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NEWSLETTER

Political Intelligence and Insider Trading: An Enforcement Update

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The closing weeks of 2015 brought two significant developments in the ongoing efforts of the U.S. Securities and Exchange Commission (SEC) to police the misuse of "political intelligence"—inside information about prospective government actions derived from government sources—in trading in the securities of public companies. On November 13, 2015, in the Southern District of New York, U.S. District Court Judge Paul G. Gardephe issued a ruling granting in part, and denying in part, the SEC's application for an order to enforce investigative subpoenas served on the Committee on Ways and Means of the U.S. House of Representatives (and on the former Staff Director of the Committee's Health Subcommittee) in connection with the agency's insider trading investigation involving the alleged leak of material, nonpublic government information. In a separate development, on November 24, 2015, the SEC issued an administrative order instituting cease-and-desist proceedings and announced the agreement by Marwood Group Research LLC—"a political intelligence firm" and registered broker-dealer—to admit wrongdoing and pay a $375,000 penalty for compliance failures arising from the manner in which "Marwood sought and received from government employees information about pending regulatory or policy issues involving the agencies that employed them."

The subpoenas at issue in Judge Gardephe's ruling were served by the SEC as part of its investigation into allegations that spikes in the trading volume and in the value of the securities of certain health insurance companies on April 1, 2013, may have resulted from the leak from the federal government of material, nonpublic information regarding a change in Medicare Advantage reimbursement rates.

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Although long-awaited—the subpoena enforcement action against the House and former House staffer had been pending since July 2014—Judge Gardephe's Memorandum Opinion and Order was correspondingly both comprehensive and carefully argued. The Opinion made relatively quick work of dismissing several of the arguments put forward by the House respondents—as represented by the Office of General Counsel of the House—in objecting to the SEC's application for an order to enforce its investigative subpoenas, including arguments that: enforcement of the SEC's subpoenas against the House is barred by "sovereign immunity"; the court lacks personal jurisdiction over the House respondents; venue in the Southern District of New York is improper.

The crux of Judge Gardephe's Opinion concerned the House respondents' objection that enforcement of the SEC investigative subpoenas is barred by the Speech or Debate Clause of the U.S. Constitution because, in the respondents' words, "the documents and testimony at issue are protected absolutely against compelled disclosure" by that Clause. In his Opinion, Judge Gardephe provided an extended exposition of the meaning and scope of the Speech or Debate Clause, which provides that "for any Speech or Debate in either House, [Members] shall not be questioned in any other Place." U.S. Const., art. I, § 6, cl. 1. Judge Gardephe also undertook a close and careful analysis of which of the categories of documents subpoenaed by the SEC from Ways and Means and from the former Subcommittee staffer constitute or reflect "legislative activity" falling within the protection from disclosure provided by the Speech or Debate Clause and which of the categories of subpoenaed documents—for example, statements to "members of the public" (including lobbyists)—fall outside of this protection and are, therefore, subject to production to the SEC.

What is essentially at stake in this SEC subpoena enforcement matter is the question of whether, notwithstanding the much ballyhooed STOCK Act of 2012, Members and staff of the Congress can really be investigated (and prosecuted) for insider trading based on information obtained by them in the course of their government service? The answer to this question provided by Judge Gardephe's ruling is, "Yes" (even if a qualified "yes"). Not surprisingly, therefore, on November 30, 2015, the U.S. House respondents filed a notice of appeal and a motion to stay Judge Gardephe's order pending appeal. On December 7, Judge Gardephe, citing the "serious questions" at issue, granted the motion for a stay. Almost certainly, this matter will find its way to the Supreme Court for ultimate resolution.

The potential misuse of material nonpublic information to inform securities trades is also at the heart of the SEC's administrative action and order in the matter of Marwood Group Research LLC. As noted, Marwood, with offices in Manhattan and in Washington, D.C., is both a registered broker-dealer and what the SEC specifically labels a "political intelligence firm," that is, a provider to clients, including hedge funds, of "research and analysis . . . as to the likely outcome of legislative and regulatory events occurring at both state and federal levels." As part of the research process, Marwood analysts, at the encouragement of Marwood's management, "sought and received from government employees information about pending regulatory or policy issues involving the agencies that employed them." According to the SEC order, during 2010 "[s]ome of the information . . . presented a substantial risk that it could be [material non-public information]" and that, "[b]ased in part on that information, Marwood drafted research notes and distributed those research notes to its client, or otherwise communicated Marwood's conclusions to its clients, who were likely using that

information to inform securities trading." Marwood agreed that this conduct violated its statutory obligation, as a registered broker-dealer, "to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material nonpublic information."

The Marwood matter involved no finding that an actual insider trading violation based on the use of government information occurred, and the legal force of the ruling applies directly only to regulated entities subject to the SEC's jurisdiction. Nonetheless, like the SEC's ongoing pursuit of enforcement of its investigative subpoenas to the U.S. House, the agency's action and order in Marwood should be taken as a clear signal to securities firms that use—and to firms and individuals, whether regulated by the SEC or not, that provide—political intelligence: The SEC will continue to shine a searchlight on the potential misuse of political intelligence in connection with trading in the securities markets, so establishing, and following, effective compliance measures is essential.