

July 1, 2014

## STOCK Act Update

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### **SEC Confirms Criminal and Civil Investigations of Potential STOCK Act Violation; Moves to Enforce Subpoena to Congressional Committee and Staffer**

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#### **SUMMARY**

A recent SEC court filing confirmed the existence of enforcement investigations into a potential violation of the Stop Trading on Congressional Knowledge (STOCK) Act. In a subpoena enforcement action filed against the House Ways and Means Committee and the staff director of its Health Subcommittee, the SEC revealed details of criminal and civil insider trading investigations arising from a potential leak of reimbursement rates announced by the U.S. Centers for Medicare and Medicaid Services (CMS) after the close of the stock market on April 1, 2013. News of the rates, which were more favorable than expected, lifted certain healthcare stocks.

The SEC, the FBI, and the Inspector General of the U.S. Department of Health and Human Services are investigating whether government sources made unauthorized advance disclosure of the rates to a lobbyist, who passed the information on to a broker-dealer and to various market participants.

The SEC filing reveals not only enforcement interest in a matter that received substantial press attention last year, but also that the authorities are bringing to bear some of the same techniques employed in traditional insider trading cases. In addition, the Ways and Means Committee's objection to complying with an SEC subpoena based on the Speech or Debate Clause reflects the difficulty that enforcement authorities may face in proving insider trading cases involving government-sourced information.

#### **DISCUSSION**

Securities Exchange Act Section 10(b) and Rule 10b-5 impose liability for trading on material nonpublic information that is provided in breach of a duty to keep it confidential. Signed into law in 2012, the STOCK

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Act imposed on members and employees of Congress (as well as Executive and Judicial Branch personnel) a duty “to the United States government and the citizens of the United States” with respect to material nonpublic information that they obtain in their official capacities.<sup>1</sup> As discussed in [our April 2012 memo](#) on the STOCK Act, government tippers and their tippees can be held liable under traditional insider trading principles for trading on government-sourced information that is provided in breach of a duty to keep it confidential.

The investigations described in the SEC filing appear to arise from a “flash report” sent by Height Securities, LLC to nearly 200 clients shortly before the market closed on April 1, 2013. The report provided advance notice of a CMS policy change regarding Medicare reimbursement rates and highlighted two stocks it predicted would benefit from the expected announcement. Humana stock increased approximately 7% between the time the flash report was issued at approximately 3:40 p.m. EST and the market close. According to the SEC filing, the source for the report may have been an email from a lobbyist at Greenberg Traurig LLP, who told the SEC that he had spoken about the CMS announcement with Brian Sutter, a House Ways and Means Committee staffer (now subcommittee staff director), 10 minutes before sending the email.

The lobbyist’s email to Height Securities, which cited “very credible sources” on the upcoming announcement, indicated that CMS had changed its reimbursement methodology to assume that Congress would eventually act to prevent a scheduled reduction in Medicare physician payment rates, as it had done previously; as a result, certain payments that were expected to decline 2.3% from the prior year would instead increase by 3.5%.

According to its court filing, the SEC initiated its insider trading investigation into the source of the Height Securities flash report on April 9, 2013, just days after the CMS announcement. In January 2014, the SEC requested documents and an interview with Sutter. The Committee and Sutter resisted the SEC’s requests on various grounds, including the Speech or Debate Clause of the U.S. Constitution, which provides that members of Congress “for any Speech or Debate in either House . . . shall not be questioned in any other place.”<sup>2</sup> The SEC issued subpoenas to both on May 6, 2014, demanding testimony from Sutter and documents from both Sutter and the Committee, including Sutter’s communications with CMS, Sutter’s communications with Greenberg Traurig, Sutter’s personal and work phone numbers and email addresses, Sutter’s work phone records, and Sutter’s communications related to the confirmation of a new CMS Administrator, which had been linked to the CMS policy change in the lobbyist’s email to Height. The SEC made limited efforts to compromise with the House Counsel but refused to commit to “end the Committee’s and Mr. Sutter’s involvement in this matter” as a condition of reviewing documents, as the House Counsel had proposed in a letter on June 17. The SEC filed its

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<sup>1</sup> Section 21A of the Exchange Act as amended by Section 9 of the STOCK Act.

<sup>2</sup> U.S. Const. art. I § 6.

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subpoena enforcement action in the United States District Court for the Southern District of New York on June 20.

The SEC filing described evidence suggesting that Sutter was the source of the disclosure, including emails indicating that Sutter had communicated with at least two individuals at CMS in the week prior to the announcement, and alluded to additional information linked to Sutter protected by a confidentiality agreement. The filing indicated that the lobbyist had spoken with the SEC and confirmed discussing the CMS announcement with Sutter in their April 1 phone call. The SEC also revealed further details of Sutter's relationship with the lobbyist, including Sutter's conversations with a colleague of the lobbyist over the previous month and emails between Sutter and the lobbyist on the day of the announcement arranging a phone call.

The filing also suggests that Sutter provided false exculpatory information to the FBI in an interview. News reports indicated that the interview took place at Sutter's home in the evening without counsel present. The SEC highlighted a letter from the House Counsel indicating that after "some time for reflection," Sutter's recollection of the events had changed from what he had told the FBI several weeks after the incident. It appears Sutter has not provided further information to authorities since the FBI interview.

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### IMPLICATIONS

The SEC filing confirms the government's interest in pursuing a STOCK Act claim—an issue which was the subject of public speculation after disclosure of this incident last year. Although enacted with fanfare, in the two years since the passage of the STOCK Act, there have been no civil or criminal cases brought based upon it.

The government appears to be employing many of the same aggressive investigative techniques that it has used with success in recent, traditional insider trading investigations. For example, the FBI appears to have confronted Sutter at his home (presumably without prior announcement), a tactic that it has touted as being effective in inducing confessions and cooperation. Here, the SEC seems to draw an adverse inference from the fact that Sutter apparently provided false denials in that interview. The SEC has also evidently received significant cooperation from the lobbyist.

That the SEC has filed a subpoena enforcement action in the face of an assertion of a constitutional privilege claim by the Ways and Means Committee reflects an aggressive approach, and a willingness to devote substantial resources to the investigation of this matter.

The resistance of the Committee and Sutter to the subpoenas highlights the difficulty associated with investigating congressional sources of information. The Speech or Debate Clause of the Constitution provides "absolute" protection for all congressional activities that fall "within the sphere of legitimate

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legislative activity,”<sup>3</sup> but has not been held to protect conduct “not a part of the legislative process itself.”<sup>4</sup> Such cases outside the scope of the Clause generally have involved bribery or similar crimes. It remains unclear whether the Clause could block enforcement of subpoenas based on potential Exchange Act violations, particularly where Congress amended the Exchange Act to empower the Executive Branch to pursue members of Congress and their staffs for sharing material nonpublic information inappropriately.

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<sup>3</sup> *Eastland v. U.S. Servicemen’s Fund*, 421 U.S. 491, 501 (1975) (internal quotation marks omitted).

<sup>4</sup> *United States v. Brewster*, 408 U.S. 501, 528 (1972).

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## CONTACTS

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### New York

Steven R. Peikin	+1-212-558-7228	<a href="mailto:peikins@sullcrom.com">peikins@sullcrom.com</a>
Kenneth M. Raisler	+1-212-558-4675	<a href="mailto:raislerk@sullcrom.com">raislerk@sullcrom.com</a>
Jay Clayton	+1-212-558-3445	<a href="mailto:claytonwj@sullcrom.com">claytonwj@sullcrom.com</a>

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