contorinis, 692 F.3d 136, 142 (2d Cir. 2012). Not surprisingly, in the examples noted above, the individuals involved may be able to point to the flow of public information about COVID-19 as justification for any trades.

Second, prosecutors must prove a direct or indirect benefit to the tipper. The prototypical examples
of a personal benefit include the receipt of “something of value” in exchange for the tip or a gift of confidential information to a trading relative or friend. *Salman v. United States*, 137 S. Ct. 420, 423 (2016). Gifts of information to political or ideological allies, or a representative’s constituents, may not qualify.

The personal-benefit requirement may not present as serious an enforcement obstacle, at least on the criminal side, after the Second Circuit’s decision in *United States v. Blaszczak*. See 947 F.3d 19, 33 (2d Cir. 2019). *Blaszczak* allows prosecutors to bypass the personal-benefit requirement by charging under 18 U.S.C. §1348, a criminal securities fraud provision adopted in 2003 as part of the Sarbanes-Oxley Act. Although *Blaszczak* has not yet passed Supreme Court review, for now Title 18 offers a tempting alternative for prosecutors, in addition to other charges such as wire fraud and theft of government property.

Finally, government information is often protected by other privileges. In Congress, the Speech or Debate Clause and associated privileges prohibit “questioning” members of Congress or their staffs related to legislative business, including committee reports and “things generally done in a session of the House by one of its members in relation to the business before it.” *Powell v. McCormack*, 395 U.S. 486, 502 (1969) (citation omitted). This protection may make it impossible to subpoena Congressional staffers to testify about certain uses of government information.

**Future Developments**

The COVID-19 pandemic combined with the recent election may have a direct impact on insider trading enforcement. Under the Trump administration, the SEC’s insider trading enforcement has dropped to its lowest level in decades, whether measured by the number of cases or number of defendants. A recent NPR article concluded that new insider trading enforcement actions have fallen to their lowest level since the Reagan administration. See Tom Dreisbach, “Under Trump, SEC Enforcement of Insider Trading Dropped to Lowest Point in Decades,” *NPR* (Aug. 14, 2020).

The pandemic has yet to result in a reversal of this trend. Although Attorney General William Barr has directed all U.S. Attorneys to “prioritize the detection, investigation, and prosecution of all criminal conduct related to the current pandemic,” there have been no major insider trading charges based on pandemic-related information. Memorandum for All United States Attorneys, Office of the Attorney General (March 16, 2020). Of course, such charges may be in the pipeline, particularly considering that the SEC has repeatedly warned market participants not to engage in insider trading in the midst of the COVID crisis. See Statement from Stephanie Avakian and Steven Peikin, Co-Directors of the SEC’s Division of Enforcement, Regarding Market Integrity (March 23, 2020); Statement from Marc Berger, Deputy Director of the SEC’s Division of Enforcement, The SEC Speaks 2020 (Oct. 8-9, 2020).

An incoming Biden administration could encourage the SEC and federal prosecutors to prosecute apparent insider trading more aggressively. Given its proposal to create a Commission on Federal Ethics, it may also be more willing to scrutinize its employees’ conflicts between government service and personal business. Finally, it could attempt to prevent the selective disclosure of material non-public information, much as Regulation Fair Disclosure (FD) does within public companies. See 17 C.F.R. §243.100–243.103.

Regardless, we expect the SEC and federal prosecutors to continue to prioritize insider-trading enforcement, and government officials must take great care to avoid using material nonpublic information for their—or another’s—personal benefit. And private sector investors receiving private briefings from government officials must be similarly careful to avoid trades that could be viewed as based on material, nonpublic information, or actions that provide some benefit to officials providing that information.

Michael C. Miller and Michelle Levin are partners, Bruce Bishop is of counsel and David Hirsch is an associate at Steptoe & Johnson.