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New Criminal and SEC Charges Signal Aggressive Enforcement of Insider Trading Liability for Disclosure of Political Intelligence

On May 24, 2017, the U.S. Attorney's Office for the Southern District of New York ("SDNY") and the U.S. Securities and Exchange Commission ("SEC") announced insider trading charges relating to a scheme in which a federal government employee is alleged to have provided confidential information involving Medicare and Medicaid reimbursement rate decisions to a political intelligence consultant, who in turn relayed the information to a hedge fund that allegedly reaped \$3.9 million in gains from trades made on the basis of the illicit information.¹ The case, *U.S. v. David Blaszcak, et al.* (SDNY), is significant as it signals a return to a broader view of the personal benefit requirement in insider trading cases in the wake of the Supreme Court's decision in *U.S. v. Salman*, which rejected the more limited view announced in *U.S. v. Newman*. Moreover, the case potentially suggests an even more aggressive enforcement posture in the area of political intelligence, as prosecutors and regulators begin to take full advantage of the authority granted to them under the STOCK Act.

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Background

Political intelligence consultant David Blaszcak, founder of Precipio Health Strategies and former employee of the Centers for Medicare and Medicaid Services ("CMS"), is alleged to have obtained key confidential details about upcoming reimbursement rate decisions being developed by CMS from his close friend and former colleague at CMS, Christopher Worrall. Worrall worked as a special assistant in the Office of the Director for the Center for Medicare, a position which afforded him broad access to CMS's confidential deliberations about upcoming reimbursement rate decisions. The Indictment alleges that on several occasions, Worrall tipped Blaszcak about the details of pending Medicare decisions on rate payment schedules that would impact the stock prices of companies that offered products and services covered by Medicare. Worrall allegedly provided this information due to his longstanding friendship with Blaszcak, as well as for career advice and out of a hope that Blaszcak might help ensure him lucrative private sector employment. After receiving the confidential rate payment information from Worrall, Blaszcak is alleged to have relayed the information to Jordan Fogel,² Theodore Huber, and Robert Olan, current and former analysts at a hedge fund client of Blaszcak's political intelligence firm. Over the course of the almost two-year period alleged in the Indictment, the hedge fund, which numerous media reports have identified as Deerfield Management ("Deerfield" or the "Fund"), allegedly made illicit profits totaling \$3.9 million based on the information provided by Worrall and Blaszcak.³ In exchange for his services, the Fund is alleged to have paid \$263,000 in consulting fees to the political intelligence firms employing Blaszcak over this period.

The Indictment alleges that, for example, Worrall provided Blaszcak a tip in May 2012 that CMS was planning to cut reimbursable treatment times for two radiation oncology treatment procedures. Blaszcak then passed the information along to Deerfield (and before CMS announced the rule), noting for example that the information he was

¹ See SDNY, [Four Charged In Scheme To Commit Insider Trading Based On Confidential Government Information](#) (May 24, 2017), [hereinafter "SDNY Press Release"]; SEC, [SEC Files Charges in Trading Scheme Involving Confidential Government Information](#) (May 24, 2017).

² Fogel has already pled guilty to insider trading charges. See SDNY Press Release.

³ See, e.g., Brendan Pierson, [5 hedge funders and government insiders have been charged with illegal trading](#), Business Insider (May 24, 2017), (identifying the hedge fund as Deerfield).

providing was “not out there.” In addition, Fogel’s notes at the time reflect that the radiation oncology trade was listed as his “Top Short,” that the trade was based on Blaszcak and another consultant’s “inputs on pending reimbursement cuts,” and that Fogel wrote that the trade “should create some shock” because the information was not on the “radars of sell side, buy-side, or industry.” Shortly after receiving the information, and on the analysts’ recommendations, the Fund shorted over 2,000,000 shares in three medical device companies that would be negatively impacted by the rate treatment time cut. According to the Indictment, after the CMS rate cut was announced in July 2012, the Fund made approximately \$1.8 million on its short of these three companies’ stock.

In another example, the Indictment alleges that Worrall provided Blaszcak a similar tip in March 2013 regarding CMS’s plan to cut the reimbursable rate for various kidney dialysis treatment, services, and drugs, which ultimately led Deerfield to short over 100,000 shares in impacted companies (again before CMS announced the rule). Deerfield allegedly made approximately \$865,000 on the trade.

Analysis

This recent action is a notable example of the Government taking a broad view of what constitutes a “personal benefit” sufficient to trigger insider trading liability, as set forth in the U.S. Supreme Court’s recent decision in *U.S. v. Salman*, 137 S. Ct. 420 (2016). Interestingly, the personal benefit Worrall allegedly received here is not demonstrably different than the “career advice” that was ultimately deemed insufficient as a matter of law in the Second Circuit’s decision in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), which took a narrower view of the personal benefit requirement.

In this case, the SDNY and the SEC have asserted that the benefit Worrall received in exchange for providing the nonpublic information to Blaszcak included “a job opportunity that Worrall used to leverage a promotion at CMS” and “giving valuable, confidential information to a close, long-term friend.” The SDNY and SEC’s reliance on personal friendship and potential career advancement as the personal benefits received in exchange for the tips is consistent with the broad standard espoused in *Salman*, and is a clear signal that the Government is therefore likely to continue to pursue a more aggressive interpretation of insider trading liability.

These charges are also noteworthy in that they appear to challenge the second component of the *Newman* holding which requires that remote tippees must also know that the information was provided in exchange for some personal benefit. *Newman*, 773 F.3d at 450-51. The Government did not seek Supreme Court review of *Newman*’s knowledge of the benefit requirement, and the Supreme Court in *Salman* read the Government’s brief in that case as an acknowledgement that knowledge of the benefit—as opposed to simply knowledge of a breach of duty—was required to trigger remote tippee liability. *Salman*, 137 S. Ct. at 427.

Here there appear to be no allegations in the Indictment that the remote tippees, the analysts at the Fund, knew or even should have known that Blaszcak was providing his source in the government with any benefit.⁴ Rather, these charges allege only that the accused hedge fund analysts knew, or should have known based on their experience in the industry, that Blaszcak’s government source was in breach of a duty to the government by virtue of the duty established by the Stop Trading on Congressional Knowledge Act (the “STOCK Act”) and CMS policies regarding confidentiality. Specifically, the Indictment alleges that the analysts knew that “these CMS insiders included Blaszcak’s former colleagues with whom he had close personal relationships,” and that they “were prohibited from disclosing such information to CMS outsiders.” The lack of any allegation that the remote tippees in this case had knowledge of the personal benefit conferred to the tipper suggests that the SDNY may be taking the position that the remote tippees’ knowledge of the benefit can be inferred from the fact that they knew Blaszcak’s source was a former colleague and friend, and therefore they must have known or should have known there was some benefit being conferred in exchange for the illicit information. Significantly, the Indictment charges the defendants with a

⁴ Interestingly, by contrast to the Indictment, the SEC Complaint at least tacitly attempts to satisfy the “knowledge of the benefit” requirement set forth in *Newman*. For example, the SEC Complaint alleges that the Deerfield analysts knew, should have known, or consciously avoiding knowing, that a government employee would only disclose confidential information in exchange for a benefit, and that CMS personnel often left the agency for lucrative private sector jobs.

host of additional crimes beyond securities fraud pursuant to Section 10(b) of the Securities Exchange Act of 1934 (the “Exchange Act”), including wire fraud and theft of property of the United States, which will not necessarily require proof as to this knowledge component.

This case also reinforces that prosecutors and regulators are continuing to actively pursue cases involving the alleged transmission of political intelligence, and are beginning to rely on the STOCK Act to pursue insider trading liability against government employees and political intelligence firms.

The STOCK Act, which was enacted on April 4, 2012, amended Section 21A of the Exchange Act to provide that covered public officials—including congressional, judicial, and executive branch employees—owe “a duty arising from a relationship of trust and confidence to the Congress, the United States Government, and the citizens of the United States with respect to material, nonpublic information derived from such person’s position” 15 U.S.C. § 78u-1(g)(1). The STOCK Act therefore allows the government to prosecute both the government employee tipper and the recipient tippee in the same manner as the prototypical corporate insider and market participant.

Both the Indictment and the Complaint specifically rely upon, in part, Worrall’s responsibilities under the STOCK Act to establish the duty of trust and confidence required to trigger insider trading liability. Accordingly, the SDNY and SEC’s action strengthens the speculation of observers that insider trading and enforcement may see a shift “from Wall Street to K Street.”⁵

Takeaways

The *Blaszczak* case signals that insider trading, particularly in the political intelligence area, remains a high-priority area of enforcement. In light of *Salman*, the Government appears empowered to bring expansive insider trading claims, and firms could see an uptick in insider trading enforcement actions.

All market participants, and particularly those investment advisors who utilize political intelligence firms, should take note of this action and ensure that sufficient diligence is performed at the outset of any such relationship and that effective controls are in place throughout to ensure that no material non-public information is being obtained.

If you have any questions, or would like to discuss the above or any related matter, please contact the Ropes & Gray attorney with whom you regularly work.

⁵ Catherine Botticelli et al., *Political Intelligence Firms – Insider Trading and Enforcement Shifts from Wall Street to K Street*, 20 INV. LAWYER 1 (Dec. 2013).